Challenges in Accessing Finance for Growth-Oriented Small and Micro Entrepreneurs in Tunisia

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SMEs: Definitions

- Small and medium enterprises in industry and services sectors as those with a total investment of less than 3 million TND (about 2.1 million U.S. $).
- SMEs are businesses that are run directly by their owners whose are personally and directly assume financial, technical and moral responsibilities.
- Any business employing between 10 and 100 workers belongs to the group of SMEs. This definition is not clearly pronounced and does not appear in any official document.
SMEs in Tunisia: Importance and Characteristics

- Constitute likely the most important operator in the economy
- Reduce unemployment
- Generate new employment opportunities
- An important source of growth
- Exhibit a greater capacity to adjust and to react to market changes
SMEs Growth: Forms and Motives

1. SMEs growth involves several domains mainly:
   - Job creation
   - Internationalization
   - Product innovation
   - Process innovation
   - Organizational innovation

2. Growth oriented SMEs seek to:
   - Improve their competitiveness
   - Increase their size
   - Search for new market opportunities
   - Acquire comparative advantages
SMEs Growth in Tunisia: The Determinants

SMEs growth is attributable to a combination of traditional factors and SMEs specific characteristics such as:

- Age and size
- Internal finance,
- Capital structure
- Growth opportunities
- Factor productivity
- Entrepreneurs’ risk attitude.
SMEs Growth in Tunisia: The Challenges

SMEs evolve in a complex business environment characterized by globalization:

- The internationalization of markets,
- The need for greater efficiency and competitiveness based on innovation,
- An increasing pressure upon the management of these SMEs in order to compete globally,
- Difficulty to access to capital and loan market. Without it, SMEs cannot innovate, and cannot be competitive,
- No banks specialized in financing SMEs activities despite the existence of specific financial instruments and organisms,
- Successive financial crisis has made investment challenging,
- Corruption and bureaucratic constraints sets limits on economic and investment initiative and economic freedom,
- Protecting intellectual property is complicated and costly, the adoption of an efficient and non-costly system of patent protection could reward those enterprises that invest in creativity and innovation.
SMEs growth versus large firms growth

Specific characteristics that fundamentally distinguish SMEs from large enterprises relate to their:

- environment
- structure
- strategy
- decision making process
- flexibility
- proximity to markets
- quickness to react and reorient themselves
SMEs Growth and Entrepreneurship Quality

- Entrepreneurs may differ (country, region) by motivations (necessity, opportunity), growth aspirations (job creation, internationalization) and innovation (new products, processes, organization) behavior. This set of criterion expresses different qualities of entrepreneurship.

- The contribution of SMEs entrepreneurship to economic development and particularly growth may differ according to the available quality of entrepreneurship.
SMEs Growth and Capital Requirements

1. SMEs tend to draw capital from

- internal sources
- personal sources
- informal investment

2. As they grow, SMEs face additional capital requirements and ought to turn to external sources such as banks and public debt and equity markets.

3. SMEs have a pecking order of preferred capital sources.
SMEs Entrepreneurs Financing Decisions

There exists a complex array of factors that influence SME owner-managers’ financing decisions, in particular:

- attitude toward utility of debt
- attitudes toward risk
- culture
- entrepreneurial characteristics
- entrepreneurs’ prior experiences in capital structure
- business goals
- business life-cycle
- preferred ownership structures
- age and size of the firm
Stylized facts for financing SMEs growth activities

- There is a finance gap for SMEs as a result arising from market failure or credit rationing.
- Authors find that owner’s characteristics to be determinants of financing activity.
- Conventional wisdom suggests that informational opacity hinders SMEs’ access to external funds. SMEs are not necessarily informed about the available favorable financial conditions.
- SMEs entrepreneurs financial contentment and control by suggesting that most SMEs do not opt for rapid growth and that most SMEs owners prefer to retain control by not applying for external capital.
- Authors are unable to explain satisfactorily how SMEs entrepreneurs choose between different types of finance relying on internal sources of funds (owner’s starting capital, owner’s loans, and retained earnings) and external debt from financial institutions to finance their business operations and real options for growth. There exists a pecking order of SME finance.
- Access to credit is a fundamental aspect of access to financial resources, thus guarantees are key elements.
Characteristics of financing Scheme for growth oriented activities SMEs in Tunisia: Bank Financing

- Banks are the financial institutions most used by SMEs to obtain financing, hence debt is the primary financial recourse.
- SMEs feel that access to loans offered by banks is relatively difficult.
- SMEs have difficulties in accessing finance because they focus on debt and that the relationship of SMEs with banks remain fragile.
- Access to finance is not very visible for SMEs, not very well received by SMEs.
- To finance SMEs growth activities, the guarantee is the rule for any credit application. Credit guarantees required by banks are the main obstacle to access to bank credit.
- Local commercial banks may ask for a guarantee higher than the value of loan.
- SMEs consider access to bank credit, as well as its cost are the two main obstacles that hinder their growth.
Characteristics of financing Schema for growth oriented activities SMEs in Tunisia: Non Bank Financing

- Self-financing and informal financing especially profit reinvestment remains the main source of funding for Tunisian SMEs.
- Funding through investment companies to venture capital (SICAR) and other nonbank financial institutions play a minor role.
- The use of risk capital (venture capital) for financing of SME activities is not on the agenda of SMEs entrepreneurs.
- Leasing and renting are the means of financing most often used by SMEs to support their activities.
- Often analysts and stakeholders consider that administrative procedures are considered cumbersome and complex and are characterized by important delays.
Lending Technology

- A **lending technology** corresponds to combination of primary information source, screening and underwriting policies/procedures, loan contract structure, and monitoring strategies/mechanisms.

- Lending technologies are often categorized into two types:
  - **transactions lending** based primarily on “hard” quantitative data, viewed as being focused on informationally **transparent borrowers**, 
  - **relationship lending** based significantly on “soft” qualitative information, seen as used for **opaque borrowers**.

- There are a number of distinct transactions technologies used by financial institutions, including **financial statement lending**, **small business credit scoring**, **asset-based lending**, **factoring**, **fixed-asset lending** and **leasing**.
Characteristics of financing Schema for growth oriented activities SMEs in Tunisia: The fundamental issues

- How to change attitudes of SMEs entrepreneurs toward alternative financial orders and hence to influence their pecking order between various financial sources.
- To grow, SMEs ought to rely on equity, it is not clear how SMEs could move from a culture of debt to a culture of equity.
- Administrative procedures are characterized by delays, cumbersome and complex.
- How to improve visibility and overcome informational opacity.
- Corruption and asymmetric treatment.
- The question of adequacy and effectiveness of the lending technology with both of its components transactions lending and relationship lending to the financial needs and growth requirement of SMEs, and thus overcome loan guarantee obstacles.
- SMEs do rarely recourse to the financial market due to a sheer ignorance by SMEs entrepreneurs of financial market and the perception considering that this market is reserved for large enterprises.
SMEs Financing Institutions in Tunisia

- Financial institutions: largely controlled by the public sector with all bureaucratic effects, in addition no specialized financial institutions for SMEs.

- Guarantee funds: not working properly, poor management by public entities. Problems related to loan guarantee credit remain the major obstacles for SMEs to credit access.

- Investment venture capital (SICAR): A relatively new concept in Tunisia and available information on SICAR activities is not widespread in the private sector.

- Special funds for the promotion of SMEs: FOPRODI

- International Programs: contingent and in support for business partnership
National Guarantee Fund

A special guarantee fund created in 1981 to support SMEs to overcome the classic problem of credit guarantee:

1. Secure term loans for the creation and expansion of SMEs and more generally small scale businesses and export credit,
2. Take over the debts and unpaid interest from the rescheduling of loans (debt service rescheduling.
3. Ensure the participation of a SICAR to the equity of a company
4. Support a percentage of costs of prosecution and litigation recovery of loans.
5. Since 1999, management of NGF has been assigned to an insurance company, Tunis Re to increase its effectiveness.
Venture Capital (SICAR)

• Since 1990, several investment companies Venture Capital (SICAR), public and private, to promote private investment (especially in SMEs) through an equity participation of Tunisian Businesses.

• SICAR manage their own funds but also special funds, such as those made available by other special funds (e.g. FOPRODI)

• The SICAR sign an agreement with the project developer that defines the conditions for surrender (retrocession) of the company, on average, a SICAR is participating for 5 to 7 years in the equity of the firm.

• The interventions of a SICAR are generally more oriented towards industry and services and cover at least three areas:
  • Provide support before any program-related investments, upgrade or projects with high added value.
  • Provide managerial support by assisting the project sponsors to develop internal organization, their marketing strategy and policy.
  • Provide a support service to facilitate further research of industrial and commercial partnerships by some SICAR, such as the Society of Participation and Investment Promotion (SPPI) being part of international networks of venture capital companies (EUROSUD CAPITAL 1999; SPPI, 2000; SOUTH SICAR, 2000).
Special Funds: FOPRODI

- Created in 1973 with three main objectives:
  - Promotion of small and medium-sized new entrepreneurs by providing sufficient capital
  - Decentralization of industry
  - Reducing unemployment.

- Several drawbacks due to:
  - the dominant role of commercial banks in the management of public funds and minimal competition between them.
  - the distortion caused by certain incentives (no collateral is required, low investor participation in equity, highly subsidized interest rates) led to a decrease in bank interest;
  - a credit guarantee poorly designed and inefficient (to encourage the participation of banks in financing SMEs) and a weak bankruptcy law.

- The Fund was reformed in 1999 and new measures to overcome these drawbacks:
  - mandatory participation in the SICAR financial program which consists of their own resources and funds FOPRODI;
  - increasing the investment threshold of 1 to 3,000,000 DT (0.7 to 2,100,000 U.S. $) to access the FOPRODI;
  - modifying the intervention of National Guarantee Funds to provide additional incentive for banks to finance investment projects.
International Programs and Growth Oriented SMEs

- **Euro-Tunisie Entreprise (ETE-EU)** finance up to 70%, on cost sharing basis, of all assistance activities and training to SMEs such as in:
  - Implementing plans Diagnostic Plans for Upgrade Program;
  - Specific interventions in the field of control and quality certification;
  - Organizing events of business partnership;
  - Introducing innovative technologies.
  - Provide national experts from different fields (management, marketing, production, accounting and financial matters), recruited on a project basis.

- **Euro-Mediterranean cooperation** between SMEs, part of European policy, to
  - to promote the creation of joint ventures, especially among SMEs.
  - to support private sector development in Mediterranean countries
  - to stimulate partnership is considered an important instrument
  - to strengthen the competitiveness of Mediterranean SMEs,
  - to the transfer of capital, know-how and technology
Policy Recommendations

- To facilitate the growth and development of small enterprises, it is important to establish a comprehensive system of policies and financial instruments to support SMEs by providing the sources and types of financing most appropriate for each stage of their life cycle.
- There is a need for a reengineering of the lending technology to insure an efficient and balanced bank (regional and sectoral) financing of growth activities of SMEs.
- Credit guarantee instruments, need to be provided in a rather efficient way of easing SME’s access to financial resources.
- Need to ease administrative procedures and improve informational visibility.
- Growing firms need access to stock markets. Listing requirements should be reviewed to make sure that firms can accede to these listings. These criteria need to be proportionate to their dimensions as well as to the type of investor they are addressing.
- Since, SMEs have difficulties in accessing finance because they focus on the debt and that the relationship of SMEs with banks remain fragile. There is a need for better mutual understanding.