SME's Vs. Bank Borrowing _ PartI

Author: Malek Al Khatib, MBA, CCRP

In the Middle East and Africa region (MEA), Small & Medium size business (SME) consists of more than **90%** of all firms outside the agricultural sector. SME and especially start-up businesses face many challenges in accessing financing compared to corporate institutions in Arab Region. In 2013, for example, SMEs' access to credit facilities was not impressive. In Emirates NBD Group, SMEs makes up **0.27%** of the total group's lending portfolio. In Arab Bank plc, SMEs represented only **3.4%** of the lending portfolio. In Abu Dhabi Islamic Bank, SME lending represents only **5.8%** of total lending portfolio. Such figures proved the huge gap between the business demography and funds allocations.

I have passed through many Journals handling the SME's and its risk mitigation. One of the interesting paper attracted me to read is the "Financial Challenges That Impede Increasing the Productivity of SMEs in Arab Region ", *Emine* (2012).

The paper found that there is a positive relationship between bank lending and SME development, but unfortunately banks in Arab region still have the poorest financial information on SMEs.

Many Banks' initiatives came to the picture between the years 2004 and 2012, to boost SME's lending portfolio, however, the challenges were higher!

SME's proved its strength during financial crises compared to corporates, not because they are less risky, but because another reason. Another paper conducted by Altman, Sabato, & Wilson (2010), stated that; small firms have a lower risk profile due to a lower **default correlation** with each other and not because they are considered less risky in terms of lower expected losses, compared to larger firms. That means SME's has no "**Domino Effect** "to impact each other. Domino Effect was one of the major catalysts of 2008 crisis between large corporates, and many articles about it are accessible for further reading.

In Arab region, SME's, unlike corporates, are highly dynamic, of which annual and historical financial data could be miss-leading and not reflecting the current status of the business, beside the fact that in most cases financial data is not available, or not shared !

Understanding SMEs business nature is one of the essential steps to start mitigating their risk. This will lead the lender to focus on the "**determinate factors**" that may cause a potential default for an SME. Many of these factors are not financial and if such factors were identified, and if the same standardized time and efforts to collect information about the SME's will be saved.

In 2012, Basel capital requirement was further revised, and banks were given the option to use a more risk-sensitive approach for calculating the regulatory capital charge for credit risk – based on their own rating procedures in which the credit risk weights are determined using borrower-based risk parameters (also referred to as Internal Ratings Based (IRB) approach). Banks in Arab region usually do not have credit scoring model that can help them to ease the Basel II requirements, especially for SME's.

The question now; if such determinants factors were identified and mitigated, are Banks in our region still welling to adapt and revise lending prices and practices against SME's ?

One of the initiatives exercised in 2013 form Qatar between **Qatar Stock Exchange** and **Qatar Development Bank** to establish a program to assist qualifying companies with a grant to assist in the payment of certain professional fees associated with listing on the **Qatar Exchange Venture Market (‘QEUM’).** The program is aim to share the most possible information about the listed SME, in order to ease borrowing and raise funds from outsiders who will be a future shareholders. However, how many Qatari SME owners are willing to sacrifice their business information and share their wealth with minimum 20 shareholders to obtain the ease funding specially most of SME's are family owned business!!

To be continued part II