



CENTRAL BANK OF EGYPT  
Egyptian Banking Institute



## Introduction of Advisory Services to SME Banking Proposed Banks' Action



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December 29, 2011

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## **Acknowledgements**

*This mission has been carried out in the framework of the partnership agreement signed between EBI and the CIDA financed BDSSP project extended to Egypt. This project was intended to support the development of advisory support services for the private sector in Egypt.*

*The expert would like to thanks all the interviewed persons, from EBI, from the banks and Egyptian professionals familiar with the issues, for their kind cooperation and their proposals, which have been critical to the formulation of this note.*

*The expert takes full responsibility for the contents of this independent note. Although this note has been prepared in good faith and with the due professional care, this is a very rapid overview based on the experience of the author, desk work and a very limited field work in Egypt.*

## 1. Introduction

Supporting SMEs development in Egypt means, in practice, supporting a significant part of the whole economy. More than 95% of the enterprises are said to be Micro, Small and Medium Enterprises and SMEs are said to contribute to 75% of employment and 80% to GDP<sup>1</sup>. Whatever their definition (different within banks and between banks and SME law<sup>2</sup>), SME banking is now well established in Egypt. EBI has significantly contributed to the development of this activity in Egypt. The importance of SME Banking has been growing from one year to the other. About 16 out of 25 banks in Egypt are now involved in SME Banking. The facilitation / integration of advisory services offered to the SME Banking client will be instrumental to the healthy growth of the SME. But the introduction of advisory support to SMEs by banks must take into account the characteristics of this sector, its problems, and the already existing support programmes. It should also consider the issues associated with (i) governance and conflict of interest as well as (ii) informal activities.

In spite of perceived increased risks<sup>3</sup> and in spite of how the SMEs are perceived today, the banks are going to address more and more the SME market as the corporate segment may become too crowded and too competitive, with falling margins. In addition to the individual interest of the banks, a SME strategy will contribute to the social mission of the banks, providing opportunities for new young entrepreneurs and contributing to the creation of employment.

But the approach to SMEs is complex given the sheer number of enterprises in need of support, and the relatively low level of entrepreneurial and financial skills of enterprises. Moreover, the sector mix of SMEs covers all sorts of activities, from trade to high tech, passing by agro industries and services. The Egyptian economy is diversified. To the official number of SMEs, one must add the entire informal

<sup>1</sup> / source Mohamed Omran SMEs Stock Exchange in Egypt

<sup>2</sup> / SME law (law No 141/2004) defines segments by paid-up capital and employment

	Paid-up capital (Million EGP)	Employment
Medium	1 to 5	51 to 99
Small	0.05 to 1	< 50
Very small	< 0.05	

<sup>3</sup> / Further analysis on risk associated with SMEs might be necessary. Individual risk with SMEs might be higher than with corporates, but global portfolio risk of a SME portfolio is spread out.

sector, which is not negligible and not limited to very small/micro enterprises. While they cannot be classified as medium, there is may be as many small informal enterprises (5 to 50 employees) as there are of formal, or may be more. This will be a new source of clientele for banks in the future.

Given the number of days allocated to this task, this note is based on a very limited research and cannot be considered as exhaustive. However, it gives broad indications of initial actions to be undertaken by banks, to be completed as soon as better understanding of the needs is disseminated and initial impact of the first actions is positively evaluated.

## 2. Objectives

A number of Egyptian banks might be interested in providing or facilitating the delivery of advisory support to their SME clients. The objective of this note is to clarify the initial steps to be taken in order to introduce the concept in the bank and to implement it.

For each bank, the final objectives should be to

- increase the number of SME clients
- decrease the risk associated with young SMEs
- assist its SME clients to grow, in Egypt and abroad.

## 3. Major constraints to develop advisory support services

### 3.1 *Understanding the needs of the clients*

SME banking activity is relatively recent and the needs of the SME clients are not always well known (each loan officer has to process and follow-up a large number of SMEs and he/ she does not know necessarily very well the clients). Banks should review their activity and first segment it in:

- Loan request rejected
- Start-up
- Young companies (less than two years old)

- Mature companies, broken down in two sizes small and medium.

An in-depth analysis of each segment would be necessary to understand better the clients (and their gaps and needs) and evaluate if the provision of advisory services would have modified positively the prospect of the enterprise and decreased the bank risk. This should be done on a meaningful sample, depending of the size of the SME portfolio of the bank

Segment	Analysis
Loan rejected	Examine the main causes of the rejection (with the exception of creditworthiness) and evaluate what kind of advisory support would have changed the outcome of the process <ul style="list-style-type: none"> <li>- New companies</li> <li>- Companies with expansion projects</li> </ul>
Start-up	Review more carefully the business plan of the companies in order to evaluate improvements that would be necessary to facilitate growth and avoid failure
Young companies	Make a diagnosis to assess if the company evolution is in line with the original business plan, and check the cash flow evolution If not, evaluate the necessary remedies to improve the chances of survival
Mature companies	Check their needs for growth, in particular their needs for partnership (new products, new markets, know how, etc) financial restructuring (debt, but also equity, cash/ receivables, etc) and check the governance situation, often a problem when the family company grows

### **3.2 How to reach and grow so many enterprises**

Banks need to understand the volume of work requested and the nature of advisory work that might be needed as well as the training needs for their loan officers or the profile of their advisers. Not all advisory services should be provided by the banks, but a bank needs to know which services would be better carried in-house so as to later strengthen its links with the company, and also improve the understanding of the company's business, enabling a loan officer to better evaluate the risks.

At the end of its internal evaluation, in order to identify the needs both in terms of number and in terms of substance and to decide those services to be provided in house, and those for which a referral will be offered, it is critical to segregate and segment the needs. Probably, the outcome of the analysis will be split into

- The basic issues and repeat needs which could be solved by a series of semi-standard tools and advice; and
- The more complex needs which would require a more complete diagnosis and skilled and specialised counsellors.

### **3.3 Skills of the staff**

The SME bankers have not yet been used to provide advisory support services for enterprises, and have not been recruited for this new task. The documentation they use to appraise loan requests is mostly formal and does not seem to include an analysis of the growth potential of the company. Moreover, the SME bankers are not always at ease with the small entrepreneurs; they come from different background and speak a different language, difficult to understand for enterprises. Requesting them to provide advices to their clients would certainly require more training. Moreover, some new profiles may need to be recruited

### **3.4 Cost of support services and pricing of services**

Providing advisory services has certainly a cost, whether the services are provided by the loan officer or by an independent adviser. Even the supply of referrals means that the banker has identified what the problem is, and has spent some time to make

a diagnosis. This cost can be included in the standard bank prices (interest rates, various fees) for the basic services, especially for new clients or charged separately for current clients if they are not linked with the provision of financial services. A proper evaluation of cost/ benefit will be needed, direct benefits for the bank (decrease of risk, increased volume of the portfolio, etc..) and social benefits for Egypt (as part of the social mandate of the bank).

### **3.5 Governance and risk of conflict of interest**

While at this stage, the risk is minimal in Egypt, this aspect should not be overlooked. In Europe and in the US, most banks are very careful with the nature of advice they provide and possible legal responsibility of providing advice. Once a decision to provide advisory services by a bank is taken, the organisation of the delivery of such services should take into account this governance aspect.

## **4. What are the most urgent needs for support**

Given the current limited advisory services offered by banks and the nature and apparent attitude of Egyptian SMEs owners, it would be premature to offer a full range of services as exists in a number of other countries. The introduction of advisory services might be gradual so that banks can measure more fully the cost/ benefit and adapt their procedures so that advisory services become part of the standard procedures and offering.

The **new entrepreneurs** badly need advisory support to prepare their project and operate their enterprise, and this should certainly be a priority given the high level of reject of loan requests in this segment. More **mature SMEs** are also in need of advisory services to expand and grow, creating value and employment.

Bank advisory services should not replace public advisory services (such as SFD, GAFI, IMC, BDS) or advices provided by specialized consultants, but complement

them and should be fully coordinated with the various advisory centres where they can send their clients for specific support.

From our very limited assessment, we would segment the advisory services needs into two main segments

Potential needs for advisory services to be provided by banks in Egypt	
Setting-up an enterprise Enterprise less than 2 years old	Enterprise more than 2 year old
Business Plan (but not feasibility study) Cash flow planning and management; Payments and receivable management Finance planning	Efficiency improvement (technical & financial); referral for technical or specific issues Structure optimization (size of capital vis vis debt, external partner)
Restructuring in case of financial difficulties	Restructuring in case of financial difficulties or market condition changes Partner identification (for know-how and/ or export) Merger and acquisition
Legal and tax advice	Legal and tax advice
	Improvement of governance

### 5. Who is doing what in terms of advisory services?

While the idea of advisory services is new for banks in Egypt, it is not new to a number of professionals and institutions. Some advisory services are already provided in Egypt, but the scope and focus are limited if compared to size and variety of the needs. As mentioned above, if the banks should internalize the concept of advisory services, they should not provide themselves all services and need to cooperate with other stakeholders active to support enterprises, and/ or send their clients to reliable consultants.

As of today, the main public/ private institutions active in supporting SMEs (with various definitions) are



IMC; GAFI; BDS

SFD for start-ups

NGOs

Donors' programmes (USAID, EU, KfW, AfD among others)

Many specialized private consultants and accountants

EBI intends to set-up a support advisory services activity, and would be able to assist banks with existing services, donors' programmes and other external activities that might be interesting for SMEs clients of banks.

## 6. Possible support from EBI

While the strategies of various Egyptian banks may differ, some common core approaches may be developed jointly through EBI. Training may be organized by EBI and global awareness campaign, both for banks and clients (separate campaigns) would need to be developed by EBI.

## 7. Possible activities to be developed by banks in the field of support services for SMEs

### ***7.1 Understanding of the clients' needs; developing toolkits to provide basic support and organization of the advisory services delivery***

Based on the analysis of needs (see above 3.1), the banks will be able to define their approach to delivery of advisory services (products, toolkits, procedure) as well as decide which services will be in-house services, and which services will be only provided as referrals. They may also review their appraisal procedures in order to introduce a better evaluation of the growth potential and in some cases conditionality for loan renewal associated with advisory services.

## **7.2 Training of staff**

As mentioned above, banks cannot assist all their clients with a full range of advisory services and in a number of cases will refer them to other public institutions or to specialized consultants. To do so, they need to have both (i) staff capable to diagnose the problems, and (ii) a roster with the references of pre-selected consultants. This roster could be provided by external institutions such as EBI and completed with feedback from the bank staff.

Short training courses may be developed (for example with EBI) and proposed to loan officers to up-grade their skills and develop their know-how in term of approach to delivering advisory services.

## **7.3 Development of awareness campaign for enterprises**

Banks may contribute to awareness campaigns for SME clients in the various governorates. The main focus of these workshops or seminars would be

- What is a good project that can be financed by a bank?
- How to prepare a project; in addition to the technical aspects, what are the most important questions an entrepreneur needs to address
- What kind of documentation a bank requires, and why
- How the bank can help the entrepreneur with advisory services

## **7.4 Developing alternative or complementary ways to approach advisory services for companies: “peers support”**

In certain zones with clusters of enterprises (for example tourism or industry), Banks may have a significant number of large clients or medium high enterprises. The local branch may investigate if these enterprises would be a volunteer to provide coaching for the new entrepreneurs. They could help them with networking, with the choice of a supplier, with the choice of advisers and consultants, and with basic advices (for example “we have had similar problems in the past, and we have done this ...”) which are critical in the first years of growth. The role of the bank branch of the zone

would be to identify “godfathers” willing to help young entrepreneurs and to propose such a support to the young entrepreneurs of their portfolio.

## 8. Recommendations and mechanisms of activation:

The final objectives of this proposed work should be

- SMEs can get better access to finance if they are provided with external support. The banks can provide some of this support.
- SME advisory services from banks are feasible and can be implemented through a model combining better diagnosis, provision of specific tools and advice/ support provided either directly by the banks or both by banks and specialized institutions and private advisers.

Based on the above analysis, and to achieve the objectives, it is recommend the following course of action built on a pilot phase followed by a full scale implementation. EBI would have an important role: launching the initiative, facilitating the work on the pilot phase, acting as a resource centre (to identify an initial core group of advisers) and preparing a structured and inclusive approach based on the results of the pilot phase.

### 8.1 Creation of a pilot

The objective of this phase is to develop a model, not created by outside consultants, but owned by more advanced bankers and based on their daily practice and experience. It should lead in a second phase to the creation of a more structured and inclusive approach, which can be implemented by all bankers. The main steps of this phase are:

- (i) **Identify one or various banks willing and able to design, test and implement those services; and get the support of the Central Bank of Egypt in order to secure confidence among banks’ management.**

**(ii) With those banks, set up one or various “focus groups”,** among the lines of the marketing practices, to develop tools that will be used by the bank advisers. This group should include bank staff, teaching or advisory staff in constant contact with the SMEs (for example Social Fund staff teaching basic management practice to new entrepreneurs), specialized consultants with track record and SME owners. Such a group would represent all concerned parties (Banks and SMEs) and practitioners used to communicating management messages. The main tasks of this group will be to (i) identify more specifically the issues preventing the banks to lend more to SMEs, and that can be addressed by banks support; (ii) propose advisory processes that can be implemented by the banks at a reasonable cost; and (iii) develop improved tools to be used by the banks’ officers (scoring boards better adapted to SMEs, relying less on financial documentation and more on past and potential performances of the owner, on the reputation of the owner among his peers) and in-house advisers . The team should also include (or have access to) legal and compliance specialist, to advise on limits to the future interventions (mainly responsibility of the bank as an advisor, confidentiality of data, risk of conflict of interest between adviser and loan officer). As the scheme is intended to start slowly and target small loans, its impact on the banks’ prudential ratios will probably be minimal, but will need to be checked in order to secure confidence among bank management.

Another aspect to be covered by the focus group will be incentives for staff dealing with SMEs and HR management. This will be critical to facilitate the implementation, and motivate the staff, at the pilot stage, but more important in the implementation stage.

Based on their experience and previous identification of problems, the focus group should decide whether they will implement and test the pilot in one or two geographical areas with different characteristics, or in different sectors, again with different characteristics.

**(iii) Develop a group of advisers (internal or external) to start advising SMEs.**

This new type of intervention must be widely publicised – but in a limited number of pilot geographical zones. Those advisers would work alone or in teams. Using active or former successful SME owners in the team is advised, as the SME will more likely listen to one of theirs, with similar experience. Those advisers should become able to judge of the potential of a SME manager by the way she/he acts (knowledge of the trade, reliability, ability to meet objectives) rather than rely on financial documentation; and advise them of improvement or remedial actions as necessary to secure the growth or future profit of the SMEs, that is its sustainability.

The advisers should meet frequently to exchange on issues they have detected, new problems and new ideas for tools to be developed.

**(iv) Start publicizing the advisory service within a limited number of pilot zones or sectors.**

In pilot zones, all the SMEs should be aware of the new service – but the awareness should not exceed the pilot areas, in order to test the system before launching it on a full scale. Alternatively, instead of geographical zones, a given sector (e.g. bakeries, mechanics, and restaurants) could be used as a pilot scheme. This would be a little more difficult (spreading the interventions over a larger zone) but would have the significant advantage of being able to employ sector specialists, who could be trusted by the SMEs for their skills in a given field, and by the banks for their knowledge of the sector (they would screen out fancy business plans with targets impossible to achieve).

In order to be able to measure the improvements brought by the new approach and its impact, it will be critical to identify main criteria to be monitored and establish a baseline for the pilot covering the various criteria to be improved (for example number of enterprises receiving loans, number of loans, size of loans, maturity, number/value of non-performing loans, etc..)

## 8.2 Finalization of an approach and implementation

After a year of activity, the focus group, and external professionals review the results and draw lessons:

- a. What attracted SMEs to those services, what kept them away from them (e.g. availability of information, cost)
- b. Were the services considered useful by the SMEs (did they come back for more, did they advise their friends to use those services ?)
- c. Was there a result which could be attributed to those services? (increased number of loans, lower rate of failure, higher growth of sales of clients, increase in the number of clients of the banks)
- d. What has worked, and not worked? What should be changed or improved to secure success?
- e. What has been the cost of the pilot approach?

Based on the pilot experience and its cost/benefit, the approach may be presented to banks, and a proposed improved approach may be presented to all banks. In addition, sources for funding and support mechanism for SMS external advisory services proposed by banks will be proposed to enable all SMS to get access (e.g. partial subsidy adapted to the use of these services, provided either as a discount, or as service checks, or any other form as appropriate). It is then up to the individual banks to decide and start implementing an advisory scheme. The core advisory approach, that would need to be customized by each bank, may be disseminated through the preparation of a paper and various seminars.

EBI may also have an important role and provide banks, and their SME clients, in

- Assisting in the finalisation of the proposed approach
- Supporting banks willing to implement such a scheme
- Creating and up-dating a referral roaster
- Working with banks and other institutions to identify funding (e.g. IFIs, donors, individual banks) to facilitate the implementation of the scheme

- Work with other institutions (Central bank, ministries, SFD) to set-up an independent monitoring and regular evaluations
- Organize training and/or sensitisation seminar for SMEs

The forward way will be long and complex and the scheme cannot be implemented only by banks. But the potential impact of such a scheme is so important; not only for individual banks, but also for the future of Egypt where million jobs need to be created that banks should start. It is particularly worthwhile to start working on such a scheme, even imperfect as not doing anything would add to the disconnect between expectations of young and small businessmen and the apparent priorities of the elites.