Market Assessment of the Financial Needs of Very Small, Small, and Medium Enterprises in Tunisia

EXECUTIVE SUMMARY

In partnership with: Canada's Department of Foreign Affairs, Trade and Development, the Danish International Development Agency, Switzerland's State Secretariat for Economic Affairs, UKaid and Japan.

IFC International Finance Corporation WORLD BANK GROUP

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INTRODUCTION

This executive summary is based on an International Finance Corporation (IFC) market assessment of the financial needs of very small, small, and medium enterprises (VSSMEs) in Tunisia.

IFC, as part of its program to improve access to finance in the MENA region and in close cooperation with Tunisian public and private stakeholders and other international financial institutions, commissioned a market study to Ernst & Young in order to identify the needs of VSSMEs in Tunisia. The study aims at enhancing access to finance and improving Tunisian VSSMEs banking through:

- The evaluation of the existing gaps between the needs of VSSMEs and the existing offer of banking services,
- The identification of growth opportunities for financial institutions (FIs) in terms of VSSMEs market,
- The development of specific recommendations to government and financial institutions.

This study was conducted over eight months and was completed in June 2014.

I. SCOPE OF THE STUDY

Among the 602,200 companies that are listed in the National Register of Enterprises (NRE) in Tunisia, only 800 stated that they employ more than 200 people as of 2011. All others are considered by the study to be VSSMEs. These businesses employ 580,000 people, which accounts for 56 percent of jobs in the private sector (National Institute of Statistics, NIS) and around 40 percent of Tunisia's gross domestic product (French Embassy, 2010).

The conclusions and recommendations of this study are based on information gathered from 1,412 companies through individual face-to-face interviews as well as discussions with 17 financial institutions, and 10 public institutions.

This study adopts the NIS definition of VSSMEs, which is based on the number of employees and covers enterprises employing from 1 to 199 people.

II. IMPORTANCE OF VERY SMALL, SMALL, AND MEDIUM ENTERPRISES IN TUNISIA

The importance of VSSMEs for the economy is well known. Half of commercial banks and nearly all leasing companies consider them a priority market.

The government has put in place various mechanisms to promote VSSME financial inclusion. It has done this mainly by reducing the exposure of financial institutions serving this segment through guarantees as well as financing and co-financing mechanisms. It has also provided technical support to enterprises through sector support programs.

VSSMEs are considered a priority market for half of commercial banks and almost all of the leasing companies of the panel study. All financial institutions, regardless of their strategic focus, already serve VSSMEs. Financial institutions deliver a diversified range of financial products, including short-term and long-term loans, payment facilities, and deposit and insurance services. They have been introducing more flexibility into their guarantees to ease access to credit and leasing. Some have dedicated account managers for small enterprises; others have created dedicated business units to better serve smaller businesses.

Currently, around 71 percent of VSSMEs are banked; the ratio reaches 100 percent for medium enterprises of more than 50 employees. According to estimates based on the Tunisian central bank, 350,000 VSSMEs and micro-enterprises (58 percent of the total) have outstanding bank loans that amount to 4 billion Tunisian Dinars in addition to 1.7 billion Tunisian Dinars in leasing contracts as of December 2012. Eighty percent of VSSMEs that requested a loan succeeded in obtaining it.

III. LIMITED ACCESS TO FINANCIAL SERVICES FOR VSSMEs

However, access to finance for VSSMEs is still far from being fluid. Twenty-nine percent of surveyed VSSMEs have never tried to open a bank account, either in the name of the company or its owner. VSSMEs are financing working capital with treasury funds (75 percent), savings of the owner (40 percent), and supplier loans (34 percent). A few companies finance their operations in a different way: companies linked to a larger group (2 percent) have been conducting regular business relations with financial institutions, obtaining loans and other financial services.

Gaps between the supply and demand of financial services for VSSMEs persist in (i) type and amount of funding available and (ii) diversity of financial services.

- Type and amount of funding available:
  - There is a mismatch between the demand for short-term financing and the supply of loans that must be secured by collateral; 37 percent of VSSMEs declare a need for loans to finance their working capital.
  - There is a lack of funding in the early stages; only 14 percent of VSSMEs finance the set-up of their activities with a bank loan or lease.

- Diversity of financial services:
  - Public authorities and financial institutions focus more on access to finance than other banking services, such as insurance, treasury instruments, debt recovery, and financial education. These services would help VSSMEs to improve their management and allow financial institutions to increase their profitability in this market.

The gap between the product offerings of financial institutions and the financing needs of VSSMEs might be explained by VSSMEs' lack of trust in the financial system, as many VSSMEs consider loans to be an additional source of risk rather than an opportunity.

VSSME financial inclusion is limited by both the capacity of borrowers and financial institutions. The gap between financial institutions and the VSSME market is explained by a combination of mismatches between potential borrowers, financial institutions, and market infrastructure.

VSSME FINANCIAL INFORMATION IS OFTEN INCOMPLETE OR UNAVAILABLE

Financial institutions are often deterred by:

- a lack of transparency among VSSMEs (only 60 percent keep accounts and 33 percent have certified financial statements);
- a lack of financial projections (only 36 percent have a business plan and 50 percent would like to develop one); and
- the heavy reliance of VSSMEs on cash; (78 percent of supplier payments and 90 percent of salary payments are in cash).

Also, VSSME median revenue (45,000 Tunisian Dinars) is far below the threshold used by financial institutions to define a small or medium enterprise, and very few VSSMEs (15 percent) wish to expand.

FINANCIAL INSTITUTIONS DON'T EXPLORE ENOUGH OPPORTUNITIES RELATED TO THIS MARKET SEGMENT

Tunisian financial institutions weakly exploit the potential of the VSSME market and do not take sufficient measures to tackle the issues of information asymmetry. No Tunisian financial institutions (specialized institutions excepted) have implemented a tailored strategy for this market. Financial institutions consider VSSMEs to be a core part of the country's economy, yet a risky one. Very few consider VSSMEs to be intrinsically interesting and profitable. Therefore, financial services provided to VSSMEs have remained traditional. They center on a range of relatively flexible standard products imitating retail and corporate products and offered via branch networks. The focus is placed on funding, which is granted according to a VSSME's performance and financial risks as well as suggested guarantees. However, this method is not working for the 66 percent of VSSMEs that are not banked and are unable to show proof of valid accounting. Financial institutions are very aware of the limits of their current approach as it results in having to deal with the same limited number of bigger companies, given the difficulty of serving the majority of the market that is considered high risk.

EXISTING INFRASTRUCTURE TRIES BUT FAILS TO OVERCOME VSSME FLAWS AND DOES NOT FOSTER INTEREST AMONG FINANCIAL INSTITUTIONS IN THE VSSME MARKET

Measures taken to reduce the asymmetry of information between financial institutions and VSSMEs are insufficient. Actions that were implemented to technically assist VSSMEs gave poor results.

National governmental initiatives to facilitate VSSME access to finance through guarantee funds and public banks also showed limited results. Only 12 percent of VSSMEs know about SOTUGAR, the Tunisian Guarantee Company. Three percent have ongoing funding from the Tunisian Solidarity Bank, and 1 percent has financing from the Bank for the Financing of Small and Medium-Sized Enterprises. This public system of financial support is provided through a number of specialized structures that are based upon a company's size and activity as well as the type of services it offers. Entrepreneurs are often lost between the different structures and processes, which are cumbersome and intimidating.

Finally, the tunisian central bank provides data on VSSME debt, but the information remains largely untapped.

IV.GENERAL RECOMMENDATIONS

In order to address issues that are limiting the access of VSSMEs to financial services, it seems necessary to pursue the existing efforts while respecting three key principles:

1. INCORPORATE EFFORTS TO ASSIST VSSMEs INTO A MORE ORGANIZED AND COORDINATED NATIONAL STRATEGY

VSSMEs are the focus of many organizations, including the government, financial institutions, and professional organizations. These groups should co-ordinate their efforts based on a common understanding, or even a common definition of VSSMEs, in order to match government initiatives and financial products. This would build a greater understanding of the market.

2. EXPAND EFFORTS TO ASSIST VSSMEs TO INCLUDE A FULL RANGE OF FINANCIAL AND NON-FINANCIAL SERVICES, BEYOND CREDIT

Today, VSSME assistance efforts are oriented towards corporate finance. However, lending is only one of many financial services that VSSMEs need for their daily operations and growth. Furthermore, according to international experience, credit services are not sufficient to make the VSSME market a profitable one for financial institutions. Offerings should go beyond funding to cover further financial needs.

3. ADDRESS THE DIVERSITY OF THE VSSME SECTOR

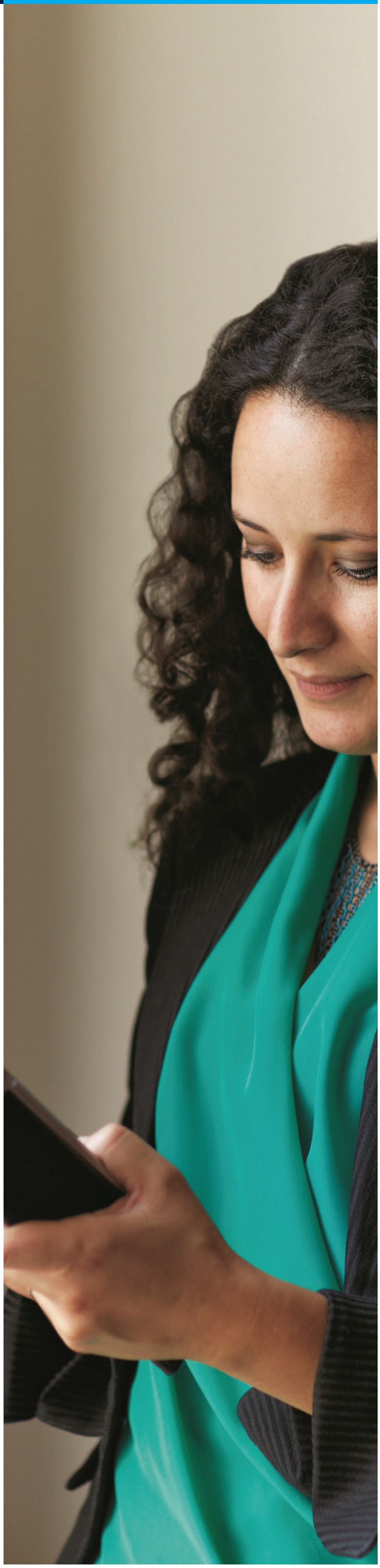
The VSSMEs market is very heterogeneous, both in terms of needs, expectations, and risk levels. To better tailor their actions, financial institutions and Tunisian public authorities should segment this market into homogenous subgroups. This study proposes two types of segmentation.

1. A marketing segmentation based on socio-economic criteria intrinsic to VSSMEs. It identifies homogeneous groups, based on business activities and ownership types. Eleven groups were identified, although each financial institution can decide to develop more.
This segmentation allows financial institutions to develop targeted communications towards these groups, not only through advertising campaigns but also through product packaging and the organization of distribution channels.

- **Banks consider women entrepreneurs, young graduate entrepreneurs, and retailer**s as more attractive segments than banked VSSMEs due to their high potential. Thus, financial institutions should consider recruiting more of these clients and develop cross-selling products for them.
- **Wholesalers, importing and exporting VSSMEs, professionals, and vssmes linked to a larger entity** are currently the most served segments. Financial institutions should build retention strategies and promote up-scaling and cross-selling amongst these clients.
- **VSSMEs that operate in sectors like small industry, handicrafts, accommodation and food services,** are less banked, as are those in more remote areas and those who prefer Islamic banking products. Thus, efforts have to be undertaken to raise their financial inclusion level via standard financial products.

2. A strategic segmentation based on the maturity level of VSSMEs. It aims to distinguish homogeneous groups in terms of potential income for financial institutions. It allows financial institutions to adapt their products, internal organization, and distribution network to the expected revenue of each segment. It would allow them, for example, to take a mass approach for the segment with low profitability (standardized products, low cost channels, automated customer services, management and risk tool evaluation, etc.), and a premium approach for the segment with high profitability (flexible products, dedicated relationship manager, etc.).

The cross reference of these two segmentations allows the prioritization of the segments according to either government objectives or the competitive advantage of financial institutions.



V. SPECIFIC RECOMMENDATIONS FOR PUBLIC AUTHORITIES

The government has already taken full measure of its role as a regulator and supervisor of financial institutions and as a facilitator and promoter of entrepreneurship. Four recommendations for government action are listed below.

1. DEVELOP A NATIONAL STRATEGY

State efforts would gain efficiency if they were part of a formal concerted strategy that addresses a range of financial services and that is followed up by a frequent and organized reporting.

2. IMPROVE TRANSPARENCY

In order to reduce information asymmetry between financial institutions and clients, the government should intervene at two stages. The first would see the state promote VSSME financial transparency (through support programs, tax reform, and other measures) and second would see it share information on VSSME debts and payments with financial institutions and service providers through a credit bureau.

3. EASE REGULATIONS FOR CREDIT ACCESS

Interest rate and working capital credit ceilings are constraints that could be lightened and that may currently prevent financial institutions wishing to expand their offerings and financing to VSSMEs.

4. STREAMLINE THE GOVERNMENT'S ORGANIZATIONAL STRUCTURES TO SUPPORT VSSMEs

Consolidate state organizations and instruments (including guarantee plans, co-financing, grant funds, and national agencies) in order to improve their impact and efficiency.

VI. SPECIFIC RECOMMENDATIONS FOR FINANCIAL INSTITUTIONS

Financial institutions have a very important role to play. They can take several actions to enable themselves to profitably serve the VSSME market, despite the existing information asymmetry.

Banks have been testing and implementing innovative approaches to serving this market in comparable MENA countries. Key success factors include (i) a dedicated strategy (ii) a good understanding of the market, proper segmentation, and differentiation between very small enterprises, small enterprises, and medium enterprises, (iii) a strong commitment among top management towards VSSME clients that is directly reflected in organizational charts, (iv) a comprehensive range of services tailored to VSSMEs, including the promotion of non-lending products and commission revenues, (v) active use of low-cost channels of distribution, (vi) risk-management based on the evaluation of entrepreneurs' profiles rather than their guarantees and financial statements, and finally (vii) an automated information system at the core of the process.

1. UNDERSTAND, SEGMENT, AND PRIORITIZE THE MARKET

The VSSME market is too heterogeneous to serve with a single approach. It is necessary to better understand and segment VSSMEs, and to develop a specific strategy for the chosen segment. This survey identified multiple segments that could potentially be refined by financial institutions interested in this market.

2. BECOME A DAILY BUSINESS PARTNER

Developing a comprehensive range of non–lending financial services is a key success factor to attract clients, manage risks, and increase the profitability of these customers. Financial institutions should go beyond their role of lenders to become solution providers and support VSSMEs in areas such as payroll management, procurement, risk prevention, marketing, and investment.

3. OPTIMIZE OPERATING COSTS

Financial institutions can make VSSME segments profitable by adapting their procedures to the expected income generated by their VSSME clients through product standardization, customer relationship management, and the use of low-cost distribution channels. A strategic segmentation based on business revenue potential, carried out as part of this study, will help financial institutions better manage their costs and enhance their profitability.

4. REMODEL RISK MANAGEMENT PRACTICES

Innovative analysis and credit management techniques, based on the profile of the entrepreneur and his behavior rather than on the audited financial statements of the company, have allowed financial institutions in other countries to improve their market coverage while controlling their risks.

5. COMMUNICATE EFFECTIVELY

When it comes to VSSMEs, it is not only about delivering the right product to the right customer, but it is also about conveying the right information to the market.

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