



**Research Study on  
Credit and Credit Guarantees  
Executive Summary**

Submitted by  
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(EQI)

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This report examines the accessibility of credit to businesses and more particularly to M/SMEs in Egypt. In addition, it assesses the requirements of financial institutions for guarantees/ the feasibility of instituting credit guarantees facilities as a means of leveraging available finance to micro, small and medium businesses alike.

The report is comprised of five sections, the first beginning with a review of international experiences in microfinance, from which the lessons learned will be drawn and their applicability to Egypt addressed. A similar structure will be applied for the section on SMEs, followed by an in-depth assessment of regulatory support to M/SMES at the international and national level(s). As such, the implications of the new Basle Capital Accords, and the recently drafted Egyptian banking law on M/SME credit in general, will be evaluated in the third section. The findings drawn from the survey conducted for the report will illustrate the level of current credit demand among the M/SME population in Egypt's various governorates, and will be presented in the fourth section of the study. The report concludes with a set of distinct and explicit recommendations for the development of an efficient, and self sustainable M/SME credit market in Egypt.

The main challenge faced by microfinance is its integration into the financial system. Changing the drive of financing M/SME from a solely developmental and altruistic approach to a profit-making loom is the key to its survival and sustainability. In the past commercial banks have been remarkably deficient in exposing themselves; and micro-finance lending was initially developed through the alternative track of NGOs, whose institutional structures were flexible enough to devise new financial methodologies for their credit schemes.

The formal incorporation of micro-finance into the financial system, can take place through either or both of the following two tracks. The first, commonly referred to as "downscaling" in the literature, denotes the expansion of commercial banks or financial institutions services to include the micro-enterprise sector – the prime motivation being profitability<sup>1</sup>. The other alternative, NGO transformation, involves the "transformation" of the NGO into an MFI, such that it overcomes

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<sup>1</sup> The term downscaling (transitive verb) has been criticized because of the meaning that it conveys and its negative connotations implied by cutting back in size or scope. To this end, the term "bank engagement in microfinance" was adopted throughout the report to connote the commercialization of microfinance and the widening of financial services offered by banks to cover a prospective high demand market.

flaws of organizational design in property rights, and governance structures<sup>2</sup>, and becomes able to generate funds. In this respect, the transformation process allows NGOs to overcome the flaws that limit their capacity to engage in microfinance - and that are generally strengths in commercial banks.

With the purpose of increasing the availability of suitable credit to micro-enterprises, and after identifying the requirements for successful transformation and engagement in microfinance, the report examined the challenges and opportunities for these processes in Egypt.

### **NGO Provision of Micro-credit: Challenges and Opportunities**

In Egypt, and in terms of the actual extension of credit services, a number of NGOs – originally business associations that received technical assistance for extended periods of time – have successfully implemented donor-financed programs<sup>3</sup>. Such NGOs have a large number of credit extension officers, and a strong presence and knowledge of the field. Taking an average of 3 – 4 days to process the loans, these NGOs have developed databases of their clients, and attained repayment rates that fall within the range of 98 – 100%. Strong incentive schemes have been developed to ensure that the extension officers maintain high levels of repayment, and bring in new clients

Despite the success of the step lending method adopted by Egyptian NGOs (and as will be demonstrated later, banks engaged in microfinance); lent amounts at the first stage are too small to influence/ meet business needs. This highlights the need for the expansion of the NGO credit base, a move that can only be achieved, either through the renegotiation of the terms between the NGOs and the donor agencies, transformation to accept deposits and independently offer larger loan amounts in a sustainable manner, or alternatively, bank lending to NGOs. All three alternatives are unviable under the current regulatory framework.

NGO “up-scaling” in the form traditionally designated by the term – and which usually denotes transformation into an MFI is illegal in Egypt. Moreover, and as relates to taking a loan from a bank, NGOs, governed by the Ministry of Social Affairs, are defined as “moral persons” - which may not

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<sup>2</sup> In Egypt, Law 84 of 2002 allows the Ministry of Social Affairs to liquidate any association--including seizing its property, confiscating its papers and freezing its assets--if it violates certain conditions (article 42), if it joins any institution or association outside of Egypt without prior permission from the authorities/or if it accepts foreign funding without prior permission. This has seriously undermined the effectiveness of the said institutions' property rights.

<sup>3</sup> This refers in the first instance to NGOs operating under the USAID sponsored Small Enterprise Business Development Organization (SEB programme), and which consequently have received considerable amounts of technical assistance and capacity building services.

be sued in court. NGOs are also currently bound by the civil code, which sets a ceiling of 7% on annual agreed interest, and limits the receipt of compound interest/ total interest that exceeds the size of the original loan to banks and securities companies. This decreases considerably the potential returns for the NGOs, which currently operate under the code by either ignoring the restrictions, or by setting the contractual agreement directly between the borrower and the bank<sup>4</sup>. Finally, the burdensome requirements for the establishment of an NGO, and the requisites laid out in the Associations Law no. 178 of 2002 for the receipt of external funding makes the renegotiation of donor funding and terms – even if successful - extremely difficult to implement<sup>5</sup>.

### **Bank Engagement in Micro-finance: Challenges and Opportunities**

During the writing of the report, and despite the interest expressed by some banks, only two banks were engaged with the micro-finance sector, the National Bank for Development, and Banque du Caire. Interviews with both banks revealed that they are satisfied with their performance, and are currently engaged in strong plans to further extend and develop their services to micro - enterprises. Both believed that they hold an advantage over NGOs in the provision of micro-lending facilities, stressing that where historically, banks were perceived with mixed feelings of apprehension and awe, today micro-enterprises are proud to deal with a formal financial institution<sup>6</sup>. Indeed, although the experience of BdC is too recent to draw concrete conclusions from, it nevertheless has attained repayment rates comparable to those of the NBD, and which average at 99%. Both have a large number of staff, and significant outreach in all of Egypt's governorates. In this respect, BdC has been able to put the disguised employment that it inherited from its public sector origins to use, while the NBD structured since inception, its recruitment policies to suit micro – lending requirements. . Also a feature of its public sector predecessor, BdC has ninety-six working branches with seven hundred extension officers. With a longer history in micro – lending, the NBD has the largest network of micro – lending infrastructure, with each of its extension officers handling no less than 130 clients each. In addition, the bank has developed an interesting feature – mobile branches – that allow it to periodically follow up with clients at the neighborhood level. Both banks have an MIS system to

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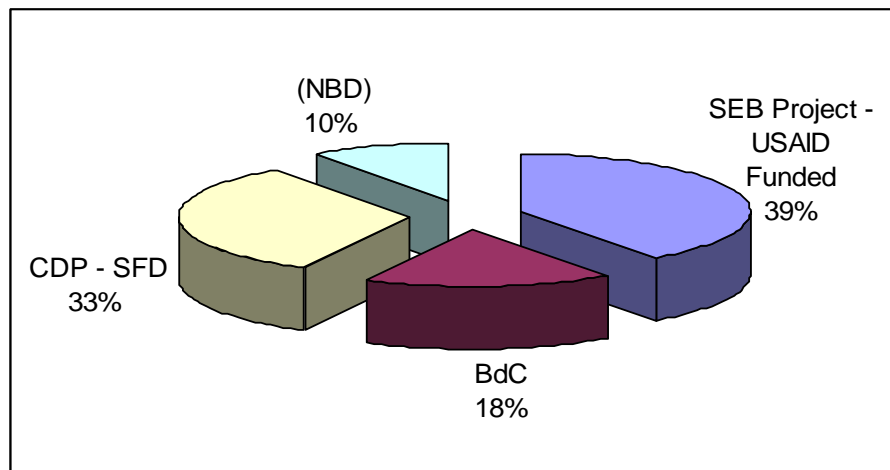
<sup>4</sup> Dr. Ziad Bahaa-Eldin, “Review of the Legal and Regulatory Framework Affecting Micro Finance”, First Draft, Presented to the Launch of the UNDP Strategy Group, May 2004

<sup>5</sup> Ibid. In one of our interviews with the head of the Egyptian Small Enterprise Development Foundation, reference was made to an attempt made by the six NGOs working in the SEB program to group together under one umbrella to influence legislators, modify the law and create a body similar to that of the Grameen Development Fund. This attempt failed due to the inability of the NGO Chairmen to choose a head for the organization. In addition, our questions regarding the possibility of modifying the law were met with skepticism – given Egypt’s current security and money laundering concerns.

<sup>6</sup> Ibid

ensure that tracking is efficient. Flexible incentive structures encourage the extension officers to attain the goals set, in the case of NBD whether in terms of increasing loan amounts, or loan portfolio<sup>7</sup>.

The success evidenced by these two banks' micro-finance schemes has highlighted the benefits of engaging with this sector to other banks – to whom there are no regulatory, or political restrictions. The only constraint noted to bank engagement in micro-finance was the limited outreach that private commercial banks possess, and which is critical given the inability of micro-enterprises to cover travel expenses and their predominance throughout all of Egypt's governorates. In this respect, former/ public sector banks are the most suited to pursue this type of activity.



**Figure 1: Microlending Institutions Market Share Working on Commercial Based Interest Rates**

### **Micro-Credit Systems and Processes in Egypt: Challenges and Opportunities**

The similarity in the goals and outreach mechanisms of both of the aforementioned banks and NGOs, as well as the nature of the micro-enterprise sector, has led to the development and application of similar lending mechanisms, and in turn challenges. To overcome and reduce risk, banks and NGOs engaged in microfinance have adopted "step lending", such that the client graduates to a higher loan amount at each "step". Also, and again as a result of the nature of the

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<sup>7</sup> Interview with Amro Abuesh, Advisor to the Chairman – M/SME Loans, and Member of the Executive Board, Banque du Caire, October 2003; Interview with Mona Mubarak, Project Manager, National Bank for Development, November 2003

micro-enterprise sector, which often lacks formal documentation of accounts and operations, both the banks and the NGOs depend primarily on loan officers for risk assessment and loan monitoring. The loan officers, usually familiar with the area in which the micro-enterprise operates, develop a personal relationship with the borrower that allows them to assess his personal as well as commercial reputation, and monitor the flow of business. This relationship is crucial to the sustainability of the credit programme – highlighting the critical role that appropriate loan officer incentive schemes can play in enhancing the performance of any given programme.

Despite the potential that the micro-enterprise sector holds, and the estimation presented by a number of reports estimating the outreach gap to reach 90%, both banks and NGOs reported considerable difficulty in accessing new clients, suggesting that the gap falls between 60 – 70%<sup>8</sup>. Since both our survey and a number of studies indicate a high level of potential demand from micro enterprises, this difficulty may in part, be attributable to bank and NGO operation within a defined loan bracket. Also, it is likely that previous studies over-estimated the size of demand by overlooking informal credit channels/ basing calculations merely on the number of micro-enterprises, as opposed to readiness to access formal credit channels. Indeed, our discussion of micro credit in Egypt would be incomplete without mention of the strong competition that formal credit channels face from the informal lending mechanisms that are available to this sector. This competition is not only from the loan sharks (whose interest rates we were informed by bank personnel reaches 120%) ; but also includes the successful model set by the informal rotational self-help credit and savings associations (*gamaiyat*), as well as borrowing from family members and friends. Though difficult to trace, it is understandable that borrowers would prefer to use their savings/ borrow from family and friends at no interest – especially since the real interest rates used by NGOs and banks range between 26 – 28%, as additional administrative costs associated with the opening of a bank account for each separate loan – a mandatory requirement set by the Central Bank, are also incurred<sup>9</sup>.

### **SME Credit: Challenges and Opportunities**

Although there has been a strong move towards the commercialization of SME credit finance internationally, the lack of flexibility of commercial lending institutions continues to inhibit the further growth and development of this sector. The credit scoring mechanisms that have emerged for SMEs, though invaluable in allowing for a thorough examination of the client's credit history,

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<sup>8</sup> Interview with Dr. Magid Amer, former Executive Director, Egyptian Small Enterprise Development Foundation, October 2003 and Amro Abu Esh, Advisor to the Chairman, M/SME Loans and Member of the Executive Board, Banque du Caire, Launch of the UNDP Strategy Group, May 2004

<sup>9</sup> Ibid

have resulted in a “cookie cutter” approach that somewhat confines lending to enterprises of a specific nature, or those engaged in traditional market activities. In this respect, and while credit scoring is an indispensable tool for risk assessment, when being applied for SMEs, it must take into account their unique structures and characteristics.

The success of the credit scoring tool is facilitated by the presence of a credit bureau. While on the one hand credit scoring depends on the use of mathematical formulae to determine the “riskiness” of the client, typically, a credit report will include information on the client’s bill payment history, outstanding debt, history of credit use, very recent credit activity, as well as the type of credit vehicles held by the borrower. The existence of such institutions and mechanisms allows for reductions in the transaction costs of the lending institution, as it is able to distinguish between high and low risk clients. This in turn, encourages the institutions supporting this sector to further engage with it, thus setting the pace for a sustainable, vibrant SME sector. With a higher rate of repayment, the financial intermediary is then able to further develop and expand its outreach and efficiency, thus providing faster more efficient services to its low risk, “good” clients

### **Credit to SMEs in Egypt: Challenges and Opportunities**

In comparison to the SME credit markets in the West and the Far East, the Egyptian credit market remains immature - tailored funding available only through the Social Fund for Development’s Small Enterprise Development Organization (SEDO)<sup>10</sup> and the National Bank of Egypt<sup>11</sup>. Despite this, and as a result of significant efforts at the reform of the Egyptian financial sector, a number of credit options have been made available which, it is believed will, to a great extent, meet market demand. Such options, which include leasing, factoring, supplier credit and commercial mortgages, are credit options, which, due to constraints placed by the legal/ regulatory environment; remain immature.

The constraints placed by the Egyptian legal/ regulatory environment, has given more traditional credit options, namely those provided by banks, more leeway. The main supplier of credit to SMEs, banks can serve this sector using a multitude of tools, including term loans, credit cards/ lines, and account overdrafts. While the efficacy of each as a credit tool to Egyptian SMEs will be discussed individually, it is important, in the first instance to present the overall accessibility of the SME sector

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<sup>10</sup> The advantages and disadvantages of which have been analyzed in the section on micro-finance in Egypt

<sup>11</sup> The Commercial International Bank – a private sector bank, and with technical assistance from the IFC is currently in the process of establishing an SME unit.

to banking services, as well as the Egyptian banking sector's perceptions, attitudes and beliefs towards them.

According to a 2004 IFC report, SME accessibility to bank services is approximately 44%<sup>12</sup>. This rate can be primarily explained by the absence of tailored services to SME needs and which emerged as one of the main requisites to successful engagement with this sector. A cursory review of the Egyptian banking landscape reveals that past experiences and the factors identified above, have constrained Egyptian bank provision of tailored services to SMEs.

### *The Perception of Risk*

By view of their very nature and structure, banks are risk averse institutions, that, as outlined earlier, prefer to work under set equity – debt ratios. Until very recently, stories of corruption and bribery rampaged Egyptian papers, describing stories of businessmen accessing significant loan amounts without guarantees, only to default and head abroad. While the New Banking Law has sought to address these imbalances and avoid them in the future, this has created a risk averse environment. Indeed, a 2002 AMCHAM report, quotes a branch manager in a state owned bank saying that "in the last few months [the bank] has not worked with a single new client – only the old guaranteed ones". This perception of risk was then further augmented by a Cairo Chamber of Commerce request to ban the publishing of reports on loan defaults in Egypt – the result being, increasing bank mistrust of clients and the setting of strict and high collateral requirements.

The high risk adverseness of Egyptian banks, and their negative experience with credit is better understood when measured against the fact that throughout and until the unstable transitional period of the 90s – when the “credit” crisis was at its peak – most banks did not even have a risk assessment department, both the Central and local banks lacking the managerial capabilities to properly inspect lending/ credit activities<sup>13</sup>. The problem was then exacerbated by the absence of internal bank and audit mechanisms inside the banks. Indeed, reports of inadequately trained, and ill motivated staff (one report refers to the fact that in one bank a posting in the internal audit department was

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<sup>12</sup> The International Finance Corporation (IFC) North African Enterprise Development, “The SME Landscape in Egypt: A Banking Sector Perspective”, The International Finance Corporation (IFC) North African Enterprise Development April 2004, p.28

<sup>13</sup> American Chamber of Commerce in Egypt, “Loan Deputies Guilty – Now What?”, Business Monthly, August 2000. In “Overhauling Egypt’s Banking System”, (Al Ahram Weekly Online, 12 – 18 September 2002, Issue no.603), Mahmoud Mohie El Din notes that until 1998, the Central Bank did not have any strict system for the supervision of credit operations.

considered a “disciplinary measure for employees”), were common; ultimately leading to a general absence of any supervisory measures over loan grants and repayments<sup>14</sup>.

In sum, and while all the banks we interviewed admit that SME lending is potentially very profitable, the dominant perception is that it is riskier than lending to larger, more well-established enterprises<sup>15</sup>. This applied even in relation to the micro – sector, for, as it was frequently pointed out, the amounts in question are significantly larger, and loan-tracking systems are automated – disallowing personal follow up. Rather, primary emphasis was made as to the need to instil safeguards against loan defaults – whether through the adoption of credit guarantee schemes, or insurance plans designed for that purpose. Interestingly, this was found to be in consistency with international findings and norms which place SME lending at higher risk than lending to enterprises of other size.

### *Loan Size*

Where the loan size has been deemed by the bank too small to cover the administrative costs that hold equal for small and large loans alike, banks have preferred to work with more advanced amounts so as to cover their costs. To this end, Egypt's very specific experience with credit lending in the past, has worked to the advantage of SMEs. A number of the banks that we interviewed noted that seeking to reduce the probability of history repeating itself, and also in response to the government's recent promotion of SMEs, they have begun to develop and tailor their services to that purpose.

This proved most interesting with the banks that have a long history of working in corporate finance and with large funds. Where banks have been willing to take on the additional costs associated with the training and redirecting of existing capital facilities to suit the needs of the SME sector, this is a reflection of the bank's growing belief and understanding that if pursued efficiently, SME lending can yield significant profit.

### *Lack of Understanding of SME Credit Needs*

Our research, both on the field and through the semi-structured interviews, revealed that there is little understanding/ comprehension of the particular credit needs of SMEs. In all the banks that we visited, SME units were either still under establishment, or simply not there. The services accorded

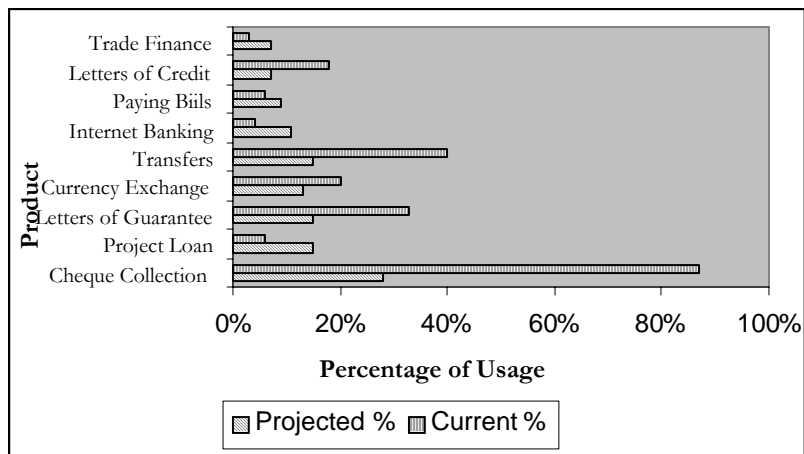
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<sup>14</sup> Ibid

<sup>15</sup> The bias against startups is typical – and common to most economies

SMEs to date, are the same that are offered to larger enterprises, or those offered to the individual consumer.

This is of grave concern given that banks hold great potential to service this sector as indicated by the findings of the above cited report, and which confirmed by our own survey findings, refer to a current credit usage rate of 12%, compared to the potential 27% surveyed who plan to apply for credit during the coming years. The chart below depicts the “projected products/ services usage and amongst [existing SME] account holders”<sup>16</sup>.



**Figure 2: Chart Showing Projected/ Current Usage of Bank Products & Services by Account Holders**

As the above table indicates, the only three services that have not reached their projected level of utilization by SMEs are project loans, internet banking, payment of bills and trade finance. The difference between bank projections and SME actual usage for these services is significant in that they indicate a lack of awareness/ suitability of complimentary to credit/ credit financial services to SMEs. The importance of this is then further exemplified upon examination of figure 6 (below), which represents SME unmet needs. Although currency exchange by far ranks the highest, quite significantly, all other services listed were credit related and included the issuance of loans, the opening of letters of credit, credit lines, and letters of guarantees.

<sup>16</sup> The International Finance Corporation (IFC) North African Enterprise Development, “The SME Landscape in Egypt: A Banking Sector Perspective”, The International Finance Corporation (IFC) North African Enterprise Development April 2004, p.28

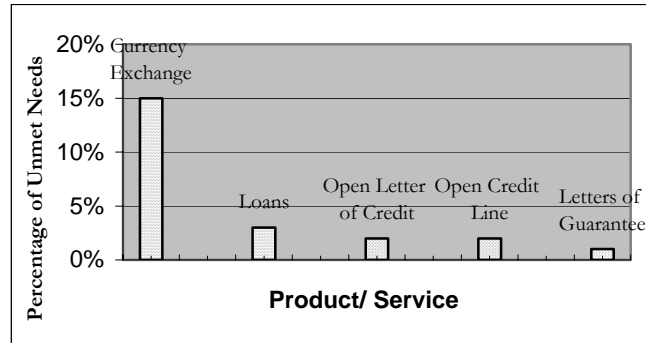


Figure 3: Chart Showing SME Unmet Needs

### SME Credit Supporting Institutions: Challenges and Opportunities

Our research reveals that there are no SME specialised credit rating companies in Egypt. The few that are operating are representatives of internationally renowned companies primarily focused on larger industries. Such companies are reluctant to undertake SME rating due to the high costs that they incur from what ultimately translates into a comprehensive assessment of the company.

Credit rating and risk assessment require transparent and reliable information systems and sources that remain particularly lacking in Egypt. During interviews with senior bank staff we were informed that only SMEs registered on the Egyptian stock exchange – a miniscule percentage given the financial requirements for enlistment – are required to divulge detailed financial reports. Indeed, and even when such reports are provided, unethical practices by various accounting firms in Egypt makes such information sources untrustworthy. Understandably, this makes the assessment of risk a difficult undertaking in Egypt, and explains to a great extent, the banks' previous disinclination to offer credit facilities to the SME sector.

On the issue of a credit bureau, and as things currently stand, a database of client credit information exists through the Central Bank for credit clients who have accessed loans above LE 40,000. While the sum, by nature, typically excludes micro borrowers (as discussed earlier). Quite significantly, it also excludes some small/ medium borrowers and makes it risky for banks and other financial/ non- financial intermediaries to finance this sector. To this end, the Egyptian government has begun to undertake serious steps to instate credit bureaus in Egypt. Our interview at the Central Bank revealed that it is taking serious steps to establish such an entity – with a lower threshold limit - the broad framework of which has been outlined in the provisions of the Unified Banking Law. We were later informed that the Central Bank will be licensing and supervising the establishment and operation of private credit bureaus. This is no doubt, a serious step

towards the emergence of a vibrant, competitive credit environment, though due diligence was emphasized as an essential requisite discussed in the majority of our interviews. A number of the interviewees pointed out that relevant information on the client's payment of electricity bills/ car loans accessed ..etc needs to be made available to the credit granting agency.<sup>17</sup>.

As pointed out above, at no point during our interviews did we find a separate unit catering to the needs of SMEs. Our interviews revealed that even in bank analysis of its data and statistics, no attempts were made to distinguish between its "regular" clients and those of the said sector.

### **Credit Forms to SMEs:**

As a result, the five main forms of credit lines availed to SMEs, namely account overdrafts, credit lines, credit cards, and term loans, are assessed within the broader realm of retail – consumer / corporate – large enterprise credit finance.

#### a) Credit Lines

The viability of credit lines, and the reduced element of risk that they bear, makes them an easier credit option for SMEs. A number of donor and banks initiatives have been developed to open lines of credit specifically for SMEs. In this respect, and away from donor driven initiatives, the first public sector bank to offer credit lines to SMEs<sup>18</sup> was the National Investment Bank in 2002. In April 2003, the African Development Bank gave the National Bank of Egypt 140 million in US\$ to establish an SME focused credit line. The success of the credit line has encouraged the bank to renew the SME line with another US \$ 80 million<sup>19</sup>.

While both initiatives are commendable and to be encouraged, it is important to note, and as our survey findings indicate, that there is very little awareness among SMEs, of these and similar initiatives<sup>20</sup>. In addition, the low utilization of this service can also be attributed to the bank perceptions of targeted clients as being high risk. As such, it is fundamental that training be accorded to bank personnel offering this service as to the specifics of the SME industry – so as to ensure the efficient use of available funds and their access of enterprises operating under the sector in question.

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<sup>17</sup> Interview with Amro Abu Esh, Manager Advisor to the Chairman – M/SME Loans, Member of the Executive Board, Banque du Caire, and Nayera Amin, Vice President, CitiBank, March 2004

<sup>18</sup> We refer to public sector banks here in the first instance due to their significant outreach and presence in the Egyptian market – which further facilitates and increases their accessibility to SMEs.

<sup>19</sup> Response to question on ADB credit line, Mr. Emmanuel Zabanita, Principal Operations Exapatriate, African Development Bank, June 2004

<sup>20</sup> This finding is in conformity with the survey findings drawn from the IFC, as depicted in figure 5

#### b) Credit Cards

In 2002, Egypt boasted the third largest credit card market in the Middle East and North Africa, despite penetration rates remaining low<sup>21</sup>. Currently, commercial credit card services target medium to large enterprises – smaller businesses then having to resort to their personal cards (retail level) to access this form of credit service.

#### c) Overdraft Accounts

Our interviews highlighted that businesses and individuals use overdraft accounts. A viable credit option for many businesses, interviewees interestingly revealed that in many instances, banks were willing to overlook defaults on the overdraft. Upon further questioning we were informed that where a client has more than one account with the bank, and is having difficulty in repayment due to bad business – the bank weighs the benefit of maintaining the client relationship (several businesses), against calling one default in. While this applies primarily to medium - large businesses, it has important implications on the accessibility of this form of credit finance to new clients – irrespective of size. Given the risk averse nature of the Egyptian banking sector (discussed above), the predominance of these types of relationships in the Egyptian banking sector makes it very difficult for smaller enterprises, or those with less/ new dealings with the bank to access/ maintain this type of credit relationship.

#### d) Term Loans

Although Egyptian law permits the issue of “clean” (un-collateralised) loans, past experiences, (including the issue of loans to bank board members without the recording of the loans on the books and the formation of undercapitalised companies especially to access the loans), as well as the inefficiencies of the Egyptian judicial system; has resulted in the setting of stringent requirements for access to credit<sup>22</sup>. This, in part explains the miniscule percentages of bank lending to the SME sector, and which was estimated in a 1997 report to range between 5 – 6% of lending by the whole banking sector<sup>23</sup>. As noted earlier, formal collateral requirements can reach as high as 200%<sup>24</sup>, while informally practices such as the signing of blank checks as a personal guarantee for payment are common. In many cases, bribes and “gifts” are required to further ease and speed the procedures.

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<sup>21</sup> Having said that, it is important to point out that the above figures point to individual and commercial cards combined.

<sup>22</sup> American Chamber of Commerce in Egypt, “Loan Deputies Guilty – Now What?” Business Monthly, American Chamber of Commerce, August 2000. This rate reached LE 1.6 billion in 2000

<sup>23</sup> Nathan Associates, “Financial Reform for Small Business Development in Egypt”, USAID Policy Analysis/office, for the Government of Egypt, December 1997

<sup>24</sup> Ibid

Another issue related to term lending is that of interest rates on lending in comparison to that on deposits. Contrary to the conditions required for a successful lending environment, the difference between the interest rates on deposits and those on loans (the interest rate margin) in Egypt is unreasonably high, (ranging between 6 – 8% as compared against the international average which holds at 3%). This, coupled with the rise in the value of the dollar against the Egyptian pound, has created a monetary environment more conducive to saving than it is to lending. Where the “interest rate differential” (the difference between the interest rate on local currency deposits and those on foreign currency) – as in the case of Egypt, the guaranteed return on the investment in the deposited amounts, renders “saving” as a secured investment.

Against this risk averse backdrop, SME lending is predominantly provided with capital provided or guaranteed by international donors, primarily through the National Bank of Egypt and the Small Enterprise Development Organization (SEDO). To date, NBE has disbursed LE 570 million in a revolving fund, accessed by 38,834 projects. This is second only to the loans issued under the Social Fund for Development’s Small Enterprise Development Organization (SEDO – SFD), which amounts to 3,917,631,718 LE.

| <b>Institution<sup>25</sup></b>                      | <b>Active Borrowers</b> | <b>Outstanding Amounts</b> |
|--|-------------------------|----------------------------|
| Small Enterprise Development Organization (SEDO-SFD) | 191,213                 | 3,917,631,718              |
| National Bank of Egypt (NBE)                         | 38,834                  | 570,000,000                |
| Total  | 230,047                 | 4,487,631,718              |

**Table 1: Illustrating the number of Small & Medium beneficiaries and the amount of lending to SMEs.**

### **SME Credit Suppliers: The Social Fund for Development**

As the largest, and as determined under the new SME law, main body responsible for the SME sector in Egypt, an examination into the services that the SFD currently avails is necessary if one is to assess the growth potential of this sector in Egypt.

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<sup>25</sup> Small and Medium credit providers are considered the ones that offer an average loan size of 15,000 LE and above.

Since the establishment of SEDO in 1997, more than 3,9 M LE has been lent out to clients. 185,319 loans have been disbursed with an average loan size of 20,395 LE. Interest rates of SEDO loans have traditionally been below market rate, and, in line with its employment generating objectives, it specifically requires that the borrower (between the age of 21 – 60) decline from taking on any other employment than the enterprise. Loan terms range between 36 – 60 months – with grace periods ranging between 6 – 18 months according to the sector of activity. Seeking to fulfill its social objectives through employment generation, the prime focus of the program has been to assist startups<sup>26</sup>, whose loans it subsidizes. More recently, it has developed a different lending bracket and instituted an incubator model to cater to the rather particular needs of information-based technologies<sup>27</sup>.

Despite the significant funds availed the SFD through government and donor agencies its credit program is overrun with difficulties. In the first instance, the SFD encounters significant difficulty in convincing the banks to approve the loans. This is mainly due to the mechanism through which SFD funds flow. As depicted in figure 2 (above), the funds are availed to the bank in the form of a loan, such that in essence, the bank bears a considerable part of the risk. Our interviews with both the banks and the SFD revealed, that a number of factors have further complicated the relationship between the SFD and the banks. Due to the mission and objectives for which the SFD was established, there is an overriding perception that the SFD's development approach to credit lending makes it willing to finance ventures that are development motivated and commercially not viable. This makes banks more diligent in their risk assessment of SFD clients, and increases the need for comprehensive, all-inclusive feasibility studies that take the particulars of each business endeavor into account. The sheer number of loans that the SFD avails makes this difficult to implement. Indeed, the SFD's feasibility study takes the form of an analysis of the sector's performance, that is in turn, rendered useless by the banks. Also, the subsidization of the interest rates, it has been argued, distorts the market, and as was the experience with one of the banks, moves the bank's original clients towards the SFD program. Default rates on loans, though maintained by the SFD to be minimal (2%), were reported by banks and borrowers as being significantly higher<sup>28</sup>.

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<sup>26</sup> Egypt has a large number of university graduates – which the Social Fund is encouraging to establish businesses rather than wait for government promised employment.

<sup>27</sup> Interview with Khaled El-Dafrawy, Manager, Loan Portfolio Quality Department, Social Fund For Development (SFD). December 2003.

<sup>28</sup> Interview with Hanaa El Hilaly and Amr Abu El Azm, Department of International Cooperation, Social Fund for Development, March 2004; Nathan Associates, “Financial Reform for Small Business Development in Egypt”, USAID Policy Analysis/office, for the Government of Egypt, December 1997

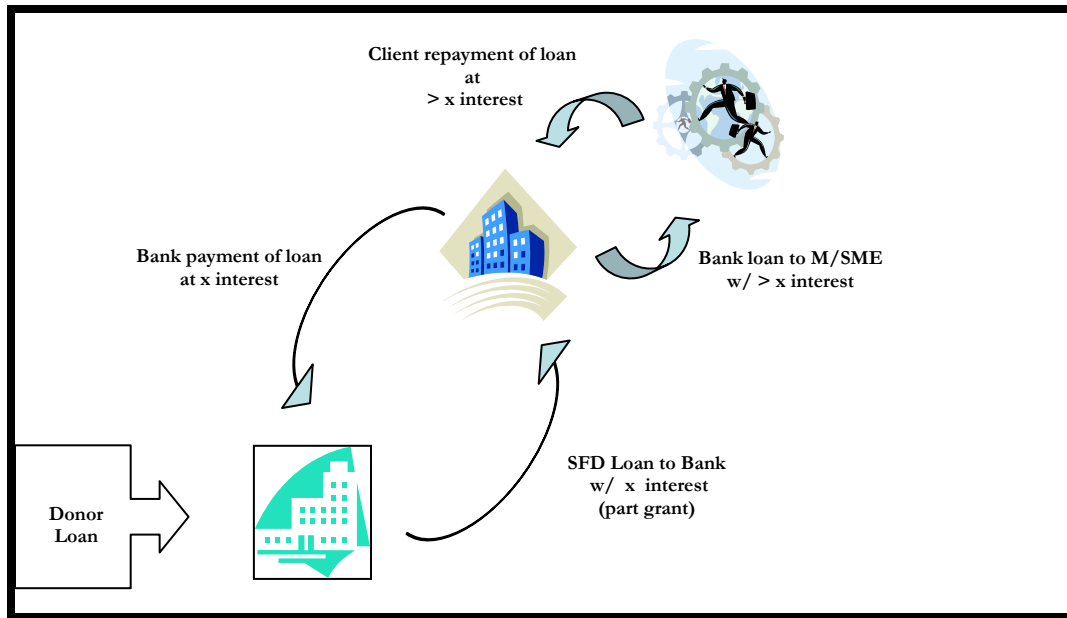


Figure 4: Flow of SFD loans/ funds<sup>29</sup>

### The Egyptian Regulatory Environment and SMEs: Challenges and Opportunities

Another essential element in increasing M/SME access to finance, is the creation of an enabling regulatory environment that recognizes and addresses the need of the M/SME sector. In this regard, it is sometimes vital to streamline existing national regulations hindering the accessibility of financing to this sector. In addition, there is an international dimension that can limit or otherwise facilitate the mentioned restructuring process.

At the international level, the Basle Committee of G-10 banking regulators has proposed a new Capital Accord, with the aim of more accurately aligning regulatory capital with the risks that international banks face. In this regard, streamlining national regulations in member countries will be required, so as to ensure compliance with the new Capital Accord<sup>30</sup> by year-end 2006.

Responding to calls for financial reform of the banking sector, and seeking to transpose the requirements of the New Basel Capital Accord (BCA II), the Egyptian government recently instated the New Banking Law no. 88 of 2003. The enacting of the law comes as the most recent of a series

<sup>29</sup> Telephone Interview with Ms. Amal Gmal El Din, Social Fund for Development and Mr. Amr Aboul Azm, Division for International Cooperation, Social Fund for Development

<sup>30</sup> This is verified by Mohi El Din Fathi, for the interview conducted with Mr. Bardai, A.– Chairman of Banque du Caire and the Federation of Egyptian Banks in The Seventh Conference for Middle-East and North Africa Banks' Officials in Sharm El Sheikh. El-Ahram: (10-Feb-2004)

of steps taken by the Egyptian government to facilitate and better cater to the needs of businesses operating in Egypt. In so doing, the law creates greater flexibility in the Egyptian banking market – granting the Central Bank (CBE) status as an independent, sole supervisory authority, in a bid to move towards greater decentralization, its executive regulations laying stricter provisions in the issue of credit.

### **.1. Credit Guarantees**

A credit guarantee is a financial instrument that involves and encourages financial institutions and, in particular commercial banks to provide access to finance to M/SMEs that have potential prospects of success, but are unable to provide sufficient collateral or do not have a suitable record of financial history and transactions to prove their creditworthiness. For that reason, the guarantee scheme (the guarantor) bridges this gap and fulfills the role of a guarantee for the M/SME to the financial institution. Thus, in the event of repayment defaults, the guarantor will repay the lender a proportion of the principal forgone.

## **Credit Guarantees in Egypt: Challenges and Opportunities**

### **1. The Credit Guarantee Corporation (CGC)**

The Credit Guarantee Company for Small and Medium Scale Enterprises was established in 1989, as a Private Joint-Stock Company under law 159/1981 – beginning its full operations in 1991. Primarily the initiative of USAID/ The Ministry of International Cooperation<sup>31</sup>, the CGC's shareholders are nine Egyptian banks and one insurance company. As shareholders, the banks thus function as a sustainable source of financial capacity to the Company, and as secondary providers of staff/management support. Generally, the CGC operates by placing interest-bearing deposits with commercial banks, these then serve as a collateral fund that potentially covers CGC issued guarantees of SMEs. It is important to note that the Company processes claims within 10 days of receipt – provided that the bank has taken legal action against the borrower.

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<sup>31</sup> The Ministry of International Cooperation lent the CGC a fifty year LE 60 million loan – with a 10 year grace period. USAID provided the CGC signed an agreement for a \$10 million guarantee fund to be disbursed over three installments. Through another agreement in 1992, this time with the SFD, the CGC was given an LE 10 million loan with a two year grace period on interest Nathan Associates, “Financial Reform for Small Business Development in Egypt”, USAID Policy Analysis/office, for the Government of Egypt, December 1997

| <b>INDICATOR</b>                               | <b>AMOUNT (IN LE THOUSANDS)</b> |
|--|---------------------------------|
| Total CGC Guaranteed Credit Dispersed by Banks | 2,550,988                       |
| Total Guarantees Issued by CGC                 | 1,338,238                       |
| Number of CGC Beneficiaries/ Clients           | 28,373                          |
| Current Guaranteed Credit Balance              | 563,064                         |
| Current CGC Guarantees                         | 314,807                         |
| Current CGC Beneficiaries/ Clients             | 8,643                           |

| <b>Sector</b>  | <b>No. of Beneficiaries<br/>(in Thousands)</b> | <b>Credit Amount<br/>(in LE Millions)</b> | <b>Guarantee Amount<br/>(in LE Millions)</b> |
|----------------|--|---|--|
| Industry       | 7065   | 1059                                      | 452  |
| Agriculture    | 1686   | 128                                       | 62   |
| Contracting    | 1436   | 393                                       | 138  |
| Services       | 1135   | 182                                       | 71   |
| Transportation | 348  | 60  | 26   |
| Tourism        | 199  | 42  | 18   |
| Mining         | 53   | 16  | 7  |
| Trade          | 8  | 3   | 1  |
| <b>Total</b>   | <b>1,1930</b>                                  | <b>1,883</b>                              | <b>776</b>                                   |

**Table 2: Table Illustrating SME Performance by Sector**

| <b>Purpose of Credit</b>          | <b>No. of Guarantees</b> | <b>Volume of Loans<br/>(in LE Thousands)</b> | <b>Volume of<br/>Guarantees<br/>(in LE Thousands)</b> |
|-----------------------------------|--------------------------|--|---|
| Working Capital                   | 8,493                    | 1,440,645                                    | 599,133   |
| Fixed Assets                      | 2,289                    | 247,296                                      | 114,364   |
| Working Capital &<br>Fixed Assets | 894                      | 97,979                                       | 35,676  |
| Others                            | 813                      | 183,247                                      | 56,206  |
| <b>Total</b>                      | <b>12,489</b>            | <b>1,948,167</b>                             | <b>805,379</b>  |

**Table 3: Table Showing Guarantees for SMEs Classified by Purpose of Credit, 1991 - 2003<sup>32</sup>**

<sup>32</sup> Materials received from the Credit Guarantee Corporation, September 23, 2004

In terms of encouragement of financial intermediaries to engage in M/SME lending even during times of recession<sup>33</sup>, our interviews reveal that a change is needed in the regulatory/executive climate, for the CGC to reach its full potential. As mentioned above, the CGC processes claims only after a court order has been issued against the defaulting client. In addition to requiring the financial intermediary to undergo significant administrative procedures, it also subjects compensation to the inefficiencies of the Egyptian legal/ court system. Claims thus may take up to 5 years to process. This no doubt, has limited the credibility of the very existence of a guarantee scheme.

Another reason cited for the reluctance of financial intermediaries to adopt the CGC's guarantee programs, relates to the calculation of its costs. In a number of interviews, it was mentioned that the CGC's calculation was problematic, and that their rates varied – leading to problems with the contracted financial intermediary. This, it seems, was the cause of the concern of various bank and non – bank agencies. When we questioned the CGC, we were informed that their method of calculation is set, and that indeed, the problem arose as a result of the bank's lack of understanding as to the method of calculation. The issue of calculation is well documented in the literature. Graham Bannock & Partners note that if and when there is transparency in the distribution of risk between the guarantor and the bank, the guarantee can serve as a source of capital for the bank; especially in a non – competitive market such as that of Egypt, as the bank can transfer the additional cost on to the borrower.

During the period that elapsed between the conduct of interviews and the write up of the report, the CGC underwent major organizational changes and shifts. An agreement was concluded between the CGC and an NGO in North Sinai, through which the CGC would provide guarantees and support services for micro-finance projects. This is the first of four agreements that the CGC is planning to undertake with similar NGOs in Egypt, and represents a shift in the CGCs' views and marketing strategies vis a vis potential clients. In addition, our interviews with senior representatives of the CGC highlighted recent moves to further engage with the banks in the screening and tracking of clients; these moves are being undertaken simultaneous to aggressive expansion and marketing in Egypt's governorates, as well as innovations in the pricing packages.

## ***.2. Cooperative Insurance Society for Small Enterprises (CIS)***

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<sup>33</sup> This is directly related to additionality, which as noted in the literature review, though one of the main objectives of guarantee schemes, is almost impossible to quantify, and hence to measure.

Operating under the insurance law, and consequently supervised by the Egyptian Insurance Supervisory Authority (EISA), the Cooperative Insurance Society for Small and Medium Enterprises was established by the SFD to serve as a credit guarantee for loans disbursed under its resources. With 10 million in startup capital – issued as shares - the Society was established as an NGO in 1999 - after the Fund had undergone a guarantee experience with the Credit Guarantee Corporation (the details of which are highlighted above). Currently, CIS guarantees 80% of the loan, the remaining 20% borne in its entirety by the bank<sup>34</sup>. The loan recipient pays 1% of the total guaranteed amount - the first year of which he is exempted from. For each LE10,000 taken by the recipient, he is entitled to a share in the Society, the profits of which he receives on an annual basis. The Society is current operating profitably, and has since, expanded its guarantee services to cover professional associations and external loans.

The CIS has the support and backing of the largest micro enterprise financing institution in Egypt – itself a quasi government body. This has worked both to the Society’s advantage and against it. On the one hand, financial intermediaries adopting SFD programs – which they must do at some level for PR and political reasons – are obliged to adopt CIS guarantees. However, on the other hand, this has resulted in a certain level of inefficiency on the part of CIS. Working under an individual model of guarantees, and comforted by SFD support, CIS is perceived as being overeager to provide guarantees. Indeed, and as an SFD staff member pointed out, if “CIS were to refuse some cases as being too risky, it would gain credibility amongst the banks. As it stands, the banks now require collateral in addition to CIS ‘guarantee’”.

### **.3. *Export Credit Guarantee Company (ECGC)***

Established by Presidential decree # 21, the Export Credit Guarantee Company was set up in 1992, as a subsidiary of the Export Development Bank. Operating under the insurance law, ECGC guarantees commercial and non – commercial risks on Egyptian exports<sup>35</sup>. A shareholding company, it is 93% owned by public sector banks, and national insurance - the remaining 7% distributed amongst Al Mohandess Insurance (private sector), and various businesses. The Export Development Bank of Egypt, followed by the Bank of Alexandria, and Al Ahly Bank are the most significant shareholders, and together they control seventy five percent of the shares. Originally established with a capital of LE 10 million and an extra LE50 million in long term support bonds, the ECGC has evolved from a non - profit institution into, during the last couple of years into a profitable business.

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<sup>34</sup> Negotiations are presently underway to distribute the said 20% between the Fund and the bank.

<sup>35</sup> The ECGC does not cover foreign exchange risks.

Indeed, when it needed an additional LE 25 million in funds, it reached an agreement with their shareholder that entitles them to 5% of its profits this present year – and 10% in the years to come. The company's capital, up to February 2003 stood at LE 50 million, with outstanding guarantees according to a 2003 report prepared by the Economic Research Forum for the SMEPol unit, reaching US\$51 million<sup>36</sup>.

One of the primary weaknesses of the ECGC is the low utilization of its services. The Export Development Bank – its main shareholder as highlighted above – is the main user of its services<sup>37</sup>. Even during our interviews with ECGC representatives, reference was made to the low involvement of external banks (even other bank shareholders) of ECGC services. This they explained, was in part, due to the relative stagnation of the Egyptian export market, in addition to the unwillingness of the banks to adopt new/ different technologies.

The ECGC currently operates under an individual credit guarantee model. Though it would prefer to work under a portfolio model, this has been strongly resisted by the banks, who feel more secure dealing under an individual model, with assessments made for each case separately, reflecting the risk and in turn credit aversiveness of the Egyptian banking sector. In the opinion of the ECGC representatives, one of its main advantages is its flexibility and adaptiveness to the needs of Egyptian exporters. The ECGC offers guarantees to all interested enterprises, irrespective of size/ sector of activity. In this respect, it does not solely focus on industries that the government is encouraging, but is available and accessible to all. Beyond its original mandate, the ECGC has developed some basic "non-financial" services to assist Egyptian exporter's access credit. It has developed models of contracts, purchase orders, billing forms, and document collection requests in English. These tools have played a detrimental role in providing smaller and less experienced SMEs with the tools necessary to access outside markets.

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<sup>36</sup> Economic Research Forum, "Research on SME Access to Export Finance", Presented to the SME Policy Development Project, Ministry of Foreign Trade, and the International Development Research Center (IDRC), February 2003

<sup>37</sup> Other than the Export Development Bank, only two banks deals with the ECGC

## **PART VII: RECOMMENDATIONS:**

The recommendations presented in this report have been developed in the manner set by the terms of reference, and which require explicit and practical suggestions to ensure that M/SMEs in Egypt access financial credit services that directly cater to their needs. In so doing, and by accounting for the findings of the study, both in terms of the level of demand for credit services by M/SMEs and also the availability and suitability of the said services; the recommendations seek to grasp some of the opportunities in the Egyptian market, while also addressing the constraints.

As the focus of this study has primarily been on the availability and quality of credit service provision to M/SMEs alike, the first set of recommendations will cover the improvement of credit facilities to M/SMEs in Egypt in general. The second set will then be further broken down to address the improvement of the outreach and effectiveness of credit facilities provided to both micro, small/medium enterprises separately. Where M/SMEs generally lack collateral requirements, the third set of recommendations will be developed with a view to enhancing the provision of credit guarantees to the said sector.

### **I. Credit**

The recommendations for credit can be categorized under the general headings of:

- Availability of M/SME Credit Services
- Suitability of M/SME Credit Services
  - a. Systems
  - b. Outreach
  - c. Sustainability
  - d. Availability of information and regulatory support

**In formulating the recommendations, utmost care and attention has been taken to draw on, and incorporate the lessons learned from international experiences. In sync with the format adopted throughout the report, each of the recommendations will address the credit needs of micro, and small/ medium enterprises separately.**

#### **1. AVAILABILITY OF SUPPLY FOR M/SME CREDIT SERVICES:**

Both field and desktop research indicate significant levels of unsatisfied credit demand by micro and small/medium enterprises. While this is primarily a function of supply, it is important to identify actual demand for credit services by M/SMEs.

a. **MICRO CREDIT SERVICES**

| RECOMMENDATION  | TO MITIGATE FINDING(S)   |
|---|--|
| Establishment of unit in SFD for the provision of regular, updated information on market demand for micro-credit services | Differences in estimation on outreach gap for demand for micro-credit services |

As the Egyptian economy is dominated by micro – enterprises, the level of potential demand for micro credit services is tremendous. That said, NGOs, and more recently, banks, have engaged with this sector. Desktop research estimates the level of unsatisfied demand for micro credit services to be approximately 90%. However, interviews and on the field investigations place this number to be closer to 70%. **To this end, our recommendation, in seeking to properly quantify and represent the level of demand for micro credit services is that a unit be established within the Social Fund for Development (SFD) (the main body identified as being responsible for M/SME credit under the terms of the new SME law), dedicated to the regular, updated provision of market information on the level of demand for micro credit services – while taking account of:**

- Formal suppliers of credit
- Informal credit networks (i.e. *gamiyaat*)
- Non-credit financial alternatives (i.e. equity finance)

It is important to note that this unit would serve as an information gathering/ disseminating structure, and would not partake in the planning/ coordination/ implementation of any micro credit programs. Rather, and in providing accurate up-to-date information on demand for services, the unit would take into account variety in the credit services available to micro enterprises whether in terms of the size of the loan, or the type of service offered.

In order to be able to fulfill this function fully and efficiently, the unit would support and access financial indicators on the performance of banks and NGOs alike. Such that **both banks and NGOs regularly provide financial statements and updates on the performance of their micro credit programs to the said unit. This would allow the unit to assess potential supply against demand, from the regular surveys it conducts.**

**b. SMALL/ MEDIUM ENTERPRISES CREDIT SERVICES**

| RECOMMENDATION   | TO MITIGATE FINDING(S)  |
|--|---|
| <p>Encourage banks to offer tailored SME credit packages by</p> <ul style="list-style-type: none"> <li>▪ Utilizing available technical assistance</li> <li>▪ Provision of tax incentives and coordinating activities of alternative financing options (e.g. leasing)</li> <li>▪ Establishment of unit in SFD for the provision of regular, updated information on market demand for SME credit services</li> </ul> | <p>No tailored credit services currently on offer to Egyptian SMEs (with exception of CIB), and resulting low accessibility rate of SMEs to suitable credit finance</p> <ul style="list-style-type: none"> <li>▪ CIB has utilized available technical assistance to develop tailored SME credit scoring tools – knowledge of which is lacking in Egypt</li> <li>▪ Alternative credit options bear great potential to the Egyptian market, and should be encouraged</li> <li>▪ Absence of market information on demand and supply of credit services to SMEs.</li> </ul> |

The risk and administrative costs that characterize small/ medium enterprise lending, has made most commercial banks shy away from providing tailored services to this sector. This has created a significant level of unsatisfied demand, as the only alternative to SMEs is to access the smaller loan brackets of the micro sector, or face the inflexible credit scoring mechanisms associated with lending to larger loan brackets. **Utilizing available technical assistance** (as was the case with the Commercial International Bank), will allow interested banks to update their systems to cater to the needs of this lucrative sector, in a manner that ensures profitability and allows them to reach the best practice attained at the micro credit level. .

As most SMEs reported equipment finance as their most pressing need, **supporting alternative credit options, most notably leasing, should be explored as a viable financial tool:** The SMEPol Unit has recently developed a detailed action-plan encouraging SME leasing services - which can be coordinated for adoption by the relevant authorities, however and as noted in the Egypt Competitiveness Report, possible incentives for leasing in Egypt include:

1. Encouraging the formation of SME leasing companies through the provision of tax incentives
2. Coordinating the services of leasing companies with existing SME development programmes

As with the case of micro-finance, **the same unit referred to above (within the SFD), would conduct regular market research and updates on the level of SME demand for credit.** The unit would take into account alternative finance options, whether in terms of equity finance (e.g. the existence of SME venture capital funds) or informal lending mechanisms. Again, and in order to be able to fulfill this function fully and efficiently, the unit would support and access financial indicators on the performance of bank SME programs. Such that **banks would regularly provide financial statements and updates on the performance of their SME programs to the said unit.**

## 2. SUITABILITY OF M/SME CREDIT SERVICES

The suitability of available credit services to M/SMEs is critical for the emergence of a vibrant M/SME credit market, and in turn SME sector in Egypt.

### a. *SUITABILITY OF MICRO-CREDIT PROVIDERS*

| RECOMMENDATION  | TO MITIGATE FINDING(S)   |
|---|--|
| Amendment of law no. 84/2002 to remove the “moral person” status from NGOs engaged in micro-finance | Non- sustainability/ continuity of donor funds/ need for larger loan amounts to micro-credit clients to accommodate current market prices  |
| Revision of NGO procedures to allow delegation of responsibility                                    | Inflexibility of current NGO procedural system (which affects both cost and time), and bearing of all financial responsibility on Chairman |
| Conduct of marketing campaigns in sites of micro-enterprise activity                                | Lack of awareness of micro-credit service providers/ outreach gap  |

Most of the NGOs that have received technical assistance have reached best practice and have adopted systems and approaches that best suit micro-enterprise needs. However, the survey revealed that there is a strong need to increase loan bracket sizes, and revise current procedures such that responsibility is justly distributed within the organization. To this end, we recommend the **amendment of law no: 84/2002 on Non Government Societies and Organizations, to remove the "moral person" status of NGOs engaged in micro-credit services.** Indeed, as the discussion on micro-enterprise credit highlighted, NGOs will only be able to respond to the market demand for larger loan brackets through transformation, renegotiation of donor packages/ terms, or by taking a loan from a bank. Under the current regulatory framework, all three alternatives are not viable. For transformation – perhaps the most fitting alternative due to its self sufficiency and the highest returns on capital – to take place, amendments to both the NGO law, and the recently drafted banking law will have to be made. Thus, this would be an unlikely alternative in the neat future. The second alternative is also inappropriate given its reliance on donor funds, and the terms of the NGO law which make it difficult to access funds coming from abroad. As such, and even where

renegotiation is possible, security concerns make the amendment of the said law to that end improbable.

The amendment of the law in the manner highlighted above would ensure that where an NGO defaults, it would be liable to appear in court – thereby ensuring that the bank would have recourse in court in case of default. This possible liability would encourage banks to lend the required amounts to NGOs with established track records in microfinance. It is unlikely that the increased interest rate that would ensue would influence the level of demand for formal credit. Indeed, and with the current repayment rates witnessed by NGOs engaged in micro finance, such a loan would bear an acceptable level of risk.

This recommendation will also address the issue of outreach – critical to market expansion in the micro-enterprise industry. As things currently stand, NGOs bear a distinct advantage in terms of outreach, as do public/former public sector banks. Private banks seeking to engage in micro-finance are recommended to do so by lending funds to the NGOs – in the manner depicted above.

In addition, **NGO procedures should be revised to allow delegation of responsibility.** Our interviews with the Chairpersons of the NGOs revealed that under the current structure, the Chairman’s approval is required for all matters pertaining to the NGO’s finances (issuance of cheques ..etc). This not only put the chairperson under legal liability, but also takes up considerable portions of time – quite costly in the finance industry. Revision of current procedures, to allow for the delegation of responsibility to ensure that less time and resources are consumed in the management of funds.

The outreach of micro-finance programs can be enhanced to fully cover the awareness and outreach gaps through the conduct of **Marketing campaigns through pamphlets in sites of micro-enterprise activity. Also, where possible, business associations can pool funds and resources to make radio announcements of their programs**

b. ***SUITABILITY OF SME CREDIT SERVICE PROVIDERS***

| RECOMMENDATION   | TO MITIGATE FINDING(S)  |
|--|---|
| Develop credit scoring mechanisms, drawing on similar national and international experiences | Need for credit scoring mechanisms tailored to SMEs. Lack of tailored services to SMEs in Egypt |
| Provision of tailored credit services to Egyptian SMEs,                                      | Lack of tailored SME services in Egypt / unsuitability of both micro and corporate credit       |

|  |   |
|--|---|
| most notably <ul style="list-style-type: none"> <li>▪ SME online banking services</li> <li>▪ SME credit cards</li> <li>▪ SME term loans</li> </ul> | to SME needs  |
| Encourage the Central Bank to recognize the risk provisions placed by banks on their lending portfolio   | Bank perception of SME market as high risk  |
| Specialized training on SME risk assessment/ accounting procedures and needs through the Egyptian Banking Institute                                | Bank perception of SME market as high risk/<br>lack of tailored services to SME needs/<br>Uniqueness of the SME credit market |
| Develop stringent accounting/ audit systems for SMEs with appropriate monitoring and follow up   | High risk perception of SME credit market due to fraud and mal-practice in accounting and audit procedures                    |

As noted earlier, the two main direct providers of SME credit services are the Social Fund for Development (SFD) and the National Bank of Egypt (NBE), (and Orix Leasing Company). There is a strong need for other banks and financial intermediaries to penetrate this segment, both in terms of accessing potential demand and diversifying services. Already the Commercial International Bank has taken serious steps towards this, and Banque du Caire has announced that it is proceeding along similar lines. To this end, and in line with these trends and government attention to SMEs, a number of steps have been recommended.

The first of such steps is the **Development of credit scoring techniques along international lines, drawing on the experience of the NBE**. The report has identified the existing “cookie cutter approaches” to credit scoring as being particularly inhibiting to both bank engagement SME lending, and SME accessibility to funds. The knowledge basis that the multi donor, IFC managed North Africa Enterprise Development center has in this field is “top of the notch” and should be garnered by banks and other financial intermediaries alike. Efforts made at the policy level to access information that would serve as an impetus/ basis on which banks can then independently develop, would be encouraged to examine the experience of the NBE/ CIB in-depth, and adapt systems accordingly

Accessibility of SMEs to bank services is dependent on the physical proximity of the bank to them. Where private sector banks do not have the outreach needed to address SME needs, developing tailored SME credit packages will also entail the tailoring of products currently offered under “retail”

/ based on the SME owners' personal records, to the needs of SMEs and in a manner that allows them to overcome their limited geographic outreach. This is to include:

- **The provision of SME online banking services**
- **The provision of SME credit cards**
- **SME Term loans**

The provision of such services entails, in the first instance the **Development of specialized training on risk assessment, and the specific accounting procedures/ needs of the SME sector by the banking sector.** Currently, the Egyptian Banking Institute (EBI) provides training on traditional banking techniques and methods. Expert training on SME finance can be coordinated with the SFD, but should take place under the auspices of the EBI – which has traditionally engaged in this type of activity. Further, it will also require the **Development of stringent accounting standards and requirements, with adequate systems of monitoring and follow-up on SMEs.** This is important in so much as the reliability of the financial reports and statistics presented by SMEs to financial intermediaries is critical for banks wishing to engage in SME credit finance. Fraudulent practices in the Egyptian accounting sector have deterred large commercial banks – more accustomed to dealing with large and “safe” corporate clients from engaging with this sector. In this respect, and even where appropriate SME credit scoring mechanisms have been developed, they are useless if banks cannot be certain of the figures on which the “risk assessment” is based.

Finally, Central Bank endorsement of SME finance is critical for increasing finance to this sector, especially given the prevailing perception amongst Egyptian banks that finance to this sector is high risk. Support and endorsement could be made by **Central Bank recognition of the risk provisions on bank lending.**

*c. SUITABILITY OF SFD CREDIT SERVICES*

| <b>RECOMMENDATION</b>  | <b>TO MITIGATE FINDING(S)</b>   |
|--|---|
| Negotiating with SFD policy setters to reduce subsidies on loans to medium enterprises/ certain sectors, while encouraging banks to use additional funds generated to establish separate units to cater to SMEs. | Lack of availability of credit to SMEs, and the unsuitability of current loan sizes to their needs. Need for more suitable loan amounts as priority to interest rates. Market distortion(s) created by subsidized interest rates. Un-willingness of banks to adopt SFD loans except for political reasons |

Currently the main body responsible for M/SME credit, the SFD has the largest amount of funding and the strongest possible role in the M/SME credit market. Its subsidized interest rates, and

political underpinnings has limited the willingness of banks to actively utilize its funds. Strong pressure is being made to commercialize the interest rates offered by the SFD. These efforts can be enhanced by **Negotiating with SFD policy setters to reduce the subsidies on interest rates for loans to medium enterprises/ certain sectors, and encourage banks to use the additional funds generated to establish SME credit units within banks.**

In contrast to the current interest in micro-credit, there is less enthusiasm amongst banks for SME credit. Availing funds to the establishment of specialized SME units, with the required credit scoring techniques (please refer to recommendations above), would serve as a first step towards further bank engagement with this sector.

Our survey reveals that amongst medium sized enterprises, the interest rate is not a concern, rather they are limited only by the unavailability of suitable loan brackets, and bank collateral guarantees and requirements. As medium sized enterprises do not bear the social connotations of the micro/ small sized enterprises political support may be elicited for this undertaking.

### 3. AVAILABILITY OF INFORMATION AND REGULATORY SUPPORT

| RECOMMENDATION  | TO MITIGATE FINDING(S)  |
|---|---|
| Establishment of separate credit information bureaus for micro, and small/ medium enterprises                                     | Absence of a knowledge base for the systematic risk assessment of micro, small and medium enterprises. Identification as the main obstacle to credit provision in the Egyptian context. Importance of credit bureau in the international experience   |
| Establishment of Commercial Courts/ Heightened coordination between the courts and the recently established loan deferment office | High perception of risk in the provision of credit to SMEs. Inefficiency of Egyptian court system reduces possibility of compensation. Predominance of mal-practice of issuing of blank cheques as a guarantee that will allow recourse to criminal courts and avoidance of the more lengthy civil courts |

Obviously, the existence of a supporting and conducive legal and regulatory framework is essential for the emergence of a vibrant credit market in Egypt. The report has identified some key issues for concern that must be addressed, and which include foremost, **the establishment of a credit information center/ bureau for M/SMEs.** Indeed, the international experience refers to a heightened difficulty in the incorporation of micro service providers in larger credit bureaus. It is therefore recommended that a database, catering separately to the micro and small /medium credit sector be developed. This center would allow lending bodies to examine the credit worthiness of each client. In the same manner currently being implemented by banks seeking to overcome the restrictions of the secrecy laws in Egypt, potential clients, agreeing that other entities view their credit

history/ information, would sign a waiver. Applied retroactively, the names of clients who refuse to sign such a waiver would be kept on record for access by other credit agencies. As discussed in the report, and confirmed by Central Bank officials, steps are being taken to establish a private sector bureau regulated by the Central Bank in the near future. It is important to note that due diligence is a requisite to the success of this bureau, however the structure and form under which the credit information center will operate is not yet known/publicized.

**In addition, it is believed that the establishment of commercial court(s), will encourage and ease up the offering of credit by banks and other specialized financial intermediaries.**

As the report has highlighted financial intermediaries have traditionally refrained from extending credit services to M/SMEs due to their high perception of risk. The Egyptian court system is inefficient, costly and lengthy. Realizing that they will have little chance of recourse in the civil courts, financial intermediaries have either totally refrained from the extension of credit services to the M/SME sector, or have adopted practices (such as having the client sign a blank check) that would allow them to pass through the criminal courts. The establishment of a commercial court(s) would increase the chance of compensation in case of default, thereby further encouraging the extension of credit services to M/SMEs.

Immediately prior to the formulation of a new government, former Prime Minister Atef Ebeid announced that steps were being taken to establish the said courts. Though the status of the court remains unclear, the new government recently announced that a unit for the follow up and monitoring of deferred loans would be established within the central bank. This unit will be instrumental in creating a more credit friendly environment in Egypt. If this stands true, **Coordinated efforts between the said loan deferment office and the commercial courts will be essential to ensure the efficient and in turn sustained, flow of operations.**

The outreach of M/SME credit providers could also be enhanced through the establishment of **Formal information dissemination channels between financial intermediaries and M/SME clients. Such channels could take the form of a credit information hotline, and a mechanism to ensure accurate accounts for SMEs.** This will be important given the strong perception of risk and mistrust between banks and M/SME clients, as well as the lack of awareness of existing credit facilities and packages, open channels of communication should be developed between financial intermediaries and their M/SME clients. In addition to detailed promotion campaigns, financial intermediaries should coordinate to provide information on their services through trustworthy channels. This could take the form of an M/SME credit hotline that would provide accurate and

timely information on the credit services available. On their part, SMEs should be able to provide trustworthy accounts and records of their financial transaction. Egyptian law only requires that limited liability companies – costly to establish – keep audited records, though they are an important requisite for the development of a vibrant credit market.

## II. Credit Guarantees

As the report has highlighted, a **number of guarantee services are already available and operating in Egypt. However, for a healthy credit environment to evolve, their role must be further enhanced and their performance improved.**

- **The Cooperative Insurance Society**

| RECOMMENDATION  | TO MITIGATE FINDING(S)   |
|---|--|
| CIS must adopt a screening policy in its issuance of guarantees                       | Bank perception of over-eagerness of CIS   |
| Re-registration of CIS away from insurance law  | Registration under insurance law limits scope of activities, and defines them away from guarantees           |
| Strong and directed marketing campaigns to banks detailing advantages of CGC packages | Lack of understanding amongst banks as to the functions and distribution of risk and costs b/w CGC and banks |
| Delay in processing of compensation claims till after transfer to legal department    | Revising current procedures to begin processing claims upon client classification as delinquent              |

The over-eagerness of CIS has made banks reluctant to view it as a guarantee agency. **It must adopt a scoring/ screening policy when choosing clients.** This will increase its credibility with banks.

More importantly, **its continued operation under the insurance law, has limited the validity of its operation as a credit guarantee instrument. It must consider revising its status to gain legitimacy, as it must also announce its capitalization rates, which have been the center of much skepticism.**

- **The Credit Guarantee Corporation**

| RECOMMENDATION   | TO MITIGATE FINDING(S)   |
|--|--|
| Strong and directed marketing campaigns to banks detailing advantages of CGC packages, with clear explanation of | Lack of understanding amongst banks as to the functions and distribution of risk and costs b/w CGC and banks |

|   |   |
|---|---|
| means of calculating costs  |   |
| Revising current procedures to begin processing claims upon client classification as delinquent | Speed the processing of compensation claims till after transfer to legal department |

Currently, the CGC has undertaken a major shift in both its approach and organizational structure. These changes are promising and could indicate an upward shift in its overall performance with the banks. While it remains too early to gauge any clear impact, **the CGC must continue to conduct strong and targeted marketing campaigns detailing the advantages of their packages and the costing mechanism used. It should also examine the possibility of speeding up the transfer of processing claims upon client classification as delinquent.**

- **National and regional credit guarantee programs**

The report has identified a number of national and regional credit guarantee programs that exist for exporters - these **programs are largely underutilized, and should be tapped into by M/SME clients**

| <b>RECOMMENDATION</b>   | <b>TO MITIGATE FINDING(S)</b>  |
|---|--|
| Coordination with government and non – government bodies to market such initiatives | Under-utilization of existing national/ regional credit guarantee programs – most notably the ECGC |
| Adoption of aggressive marketing campaigns  |  |

It is recommended that coordination take place between the relevant bodies to announce and market such initiatives. More specifically, the Export Credit Guarantee Company should undertake more extensive marketing activities that include **intensifying existing efforts being made within the ECGC to coordinate with the relevant government ministries and bodies to announce and market its activities; and diversifying marketing channels such that they extend beyond direct faxing to the factories. This is to include participation – even if by a simple booth – in trade fairs and exhibitions.**