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## SMEs: Egypt's broken backbone?

Banks are keen to loan to SMEs; now however is not the right time due to the high unpredictability in the economics in Egypt, says Levari Law Founder

✍ Menna Samir (<http://www.dailynewsegypt.com/author/m-samir/>)

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“Entrepreneurs do not operate in a vacuum; they operate in an environment and what we’ve learned over the years is that enterprises can’t truly grow until the environment

around them is supportive,” Sam Parker, Director of Shell Foundation, told Daily News Egypt.

“Policy can really help small and medium enterprises (SMEs) flourish; they don’t necessarily need the direct government funding, as in some cases owners can invest through private capital if they operate in a conducive environment which allows easy access to licenses and facilitates operations for them,” he added.

Further, Omar Khedr, Investment Manager at GroFin, said: “The growth of SMEs in Egypt is hindered by a number of factors, and even though the government stated more than once that it will work on facilitating the process of doing business for them, what they say isn’t really inflected in reality.”

A report by the Studies and Research Department at the Union of Arab Banks (UAB) noted that Egypt is considered to be one of the largest Arab countries with SMEs working in it, in terms of their density and number. There are approximately 2.45m projects in the sector and they contribute to about 80% of the GDP of the country. SMEs account for more than 90% of the private sector and they accommodate around 65% to 75% of labour.

Meanwhile obstacles continue to face the sector, remaining statistically unchanged over the years. Moreover, the accumulation of problems and the inefficient actions taken towards solving them have continued to blight the sector.



### Banks and SMEs: The ongoing conflict

According to the UAB report, the size of annual financing

needed by SMEs operating in the formal sector amounts to approximately \$1bn, however studies show that funders do not meet 10% of those requirements.

Approximately only 5% of SMEs deal with banks, and the amount of funding dedicated to SMEs ranges from 3% to 4% out of the bank's total credit portfolio, the report added.

Banks historically have not been accustomed to financing SMEs; moreover, the required procedures for funding a small or medium project are identical to those for funding a large one. For example, a loan worth EGP 100,000 requires the same effort as the loan worth EGP 100m, so banks prefer to loan larger ones to gain more profits, said Walid Gamal-Eldin, Chairman of the SMEs committee at the Federation of Egyptian Industries (FEI).

Yehia Ashour, Senior Investment Manager at GroFin confirmed Gamal-Eldin's opinion, adding that banks and financial institutions find that entrepreneurship in Egypt is weak. "Entrepreneurs tend to be unstructured and they use their business as a tool for adding money to their pockets only. They don't have the ambition to grow with their business to the next level and that is another reason why it is hard to finance them," he said.

Sherif Hefni, Partner & Founder at Levvari law firm, is of a different conviction. as he believes that Egyptians by nature are opportunists. "Since 2011 and 2012, we've seen a rise in the amount of start-ups and entrepreneurs, the opportunities present today were never present before, all you need to do is just go to the Greek Campus, attend a RiseUp conference and their workshops, and you can see the hundreds and hundreds of start-ups and entrepreneurs that are there," he said.

"If entrepreneurship here was weak we wouldn't have Vodafone ventures, Flat6Labs, Injaz and a lot others, as they wouldn't have seen the opportunities if it wasn't embedded in the culture," he added.

Going back to the inflexibility of banks when it comes to loaning SMEs, Hefni indicated that this is not just the case in Egypt.” If you look at the UK and the US for instance, banks are not a 100% keen on loaning money to SMEs, especially start-ups. They won’t lend them money because they’re too much of a high risk,” he said.

“We have spoken to banks about loaning to SMEs, they’re keen, but now is not the right time for them, due to the high unpredictability in the economics in Egypt. Banks are currently happy to facilitate loans for large companies and major projects, because that is supported by the government at this point in time.”

“Meanwhile, it is also hard to find the perfect deal, as some entrepreneurs don’t reflect the real numbers achieved by their companies, fearing high taxes,” Ashour said.

There are other problems that include the lack of credit and financial and administrative awareness of those managing the enterprises, in addition to the absence of real feasibility studies that lenders can rely on, according to Khaled Nagaty, former vice president for the MENA region at the World Association for Small and Medium Enterprises (WASME).

“Entrepreneurs, on the other hand, find that banks impose very high interest rates on them and they end up not using their services at all,” Gamal-Eldin added.

### **The foundations are not there**

“There is no definition for SMEs in the country, they’re working haphazardly and it’s just a mess,” said Khedr.

“More importantly, Egypt doesn’t have a law for SMEs, so owners don’t even have the basic guidelines they need to follow for creating their business; setting regulations is vital and this should be the starting point,” Dina Wafik, Investment Manager at GroFin added.

What the government can create is a system for SMEs, where there are lower fees, the process is easier a bit more flexible and faster, and where there is less red-tape, Hefni said.

“If the Egyptian government wishes to promote a culture of entrepreneurship, then this is not a matter of money in the first instance. Rather, it is a matter of establishing a legal framework which is straightforward, transparent, and easy-to-understand,” said Steffen Roth, Assistant Professor of Entrepreneurship at ESC Rennes School of Business in France and Affiliate Professor at Yerevan State University in Armenia.

“This explicitly involves the idea of a state that protects SMEs against corruption of any kind. Anti-corruption does not stop defending (young) company founders and owners against the need to bribe somebody or pay protection money. Often, the legal framework of a country is designed to protect those who are already active in the market, rather than those who wish to enter the market, which, again, is a huge barrier, especially for young and innovative pioneers,” Roth elaborated.

### **Human capital development needed**

Ashour believes there is a lack of innovation and potential among Egyptian entrepreneurs, and as a result they need to learn the entrepreneurial skills. “This should be in our culture; being an entrepreneur is not a hit and run, it’s something sustainable that they should carry out until the end and let it grow by time,” he noted.

The government should assist SMEs in developing their products, help them export them to other countries and market them as well as help them join exhibitions to present their products, provide them with marketing consultations and lots of other services; Gamal-Eldin suggested.

### **The informal sector**

Another problem arises as a huge number of SMEs operate in the informal sector, the government doesn't have records of them operating in the country and the reason why they do this is to run away from paying taxes; some experts debated.

Meanwhile Hefni believes the real reason that a number of entrepreneurs don't register their businesses is because the information available for setting up a small or medium enterprise is quite convoluted, and that entrepreneurs do not understand the risks and liability they're putting themselves through by working informally.

"A lot of entrepreneurs understand that at least for the first two to three years, their companies won't make any money, so there won't be any taxes to pay, and I don't think that running away from taxes is their priority," he debated.

Addressing ways to get rid of the informal market, Gamal Eldin pointed out that "at the FEI, we will be working on ways to attract SMEs to register themselves and join the formal sector; about 10 years ago the government made a very good initiative where it announced that any SME that joins the formal sector won't pay taxes retroactively and will only start paying for the future, this is something that we could revive, and actually, the initiative succeeded in letting a lot of informal enterprises into the formal field".

### **Taxes debated**

Some experts have suggested that the government could impose low tax rates on SMEs or exempt them from taxes completely. Both Khedr and Ashour, however, were completely opposed to the idea, stating that the country is suffering from enough budget deficit and that SMEs should help the economy grow.

"We don't need incentives for SMEs. If you want the country to grow make it grow with SMEs and don't make it an obligation or a burden on the country," Wafik elaborated.

Tax incentives were however highly supported by Hefni, who believes that providing tax exemptions or reductions for SMEs in the first couple of years could really benefit them, adding that tax incentives should also be given to investors, as it will encourage them to fund those businesses.

Meanwhile, Gamal-Eldin believes taxation for SMEs should be dealt with differently. As an example, he said that if a workshop has two machinery equipments, a yearly tax allocation could be placed at a fixed rate on them, regardless of the profits maintained. This way, the owner can pay taxes in instalments, making it easier and less of a burden, instead of seizing his property and machinery, noting this is what leads some owners to work in the informal market without registering. “We’re making it very hard for them to the extent that they get out of the system,” he added.

### **SMEs suffer most from surrounding environment**

There are numerous restrictions and protection fees on importing, in addition to the high tariffs that need to be paid by importers, which apply to everyone. However, those who appear to be suffering the most are SMEs.

“I don’t think the government is helping SME. It is however harming them; it is supposed to be in the process of developing the sector. However, until now, the beneficiaries from the government’s reforms and decisions are the big companies, while the small ones are grinded in the middle and they don’t gain anything,” Khedr said.

Further there’s more than one entity responsible for SMEs in Egypt, but they end up adding no value to the sector, Wakil noted. “Each one of those entities works alone in its own valley, there’s no clear strategy across all; thus they add almost nothing.”

“Even entities like the Industrial Modernisation Center (IMC) and the Social Fund for Development (SFD), are looking at SMEs from a micro level, when they should look at them from a macro perspective, their presence is useless and

they're not making a real difference. It would be better if they made collaborative agreements to help the sector grow," Khedr highlighted.

"At this point in time, the government is looking to tackle the major issues in the country to put Egypt back on track. It is taking attention away from SMEs; however we can't really blame them," said Hefni.

He further elaborated that the government is actually concerned with SMEs and they will address their issues in time. "Steps in the right direction were also taken, as the government has been talking to different companies and entities that are concerned in the SMEs ecosystem. They're starting to listen to what SMEs need; a year ago I wouldn't have said that, but they're taking a step to the right direction," Hefni suggested.

### **Finance is not always the barrier**

"Young people are the hardest hit by unemployment in so many European and Arab countries. It is my firm belief that particularly these young people need neither jobs in state-subsidised large companies, nor money for a company and to earn their living. Today, there are so many business models that work without start-up funding, and there are scholars at the top business schools and university departments who are happy to share the intellectual tools needed to make these business models work. For free! All a government needs to do is to a) allow for interaction between those international scholars and the bright and inspired youth of their own countries, and then b) allow for these young pioneers to enter and redesign their own home markets. If governments fail to provide their youth with this opportunity, they will keep on losing the best-trained and most promising of their young people to an American dream, whose nightmare character we are currently busy finding out," Roth added.

### **The German experience in brief**

Germany has been always known for its successful experience when it comes to SMEs. “They’re the backbone of the German economy,” the former German ambassador to Egypt previously said.

Roth, who is a German national, spoke further about the German experience in SMEs, stating that 99.3% of the German enterprises in 2012 were SMEs. They employ approximately 60% of all German employees.

The main hurdle faced by German SMEs is succession planning. “The challenge is indeed in finding suitable successors once a founder or owner reaches retirement age or wishes to retire for other reasons. Many founders and owners involuntarily remain active for (too) long,” Roth noted

Regarding the human development being provided in Germany, Roth noted that there are training centres and business incubators in all major and most small/medium sized cities in Germany.

The German chambers of commerce also stress the importance of regional, national, and international business networks, which is why they regularly organise business networking events, including (sometimes long-distance) travels for established and promising entrepreneurs.

As for loans, Roth indicated that normally, it is rather easy for a German citizen or possessors of a German residence title to get a business-related loan from a bank, “provided your business plan or business model makes a viable impression”.

However, unlike the situation in the US, German banks tend not to pardon bankruptcy. This is to say that once your business failed, banks will hardly give you a second chance, Roth said.

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