

CAPITAL INFUSION

Jordanian firms have always had a tough time with institutional borrowing. But as competition between banks heats up, access to precious capital is more available than ever—as long as you can handle the audit.

Abdul-Wahab Kayyali reports.



SMALL AND MEDIUM ENTERPRISES MAKE UP more than 97 percent of Jordanian companies, yet historically, they've had to grapple for every penny of institutional funding. As Jordan's financial sector modernizes, once common practices are now being reexamined. "Banks are supposed to reward SMEs based on their business plan and future profitability," said Nayef Steitieh, President of the Business Development Center (BDC). "They are supposed to reward the project, not the person."

Yet, from the bank's perspective, there is plenty of justification for conservative lending practices. Jordanian SMEs usually cannot provide the basic financial documentation required by most banks to determine loan eligibility. "Most companies ... make two balance sheets, to avoid taxes," said Abdel Hameed Al-Saeed, Executive Manager at Bank of Jordan. "The transparency is absent in Jordanian companies, because [financial] statements are unprofessional and unaudited."

Presented with insufficient information, banks have applied a simple and safe formula. "In the absence of financial information, [we] demanded assurances in the forms of collateral," said Faleh Al-Najjar, Deputy CEO and Deputy General Manager at Ahli Bank. "When [clients did not have this], we used to decline loan requests."

Obviously this created a Catch-22. If you didn't have capital, banks wouldn't lend you money. So how could you build capital? This vicious cycle has had adverse repercussions for the SME sector. "In Jordan, if you want to take a loan for JD 100,000, you have to mortgage assets worth JD 300,000 to 400,000," explained Majdi Abu Arja, Director of Business Development Services and Special Initiatives at the BDC. "This is why there is no growth."

Abu Arja explained that SME owners everywhere go to financial institutions as a last resort—though Jordanians have a particular aversion to them. "Globally, over 80 percent of SMEs are financed

through family, friends and fools," he said. "When these three are exhausted [they] go to financial institutions. We call these the four Fs."

But the traditional rules of the road are changing rapidly. Banks are now aggressively marketing themselves to SMEs. Four banks – Arab Bank, Bank of Jordan, Cairo Amman Bank and Ahli Bank – have set up specialized SME financing units. Many more are developing similar units.

"We have developed specialized products and client servicing to cover the entire country, going directly to the clients to determine their needs," said Al-Najjar who heads the SME unit at Al-Ahli. In that regard, Jordan is part of a regional trend. "You can't sit in your office and wait, you really have to be in the community," said Chris August, a British banking expert based in Jerusalem. So just what has changed? And how can your business benefit?

Compound Interest

It is simple. As the number of banks has increased in Jordan, with international banks such as Audi and BLOM entering the market, competition has spiked. Banks could not afford to ignore SMEs any longer. "As more banks are licensed, there are less juicy parts of the business to go around," remarked August, who spent six years as CEO of the Palestine Banking Corporation and has worked on SME financing in Palestine, Iraq, Pakistan and Sri Lanka.

After dealing with corporate titans for so long – usually with sub-optimal terms – local banks have turned their attention to the smaller clients. According to Al-Najjar, SMEs often will

not bargain over interest rates, and so banks can charge higher rates of interest. "If any big investor goes to a bank, he can dictate interest rates," remarked Abu Arja. "SMEs cannot."

But outreach is now a big part of the business. Banks are now sending their associates to help SMEs write financial statements. In that sense, they are also acting in a consulting capacity. "We are building information databases for client companies,

so we are able to make better lending decisions and have a closer relationship with them," says Al-Najjar. And new products are being offered, including receivables financing, inventory financing, and leasing. "Leasing is a viable option for SMEs, because they are using the asset without tying down their capital to it," says Abu Arja.

To do this effectively, banks are going into client warehouses, checking inventories, and requiring a lot more transparency – which can be a challenge for a small business. "If they need you, they will accept your practices," said Al-Saeed, head of the SME unit in Bank of Jordan. "The demand is increasing because the purchasing power of the JD is eroding."

Thus, banks no longer see SMEs as excessively risky borrowers. "When we divide the money across a greater number of clients ... we are dividing up the risk," said Al-Najjar.

"It's not that the SME sector is more risky, it's just more challenging, more problematic," said Al-Saeed about bankers' attitudes. "[We] have discovered that this is a large segment of the economy, that it's not too risky, and that it's extremely profitable."

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Institutional Hurdles

Despite recent strides, there's still a long way to go before the SME sector has an economic ecosystem of support. "SMEs are still required to pay high collateral," said Al-Saeed. "There is a slow trend to move out of collateralized lending, but the culture and regulations are the biggest obstacle."

Even today, August noted, "buying and selling is more important than writing down the figures."

As it is, the current incentive structure deepens concerns about asymmetric information.

"Nobody is honest. In the Gulf there is a lot of transparency – because there are no taxes. In Jordan, everything is hidden," said Al-Saeed. "This is a clear obstacle to SME growth."

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In the eyes of many observers, government can make a difference. "The government can help by giving tax and financial incentives to SMEs, which would encourage accurate bookkeeping," said Al-Saeed.

"The main thing the government can do is pass a permanent credit information law, which would pave the way to establish a credit bureau," said Abu Arja. "This would ... help lenders by providing information on loan applicants." As it stands right now, most banks are developing in-house credit departments that only they can utilize – an inefficient and costly practice.

Another interesting example of government support can be found in Tunisia. The Tunisian Ministry of Finance set up the SME Financing Bank to fos-

ter growth in the SME sector. The bank adopts SME projects, providing 50 percent of the required funding while helping the project owners attain 50 percent from commercial banks. That way they share the risk with the bank and—more broadly—also act as an incubator, providing information and valuable contacts for SMEs.

"We have more engineers than financial analysts to provide support for all aspects of the project," said Slim Siala, Director of the Assistance, Identification & Development Unit at the bank. "We do not consider collateral, but evaluate the project itself, the business plan, and management experience of applicants," he added.

Tunisia has experienced some of the same cultural limitations and risk-averse business culture dominant in Jordan; Siala says bank officials often lecture in schools and universities about the importance of entrepreneurship.

Government Gearing Up

The Jordanian government has the SME sector on its radar. It founded the Jordan Enterprise Development Company (JEDCO) in 2003, whose work in the SME sector focuses on enhancing exporting and marketing capacity of SMEs. JEDCO pairs SMEs with relevant sources of finance, and also provides them with general technical and administrative assistance.

Another government initiative is the Jordan Upgrading and Modernization Program (JUMP), which provides grants in the form of subsidized services to companies. These include business plan and upgrading plan development, as well as specialized consultation on product development, cost analysis and other various areas of company management. JUMP also has the national linkage program, which links large manufacturing firms with SMEs that produce necessary inputs thereby fos-

tering partner- ships and business relations.

The government has additionally rallied the international donor community to the cause of SMEs, and has channeled aid money to support SME support projects such as the National Fund for Enterprise Support (NAFES) and Tatweer. NAFES is a Japanese government aid project that aims at assisting Jordanian SMES to become more efficient and competitive by providing financial assistance to management modernization, financial and training programs.

Tatweer – the Business and Export Development Project for Jordanian Enterprises – is managed by the BDC, which is a USAID funded institution. It provides various subsidized services ranging from management consultancy to marketing development to human resource development to energy and environmental management.

Though the effectiveness of these programs and initiatives is subject for debate, they are experiences that – whether they fail or succeed – can be built on in the future.

At the end of February, The BDC partnered with JEDCO, the International Finance Corporation (IFC) and Financial Markets International (FMI) to organize the first regional SME Finance Conference in Amman which brought Siala, August and many other experts to the Jordan.

"I think it is the time for companies to start adopting new practices ... We need to start somewhere and cannot sit and blame the culture," remarked Steitieh. He is confident that the latest SME financing methods and approaches presented in the conference will resonate with Jordanians. "Companies get jealous, so when they see others prospering they will consider changing their methods more seriously." ▼