

Enhancement of the Business Environment in the Southern Mediterranean



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Improving Access to Finance for MSMEs in Egypt

“Alternative financial structures”

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Alternative financial structures



Alternative finance refers to financial channels and instruments that have emerged outside of the traditional finance system such as banks and capital markets.

Alternative finance has grown considerably after the financial crisis and particularly for MSMEs and is now regulated by the “Financial Supervisory Authority” of each country.

We should not rely, only, on banks; other models have demonstrated their ability to finance MSMEs.

Therefore Egypt should increase the number of non-banking financial instruments.



1 - Love Money or Seed Capital



- At the stage of creation, a company is financed primarily by the love money, i.e. money collected from the founder's personal assets, family and friends of the founder, to cover initial operating expenses.
- Often friends or members of the family decide to contribute to the first steps of the company for starting a new business.
- The contribution of love money at the start of a project shows to other investors that the founder has already convinced his relatives/his friends and is therefore credible and thus attracting business angels, venture capital firms, etc
- **This kind of funding would apply to start-ups and very small companies.**



2 - Loans of Honor



A support network, called incubator, helps the Promoter to structure his file, to clarify some aspects of his business plan, to take a step back and to ask the right questions.

Egypt has five incubators:

- Nahdet El Mahrousa
- Flat6Labs
- Venture Lab
- Tahrir
- Shekra

Those incubators allow to precise, test and launch the business of the Promoter, benefiting from advices, workshops, premises or equipment.

Very often there are also financial assistance through “loans of honor”.

Those short term loans, with no-interest, help the Promoter on his first steps to launch his project; it gives him a little push.

- **This kind of funding would apply to start-ups.**



3 – Peer to Peer Lending or Person to Person lending



- P2P is an online system that allows individual members to complete financial transactions with one another by using an auction style that lets members offer loans for a specific amount, a specific duration and at a specific rate.
- It matches lenders directly with borrowers.
- Members use a portal provider on line.
- Rates and terms are much more favourable than in the conventional banking system.
- The first company offering P2P was founded in UK in 2005.
- **This kind of funding would apply to start-ups**



4 - Business Angels



- Egypt has approximately one hundred angel investors, all of which are working closely with five incubators.
- A business angel is a physical person who brings money, expertise and network.
- It is most often former entrepreneurs who decide to invest a portion of their financial assets in start-ups.
- These investors have a real experience of the entrepreneurial life that leads them to share their networks and give useful advice to entrepreneurs.
- In principle, business angels are involved most of the time before traditional venture capital, to a phase where the young company is still at the embryonic stage, allowing it to survive when the entrepreneur is often isolated; but sometimes they work together with traditional venture capital.
- **This kind of funding would apply to start-ups and very small companies.**



5 - Venture Capital/Capital Risk/Private Equity



At present there are 8 active MSMEs private equity funds amounting to € 1.1 Billion (EGP 9.5 Billions), out of which only one is public.

In addition, there are three venture capital companies operating in the Egyptian market (Idevelopers, Sawari and Vodafone venture).

Furthermore there is a program called “Access to Finance and Financial Services Department (Industrial Modernization Center-IMC) which main purpose is to facilitate access to finance by encouraging the establishment of private equity instrument through participating in the capital of two funds

Venture capital is a type of private equity, a form of financing that is provided by firms or funds to small early-stage, emerging firms that are deemed to have high growth potential, or which have demonstrated high growth; and thus generating a return through an eventual “exit” event, such as the company selling shares to the public or doing a merger and acquisition of the company.

Venture capital funds induce a disciplined approach on MSMEs; Venture capital funds are helping MSMEs entrepreneurs to lay out business plans and adhere to corporate governance practices.

- **This kind of funding would apply to any kind of company.**



6 - Microfinance



The Social Fund for Development (SFD) Central Microfinance Sector provides funds through intermediary agencies such as banks, venture capital funds and Non-Governmental Organizations, which offer credit facilities to start-up and/or existing micro enterprises in all sectors.

Start-ups represent 40% of SFD's portfolio.

Other private micro-finance institutions include Bedaya, Rifi, Tanmeya, Tasahil and 440 NGO's.

Micro credit allow access to credit to individuals and small businesses in financing small projects and micro-credit programs, unavailable to them in the formal banking sector, giving them the chance to increase their income and save themselves from the poverty circle.

Microfinance is a way to promote economic development, employment and growth.

Microfinance satisfies several types of needs:

- Lifecycle needs: weddings, funerals, childbirth, education, home building, etc
- Personal emergencies: sickness, injury, unemployment, etc
- Disasters: fires, floods, cyclones, wars, etc
- Investment opportunities: creating a business, expanding a business, buying equipment or land, etc

One of the principal challenges of microfinance is to provide small loans at an affordable cost; the global average interest and fee rate is estimated at 37%, but tend to fall over time, but is still well above 30%; this allows the lender to cover offices and staff salaries; internet might be the solution rather than physical offices.

According to statistics of the Micro Banking Bulletin, in 2010 we counted approximately 1 100 microfinance institutions that were serving approximately 75 million borrowers with approximately \$ 40 billion outstanding loans.

- **This kind of funding would apply to start-ups, very small and small companies.**



7 - Crowd-Funding



- Crowd-funding is a mechanism that allows raising funds through a large public; it works via the internet network to fund projects online.
- The crowd-funding websites set up the platform where they describe their project, says how much money they need and the deadline for gathering that money.
- There are essentially three ways of attracting contributions for the project:
 - Loans (crowd-lending); usually at a low interest rate; it is paid back once the project is successful
 - Subscription of shares (crowd-equity); the funder provides money in return for part of the revenue of the project
 - Grants (crowd-donation); straight donations where the people who donate to the project expect nothing in return
- **This kind of funding would apply to all MSMEs.**



8 - Inter-Companies Loans



- A company may ask its supplier for a delay in payment for the purchase of goods.
- The company providing payment facilities, plays a role of lender to its client, by providing an implicit short-term credit.
- Inter-company credit appears as an alternative to bank credit.
- The main tools available to manage the receivables are currently credit insurance, factoring or forfeiting, in case the company wants to sell its receivables.
- **This kind of funding apply to small and medium companies.**



9 - Innovation Capital



- Big companies have decided to allocate capital and resources to start-ups which are innovating and creating new products .
- By providing capital to an innovative start-up, big companies have many competitive advantages, such as:
 - - To cooperate with innovative companies conducted by talents who never would have joined their organization
 - - To join emerging technology projects
 - - To improve the efficiency of their internal research department, by opening their research centers to innovative start-ups
 - - To understand the challenges of innovation, identify strategic risk from breaking innovations, and benchmark the performance of their own business.
- The challenge of a start-up is to develop a product for the market, and find its first clients.
 - The challenge for industry is to be the first to sell new products
- **This kind of funding would apply mainly to start-ups.**



10 - Large groups' sponsorship



- To encourage/to impose major groups, national or international, through specific incentives, to subcontract all or part of their markets with local Egyptian MSMEs
- To encourage major Egyptian groups to sponsor one or two MSMEs close or complementary to their business activity
- **This kind of sponsorship would apply mainly to medium companies.**



11 - Leasing



- There is one public leasing company working on the MSMEs segment with a total leasing portfolio amounting to € 17 Billion (EGP 145.5 Billions) for corporate and MSMEs.
- Other leasing companies exist such as:
 - *Upper Egypt Leasing Company established in 2008
 - *Orix Leasing Egypt established in 1997
 - *Plus Leasing established in 2013
- A leasing company buys on behalf of a customer a good (equipment or real estate) and then rent it to its client for a predetermined period.
- At the end of this period, the customer can either buy this asset for its residual value (option to purchase according to a previously set value listed in the contract), or renew the rental contract or ask for the recovery of the property by the leasing company.
- This system allows financing investments without giving any guarantees since the lender is already owner of the leased property.
- Leasing is based on the idea the material must be repaid by the income it provides and thereby preserve the company's cash.
- We should not compare the cost of leasing to traditional loans for the following reasons:
 - -exempt of any immediate payment or small advance payment made and thus avoid capital immobilization
 - -relief of the tax burden
 - -flexible rents allowing the investment to be financed through the use of the equipment
 - -it does not increase the indebtedness of the company
- This activity can be integrated in a bank as one of its products or can be developed in a stand-alone leasing company.
- **This kind of funding would apply to all kind of companies.**



12 - Factoring



- A supplier of goods sells its receivables (invoices) to a factoring company, which will pay it immediately by anticipation, by taking in charge the recovery.
- The activity of the factor is to buy receivables. The legal basis of this operation consists of an assignment of invoices, the factor renouncing all recourse against its customer which sold its invoice.
- The factors' clients undertake to mention on all invoices issued a clause notifying their debtors that their payment should be validly released only to the hands of the factor.
- This activity can take place within banking techniques.
- **This kind of funding would apply to small and medium companies.**



13 - Forfeiting



- The forfeiting is a credit operation by which a bank or a forfeiting company makes available to a company, against delivery of a receivable it has (bills of exchange or promissory notes), the amount of the receivable, decreased by the interest and commissions.
- It is used mainly by exporters; it enables them to receive cash immediately by selling their receivables, usually guaranteed by the importer's bank.
- The receivables are usually in the form of unconditional bills of exchange or promissory notes that are legally enforceable and freely traded on the secondary market.
- The Bank or the forfeiting company, which has discounted the draft, becomes the owner.
- This activity can be integrated in a bank as one of its products or can be lodged in a forfeiting company.
- **This kind of funding would apply to small and medium companies.**



14 - Mezzanine Financing



- Mezzanine lending has been around for more than two decades; today, investors include pension funds, hedge funds, leveraged public funds and insurance companies, as well as some banks that have established stand-alone mezzanine efforts.
- It is that part of financing between a company's senior debt and equity, filling the gap between the two.
- Structurally, it is subordinate in priority of payment to senior debt, but senior in rank to common stock or equity.
- Mezzanine financing is a hybrid of debt and equity financing that gives the lender the rights to convert to an ownership or equity interest in the company in case of default, after other senior lenders are paid.
- Mezzanine debt is used by companies that are cash flow positive to fund further growth through expansion projects, acquisitions, recapitalizations and management buyouts; they must demonstrate a track record in the industry with an established reputation and product, a history of profitability and a viable expansion plan for the business.
- It is a high-risk, potentially high-return debt form.
- **This kind of financing would apply to medium size companies.**



15 - Insurance Credit



- Credit Guarantee Company (CGC) of Egypt was established in December 1989 to assist in developing MSMEs through the application of different guarantee mechanisms to encourage financial institutions to lend to MSMEs.
- Governments have encouraged the creation of insurance credit companies in order to guarantee banks on credit operations; the percentage of cover varies and can go up to 90%.
- The guarantee benefits, only, to the banks.
- The Bank thus still retains a share of the risk in the credit, but may still ask for a guarantee.
- Guarantees programs are reducing reliance of commercial banks on physical collateral for MSMEs financing; it encourages banks to finance MSMEs with insufficient collateral .
- **This kind of funding would apply to all kind of companies**



16 - Stock Exchange



- Nile Stock Exchange (NILEX) is the first stock exchange market for growing MSMEs in the Middle-East; it was launched in 2010 by the Egyptian Exchange (EGX).
- The stock exchange has several advantages among which:
 - Collect fresh money
 - Diversification of funding sources (stocks, bonds, etc...)
 - Profit-sharing for employees
 - Increase reputation among customers, suppliers, bankers, etc
 - Ease the transfer of companies
 - Enhance greatly venture capital funds' exit strategy
- But the stock exchange cost, for an introduction, is expensive (for example in Europe, the cost is approximately 7.5% on average funds raised).
- **This kind of funding would apply to medium size companies.**



17 - Islamic Finance



There are 4 Islamic institutions in Egypt:

- * Al Baraka Bank
- * Faisal Islamic Bank
- * Abu Dhabi Islamic Bank
- * Social Fund for Development

The Islamic finance industry has expanded rapidly over the past decade, growing at 10 to 12% annually.

Today, Sharia-compliant financial assets are estimated at roughly \$ 2 trillion, covering bank and non-bank institutions, capital markets and insurance.

As the 2008 global financial crisis ravaged financial systems around the world, Islamic financial institutions were relatively untouched, protected by their fundamental operating principles of risk-sharing and the avoidance of leverage and speculative financial products.

The following key principles guide Islamic finance:

- Prohibition of interest on transactions(riba)
- Financing must be linked to real assets
- Engagement in immoral or ethically problematic businesses not allowed(arms, alcohol, pork, gambling, etc)
- Returns must be linked to risks

Basic and main instruments used include:

- Murabaha (trade with markup or cost plus sale)
- Mudaraba (trustee financing contract or profit and loss sharing contracts)
- Musharaka (equity participation contract or partnership and joint stock ownership)
- Ijara (operational or financial leasing contracts)
- Sukuk (certificates of ownership)

Murabaha agreement is one of the most Islamic instruments used in Egypt.

- **This kind of funding would apply to all kind of companies**



18 - Public Funds and Regional Funds



- The question of the intervention of public authorities in the financing of businesses has always been debated.
- Considering that businesses are the place where national wealth is created, it appears legitimate that companies and mainly MSMEs should be the first concerned by those public funds.
- **This kind of funding would apply to all companies.**



Thank you for your attention

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