



Bridging the SME finance gap in the GCC



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## Introduction

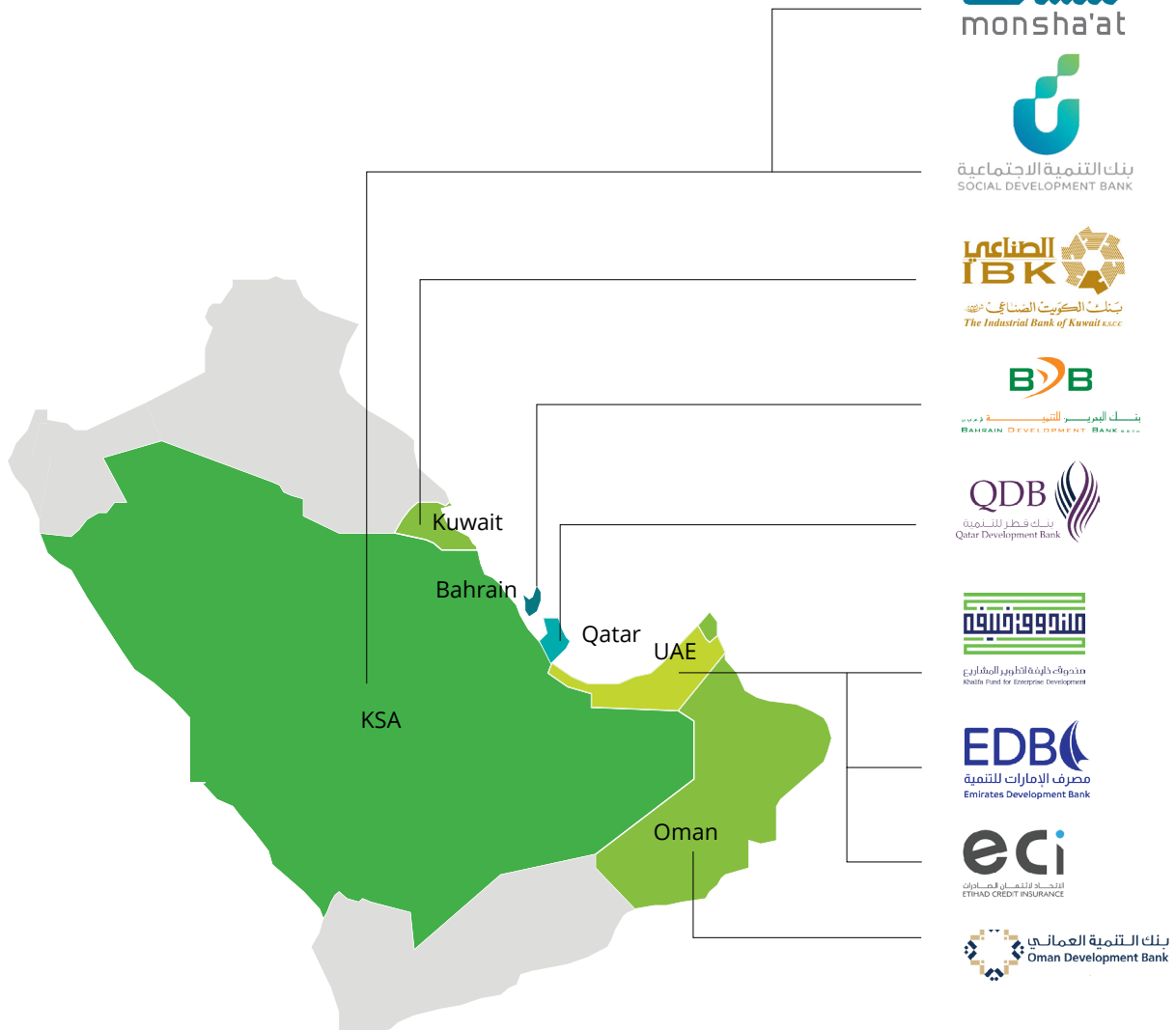
The contribution of SMEs to national economies and employment generation has been widely recognized in the GCC, making these businesses important drivers of the economy. However, due to several challenges like asymmetric information, lack of collateral, challenges in creditworthiness, amongst others, these enterprises have traditionally struggled to secure the finance needed to allow them to grow their businesses to full potential. There is a need now more than ever to support the sector by widening the offerings and financial instruments available to SMEs to cater to their unique financing needs.

## SME agendas by governments in the GCC moving in the right direction

With several government agendas in the GCC leaning towards economic diversification, support to this sector is gaining importance now more than ever before. SME development plans are now a part of national visions, several GCC countries have established plans to develop the SME sector and specialized agencies have been set-up for targeted support to the sector.

Development finance institutions such as development funds, banks, lending, and insurance institutions have been set up by several countries in the GCC to provide such support to SMEs

# SME development plans are now a part of national visions



Core activities of such institutions range from financing to providing support and capability development to promote the access to finance and sustainability of SMEs. Below is an overview of the types of products and services generally provided by these institutions:



**Equity products**

SME equity and seed funding, early-stage funding



**Debt products**

Commercial lending, social loans, long-term industrial loans, credit guarantee schemes



**Business related services**

Feasibility studies, accounting & legal services, marketing services, financial education, market research reports, SME rating & accreditation



**Development & training services**

Coaching & mentoring, entrepreneur capability building, investor community platform

# There have also been initiatives to develop supporting legislations and policies and establish enabling platforms

In addition to the above, GCC governments are working on initiatives that also provide SMEs with necessary infrastructure and training to allow them to grow organically and in turn contribute to the economy.

A recent example in the UAE is the announcement of the “Entrepreneurial Nation” initiative with an aim to becoming the host to at least 20 unicorns by 2031 and supporting start-ups valued at over US\$ 1 Bn through a series of partnerships with global companies and local development finance institutions. Achieving this milestone complements the National Entrepreneurship Agenda of the country that aims to include several programmes and accelerators to lay the foundation and infrastructure for SMEs. There have also been initiatives to develop supporting legislations and policies and establish enabling platforms. These include the “Skill-Up Academy” aimed at attracting young talent and the “Scale-Up” programme aimed at empowering unicorns.

In Abu Dhabi, the Department of Economic Development (ADDED) is responsible for delivering Abu Dhabi’s economic strategy and acting as the emirate’s economic policymaker and regulator. The Department engages with the public and private sectors and has been active in implementing many projects and initiatives including:

- The AED5 billion Abu Dhabi IPO Fund which will soon commence operations under ADDED with an aim to enhance financial inclusion for companies, enable SMEs and other private enterprises to accelerate their growth and support businesses towards potential listings on the ADX where they can further raise capital.
- The Investor Journey, an initiative that eases the process of setting up and renewing businesses, reducing regulatory and cost burden including a one-stop-shop portal; and most recently
- Supporting ADX to help develop the proposal for the regulatory framework guiding Special Purpose

Acquisition Companies (SPACs) which is now approved by the Securities and Commodities Authority.

Saudi Arabia aims to increase the GDP contribution of SMEs to 35% as part of the 2030 Vision. A general authority for SMEs has been established under “Monsha’at” to support and develop the sector by implementing projects, sourcing financial support, and setting the required policies. The Saudi Venture Capital Company (SVC) has been established by Monsha’at to invest US\$ 750 Mn and minimize financing gaps for SMEs. Additionally, the Small and Medium Enterprises Authority in the Kingdom (SMEA) has set several initiatives to support SMEs ranging from tax incentives to diversifying the sources of income. This includes initiatives like increasing the capital of the public guarantee scheme, indirectly funding SAR 1.6 Bn through investment institutions, and setting up a venture capital fund of SAR 2.8 Bn targeting start-ups.

However, due to several challenges like asymmetric information, lack of collateral, challenges in creditworthiness, amongst others, these enterprises have traditionally struggled to secure the finance needed to allow them to grow their businesses to full potential. Despite these targeted efforts being driven to the sector, a lot remains to be done to foster the access to finance for SMEs, which remains a key obstacle for these businesses.

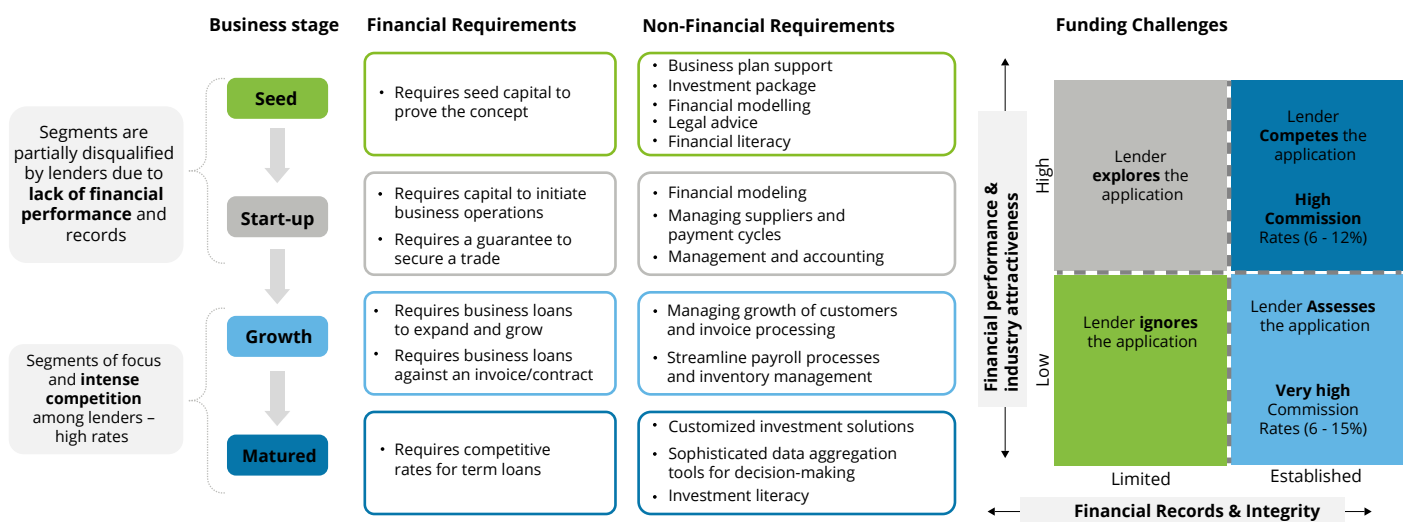
## Thinking beyond the “one size fits all” approach

While it is important to launch initiatives to drive funding to the SME sector, it is equally crucial to understand their unique requirements as SMEs seek different types of funding options across different stages of their business life cycle. SME funding

cannot take the shape of a “one size fits all” approach. Seed and early-stage equity finance is garnered towards start-up and innovative companies. On the other hand, growth SMEs seek venture capital funds or take the listing route. Furthermore,

financing entities must recognize that a broad range of non-financial needs must be coupled with SME funding at each stage to promote their growth and sustainability.

### SME funding requirements and typical challenges



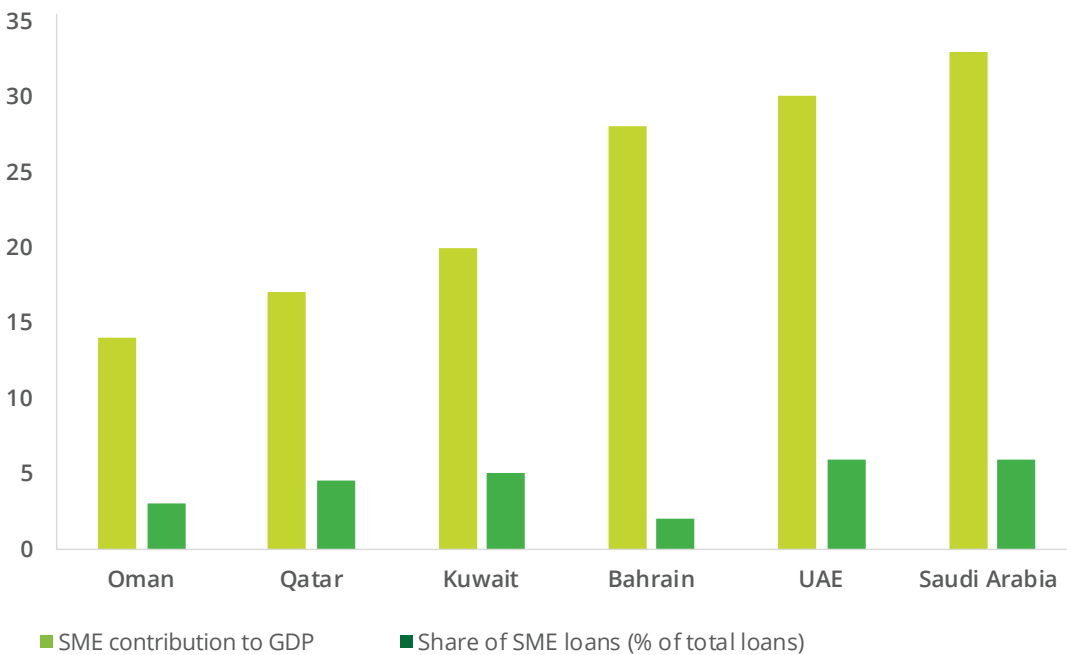
To cite an example from Dubai, most SMEs in the start-up phases primarily depend on personal funds and borrowings from friends and family. As per a report by Dubai SME, only around 9% and 3% of SMEs use Venture Capital from angel investors and bank funding, respectively, in addition to their personal equity. As per the same report, SMEs in the growth stages have a much higher propensity to procure bank funding i.e., 42% in the Medium enterprise segment, vis-à-vis 11% in the Micro enterprises segment and 19% in the Small enterprises segment.

From the perspective of entities providing finance to SMEs, debt has traditionally been the preferred mode of financing for low or medium risk SMEs with stable cash flows, feasible business models and availability of collateral. Equity finance options are preferred by financing entities with a greater risk appetite. SMEs in the seed and start-up phases often face either disqualification of applications or approvals with high rates from financing entities given their level of riskiness.

## Overcoming challenges faced by commercial banks in SME lending

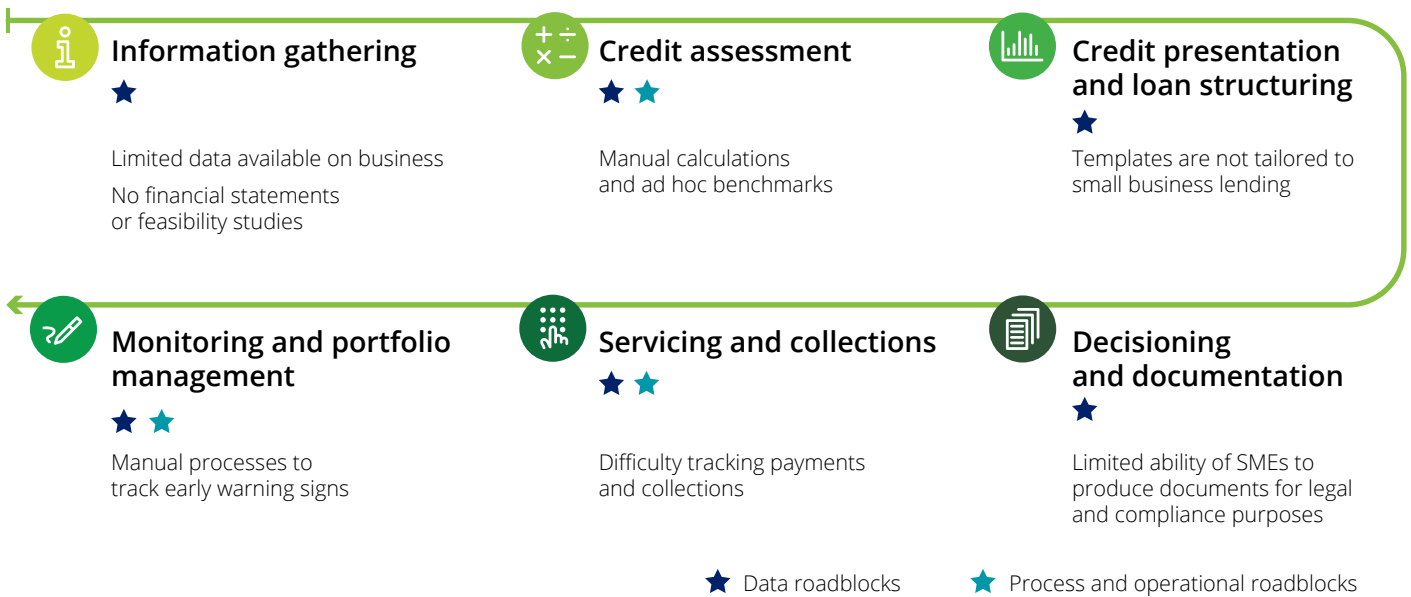
Despite their economic importance, SMEs still do not have access to formal credit channels given that credit and access to finance are concentrated to large corporations and firms. In fact, SME lending in the GCC is 3% with an estimated credit gap of US\$ 250 billion to the SME segment in the GCC region. However, SME lending in the Arab region excluding the GCC is relatively better with a total share of 9%.

Share of SME loans, 2019



Lending to SMEs is often not on top of the agenda for banks given the imbalance between cost and complications of servicing SME businesses in comparison to the potential returns to banks. Banks encounter data, process, and operational roadblocks through every step of the financing journey.











Potential areas of improvement include:

	Areas of improvement	Potential solutions for banks
Data roadblocks	Streamlining the collection of borrower information.	Rethink the required information and more effectively differentiate the level of information requested based on the potential risk exposure.
	Adopting appropriate insight-based customer segmentation strategy.	Banks can run surveys of customer needs, collect their transaction and risk data, and build a 360° view of their clients. Based on customer data, banks can segment their clients and serve them differently.
	Deploying non-traditional sources of information.	Checking account, transaction history, ATM usage, relationship tenor, and third-party information.
Process and Operational roadblocks	Developing differentiated offerings for micro, small and medium segments.	Short term loans, low interest loans, loan guarantees, letter of credit.
	Optimizing pricing strategies to maximize portfolio profitability.	Adopting a Risk-based pricing which requires risk information to be considered in the pricing products. Higher risk clients can obtain credit at a higher price, rather than be rejected.
	Improve the consistency of credit decisions.	Scoring algorithms are models that assign a quantitative score to an SME client using multiple (logistic) regression. Banks can also use Behavioral scores which leverage information that includes client behavior, such as recent customer transactions and balances.
	Selection of cost-effective distribution channels.	For smaller businesses with a lower relationship value, banks may use mass communication techniques such as direct mail and telemarketing to reach new clients. Banks can also use direct channels like branches, online banking and call centres to reduce relationship management cost.
	Update processes to make timely deployment of funds.	Banks could focus on automation of manual processes and implementing rule-based decision making to fast-track simpler and lower exposure loans and refocus precious resources on higher-value activities.

## Government and commercial bank collaboration to meet the SME demand - supply gap

Commercial banks in the region are still wary of lending to SMEs and may need the support of government backed initiatives to provide them comfort in catering to this segment. There are many effective tools that can be deployed by development finance institutions collaboratively to increase commercial bank lending and reduce interest rates on loans including insurance / credit backed schemes by development banks, funds, or insurance agencies, in addition to regulatory support backed by government incentives.

Initiative	Credit guarantee schemes	Trade finance insurance	Regulatory mandates
<b>Impact</b>	Increased credit & economic additionalities which in turn contributes to technological & knowledge spillovers and increases in overall profitability & employment	Through partnerships with commercial banks and backing of insurance provided by a governmental entity, such schemes bring down the cost of borrowing for SMEs while covering the default risk faced by banks	Key tools that have encouraged commercial banks to lend to SMEs and has been achieved when authorities impose incentives and/or exemptions when financing SMEs
<b>Global case study</b>	 CGS guarantees 10,000 loans per year worth over CAD 1 Bn offer support to SMEs during crisis & uncertainty known as “countercyclical relief”. In fact, AECM saw an increase of 25% of guarantees during 2008 Crisis and 200% during COVID leading to an increase of 80% of SMEs supported	 EXIM Bank partnered with different lending institutions in both Malaysia and Thailand to provide credit facilities such as credit insurance, export financing insurance, in addition to overseeing investment insurance activities to support the trade of goods	 In 2016, the Central Bank of Egypt has set a mandate to national banks to pledge 20% of their loans to SMEs. Additionally, rates for SMEs were capped at low levels, ranging from 5% to 12% depending on the firm’s size. Banks are provided reserve requirements exemptions for specific credit facilities
<b>GCC development</b>	 New dynamic banking sector with specialized credit institutions (SCIs) as part of the 2030 Vision. The country’s CGS, known as Kafalah has seen an increase of processed loans by 106% in the fourth quarter of 2020	 Etihad Credit Insurance (ECI) has been partnering with financial institutions to launch specialized insurance solutions and has instituted “SME Protect” to offer trade credit solutions to SMEs and support them in their expansion. ECI has plans to launch technology-based trade finance platform to facilitate financing to SMEs	 The Tender Board (official entity for government contracts) requires at least 10% of projects to be awarded to SMEs Central Bank of Oman has also issued a regulation requiring 5% of commercial bank lending to be awarded to SME clients. This is expected to increase the available funding pipeline from US\$ 1 Bn to US\$ 2.6 Bn

## Favorable regulatory and policy ecosystem for overcoming SME lending roadblocks

Efforts to channel financing to the SME segment by either development finance institutions and/or commercial banks need the support of a robust regulatory and policy ecosystem to be successful.

Several measures may be considered by regulators and government policy makers to ease the hurdles faced by SMEs, including:

- **Availability of data**

- **and information sharing:**

The availability of extensive and accurate statistics on SMEs is an essential requirement for evidence-based policy making and for financing entities to tailor products specific to SME needs. Challenges such as the lack of a consistent SME definition become a hindrance in collating such information.

- **Sector-specific analysis**

- **and ecosystem development:**

The key to establishing target support programmes for SMEs is in identifying specific sectors that require financing. This needs to be done through coordinated value-chain assessments across the ecosystem coupled with ongoing monitoring to ensure that funding diverted to business types does not lead to market saturation. At the same time, any funding efforts need to be equally supported by a supply chain ecosystem that allows for such businesses to operate.

- **Improving SME financial**

- **and digital literacy:**

Support programmes and training schemes can help start-ups and SMEs make more informed decisions and better understand their financial requirements.

- **Facilitating compliance and incentives:**

Process simplifications, particularly through targeted use of technology, can be a powerful tool to enhance compliance and to reduce its costs. Certain preferences and incentives may help support SME creation and growth.

- **Conducting regulatory impact analysis (RIA) to enhance the effectiveness of regulation and assess its implications for SMEs:**

Regulatory frameworks can support regulators in analyzing the specific impact of legislation on SMEs and in considering flexible regulatory options that reduce costs for small businesses

## Using new tools to facilitate SME finance

While several improvement areas exist in effectively using traditional funding mechanisms and tools to cater to the SME segment, the use of new technologies and tools is crucial to overcoming these constraints to SME financing.

### Support tools for SME finance



#### SME funding platforms

SME funding platforms match SMEs with a diverse range of alternative finance providers with different lending appetites and are in most cases owned **privately**, whilst public-private collaboration are also common. Most platforms focus on **debt** or **equity** or both. Majority focus on providing debt solutions due to the lower risk and a faster ROI.



#### Fintech

Fintechs can play an important role in **enhancing competition** among providers of SME financial services.



#### Movable asset pledge registry

Movable collateral registries **open up the range of borrowers** able to provide security and access lending to include those who do not own immovable property. For finance providers, collateral registries lower the risk of default and fraud by increasing transparency and formalizing the lender's claims.



#### Data analytics and cloud computing

Big data analytics and cloud computing facilitate the gathering and processing of large amounts of consumer credit performance and behavioral data to facilitate the process of obtaining **credit information**.



#### Artificial intelligence and machine learning

Artificial intelligence and machine learning combine SME registration and accounting information with geographical and socioeconomic information. Such data help to generate **real-time credit scores and profiles**.

As an example, a study has shown that the introduction of registries for movable assets has been associated with an increase in the likelihood that smaller firms obtain financing including bank loans, lines of credit, and overdraft. The financial impact is quite significant as registry reforms increased access to bank finance and to loans by 8% and 7% respectively.

The case of the Mexican RUG:



### Background

Basic movable asset pledge registry systems exist in Mexico

Creditors unwilling to supply credit to businesses against movable assets due to limited **enforcement processes**

Few creditors registered collateral and credit risk was being transferred as costs to debtors



### Secured transactions reforms

**Congress** reformed **Mexican Commercial Code** in 2009 to create **Registro Único de Garantías Mobiliarias (RUG)** as an entirely electronic notice-filing system

**Further reforms enacted** in 2014 have led to the **improvement of extrajudicial enforcement procedures** and **strengthening of creditors' rights**



### Impact

Initial **registration** of security interests **increased by multiplier of 4** in the first year

Approximately 96% of the registered collateral secured loans of less than USD 1 Mn

Total secured amount was estimated at **USD 200+ Bn of which 95% comprised of SMEs**

The GCC region is also increasingly seeing a move towards the use of registrations for movable assets. For instance, the UAE has recently passed a law enabling SMEs to secure bank loans by collateralizing movable assets in the Emirates Integrated Registries Company. Qatar has also issued its new law on “Mortgage of Movable Assets” in 2021.

Similarly, non-traditional Fintech lenders have also had a positive effect on SME growth and investment by allowing the SMEs to increase their assets, employment, and sales when compared to SMEs whose loan applications were rejected by banks in the past. By diversifying away from the banking sector, FinTech lending competes with traditional financing and reduces the risk of SMEs being exposed to banking shocks which may cut their available financing and adversely affect their growth.

The above-mentioned tools do not only help SMEs from a direct financial perspective. In some cases, when Artificial Intelligence and machine learning are used to generate credit scores, it enables SMEs to obtain the trade finance they may require thus enabling their access to funding. The use of such technologies improves the quality of the data and capture more scoring as opposed to traditional rigid credit scoring.

New technologies and tools can hence complement existing efforts in increasing SME access to finance.

The GCC region is also increasingly seeing a move towards the use of registrations for movable assets

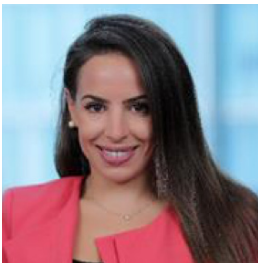
## Key takeaways

- Government-supported development finance institutions and banks are a step in the right direction in providing financing, coupled with capability development for SMEs
- There is a need to widen and tailor the range of instruments (both debt and equity) to finance SMEs to address their diverse needs at various stages of their business from seed, start-up to growth and more matured businesses
- SME financing requirements should be complemented by financing entities with non-financial services and advice as per the business lifecycle
- Share of formal credit channels and SME lending by commercial banks and financial institutions remains low in the GCC region and needs enhancement. Financial institutions may overcome their data and operational challenges with respect to SME lending in several ways which could include streamlining collection of borrower information and deploying non-traditional sources of information.
- Operational roadblocks could be addressed through smarter channels of credit decisioning, adopting risk-based pricing and other similar measures
- Development finance institutions can work collaboratively with commercial banks to increase lending and reduce interest rates on loans through several measures like insurance backed by development bank, and regulatory support backed by government incentives.
- Any SME financing and subsidy efforts need the backing of regulatory and policy support through measures like better information sharing, sector-specific support, improving SME financial literacy, regulatory incentives etc.
- Tools like SME funding platforms, movable asset pledge registries and leveraging Fintech are much needed to complement traditional efforts of SME financing.

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