Financing Micro, Small and Medium-Sized Enterprises in the Mediterranean

Removing barriers and creating incentives

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What are the incentives that must be created to improve access to finance to micro, small and medium sized enterprises in the Mediterranean.

Today and following the unprecedented events that the region is experiencing, it is more than essential to put all initiatives together at a domestic level to bring back the necessary growth to the region for its survival.

If we look at the volume of international financing poured in the Mediterranean region in 2009, we can be pleased with the number, indeed, the region attracted 20 billion € (with the European investment bank on the top of the list, mostly

focussing on Turkey, Morocco, Croatia and Tunisia, followed by the world bank, which mainly focuses on Turkey and Egypt

However, the amount of financing per capita is not more than 66€ for the whole region, which is very little of what one can expect.

After the recent political events, the prospects of growth in the region are not as it was a few months ago; this means lower prospects for FDI, and higher political risk (that will push away conservative investors). Therefore these countries must put together all possible incentives to uphold domestic investment and financing.

Today, there is a wide recognition among policy makers and international donors, that MSME is at the centre of the future development of the Mediterranean region; MSME is the engine for growth, innovation and employment creation.

The Union for Mediterranean, led by the French, has put forward an initiative for business development in the region. This initiative is being put place, although uncertainties still surround its future.

This initiative must support domestic SME players (domestic agencies to promote SMEs, and also domestic financial players and loan guarantee schemes) to ensure that funds are channelled and monitored adequately.

Specific recommendations concerned **1- the role of loan guarantee system to support national banks** and **2- the role of Private equity**

1- the role of loan guarantee system to support national banks

- There is large evidence supporting the role of credit guarantee schemes (CGSs) in expanding the availability of debt to SMEs. However, the effectiveness of these schemes in the majority of Mediterranean countries where they operate falls short of expectations.
- CGSs should be seen as partners providing banks with the opportunity to increase their activities and profit when financing SMEs. Therefore the bank-CGS relationship must be built on risk-sharing rather than risk transfer to ensure that banks and schemes jointly screen and monitor borrowers effectively;

- CGSs must be well designed in order to maximise impact, be sustainable, cost efficient and minimise moral hazard;
- CGSs must be properly governed and monitored (subject to regular and independent audits and peer reviews) to ensure that political interference remains limited;
- CGSs must have the technical capacity to understand SME risk and be selective;
- CGSs must have the appropriate resources (work force and skills) to be credible and persuasive and thus offer an adequate credit mitigation instrument to banks;
- CGS procedures should be simple, not excessively time consuming and should serve the SME to understand and improve its business plan;
- CGS cost must be affordable to SMEs; and
- CGSs must be visible to the public; a budget should be allocated for raising public awareness.

Promoting a more important involvement of well designed loan guarantee schemes will help domestic banks to channel credit to SME in a more systematic way. Regulatory incentives can accompany such development for example through preferential regulatory treatment when using a well functioning scheme. But at the same time these schemes must be monitored by the supervisory authority in these countries.

The role of the EU – through for example the EIB can be essential that is by the creation of a counter-guarantee fund to increase leverage;

As for Private Equity:

Until today, **private equity institutions** target relatively medium to large enterprises in the region. The future development of small enterprises' targeted funds will continue facing obstacles such as difficult exits, illiquidity, valuation problems, currency and devaluation risks, lack of talent and management competence and lack of investment managers' knowledge about the region. **It therefore calls for innovative investment approaches and strategies, which are highly dependent on the involvement of international institutions and donors to reduce investors' risk in this segment while supported by adequate domestic or multilateral guarantee schemes for investment. Due diligence cost for small investments, usually dissuasive, should also be compensated for by appropriate support.** In particular, the following actions could be pursued:

a. Promote a commonly accepted regulatory framework for PE/VC in the Mediterranean region to provide

certainty and predictability to foreign and domestic investors;

b. Provide fiscal incentives (such as zero tax of capital gain and others) to attract private investors;

c. Promote the creation of multiple regional funds that are managed locally by small expert teams with national and cross-border focus in order to industrialise the investment strategies in the region;

d. Support the establishment of public-private PE/VC funds which would invest in MSMEs for a longer period;

e. Enhance the involvement of national and international investment guarantee schemes through innovative schemes and instruments to reduce investors' risk for very specific funds (e.g. seed funds); and

f. Subsidise training programmes of young investment managers to develop skills throughout the region.

Other actions should be examined in parallel, create a specific segment for listing SMEs on the stock exchange to allow orderly exit for PE;

Create incentives such as relaxed listing and disclosure requirements and lower listing and trading fees to encourage

SMEs[1] to list in the stock exchange and benefit from the opportunity to raise capital within a regulatory framework designed specifically to meet their needs;

[1] Taking into consideration what the domestic Companies Law and regulations allow for in accordance with company type registration. Furthermore, this may be further explored to cater for the fact that the majority of SMEs are family-owned businesses.