



GUIDE

ON ACCESS TO FINANCE

FINANCIAL SERVICES AND TOOLS AVAILABLE IN EGYPT



Egyptian Junior Business Association
الجمعية المصرية لشباب الأعمال

supported by the Center for International Private Enterprise (CIPE)



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The Egyptian Junior Business Association (EJB) is a non-governmental organization, established in 1999 and formally registered in 2000 with a vision to become the “association of first choice among Egyptian Junior Business people who are committed to the development of a culture of Excellence, Ethics and Public Service” and a mission to “Provide a platform for dynamic business people to affect a positive business environment through Business Development & Social Responsibility promoting a culture of excellence & business ethics.”



The Center for International Private Enterprise is a non-profit affiliate of the U.S. Chamber of Commerce and one of the four core institutes of the National Endowment for Democracy. CIPE has supported more than 1,000 local initiatives in over 100 developing countries, involving the private sector in policy advocacy and institutional reform, improving governance, and building understanding of market-based democratic systems. CIPE provides management assistance, practical experience, and financial support to local organizations to strengthen their capacity to implement democratic and economic reforms. CIPE key program areas include anti-corruption, advocacy, business association, corporate governance, access to information, the informal sector and property rights, and women & youth. CIPE programs are also supported through the United States Agency for International Development.



PricewaterhouseCoopers-Egypt is a member firm of the Global Network of PricewaterhouseCoopers (PwC). PwC Egypt has served the Egyptian market for over 30 years, providing financial advisory, consulting, taxation and assurance services. We have extensive experience in helping businesses to improve and expand their business, with strong regional and global industry expertise.

With more than 400 professionals, PwC Egypt combines an in-depth knowledge of the Egyptian economy, tax regulation and local business standards with extensive coverage, breadth of resources and quality assurance mechanisms. We are a full fledged member of the global network, with access to a global wealth of expertise and knowledge bases, which support us in delivering client value in all our projects.

PwC Egypt has worked with EJB and CIPE to develop and author this Guide.

A Word from the Chairman, EJB

Egyptian Junior Business Association's strategic plan 2009 - 2015 clearly identifies "Improving the competitiveness of Small and Medium Enterprises" as one of its key strategic directions.

SMEs are a major reservoir for growth of the private sector in Egypt. Over the past years this sector has received special attention and support from various stakeholders. While some of the problems facing this sector have already been addressed and solved, other obstacles remain hindering the development and growth of the SMEs in Egypt. Access to finance has been identified among the obstacles this sector faces.

Based on this realization; and out of our belief that SMEs represent the engine for growth for our economy; the Egyptian Junior Business Association, one of the leading NGOs in Egypt, representing the young business men and women, decided to address this issue in its projects and activities for the year.

The Development of the "Guide on SME Access to Finance" was one of the major projects of the year. The process adopted in the development of this guide was based on joint interaction and **collaboration** with the different stakeholders representing small and medium enterprises, entrepreneurs, legislators, financial institutions including banks, leasing, factoring, private equity firms and NILEX. Over six sessions the different modes of finance were presented and obstacles facing SMEs access to finance were discussed. The production of the Guide marks the final stage of these series of activities. This Guide is not an end but actually a starting point for a series of activities and a chain of efforts to maximise the number of SMEs benefiting from this manual in their process to access finance.

The publication of this Guide marks the fourth cooperating with the Center for International Private Enterprises, CIPE, our partners in this project. Without their support and assistance this guide would not have been completed.

We also wish to thank PWC and their dedicated team for the effort exerted in the development of the Guide.

In conclusion, I want to thank the EJB Banking and Finance Committee, EJB members and EJB's executive who have given extensively of their time and effort to bring us where we are today. Without their dedication and belief in the importance of this work, this Guide would not have been developed.

I am finally proud to present to you the "Guide on SME Access to Finance" which proudly brings to life our core EJB values. This guide is a proactive and **Innovative** product that drives positive change in the Egyptian society. It was built through a process that symbolizes the **collaboration** and culture of **Excellence** we strive for and through a **teamwork** that was fueled by great **Passion** and **Citizenship**.

Ashraf Ibrahim El Gazayerly
Chairman, EJB



Word from the Executive Director, EJB

Another feather in our cap, with this manual EJB has once again proven it is focused on the issues at hands, proactive in its strategic directions and capable of presenting solutions to a national deficiency.

This can only happen with the perfect alignment and understanding of a well integrated committee as in our Banking and Finance committee, one of EJB's largest and probably most active committees, and in partnership and support of our strategic partner CIPE. The committee was able to effectively get the board of directors' buy-in and bring this initiative to light. In our environment of NGOs, many ideas and initiatives never see the light of day, with EJB's innovative structure and dynamic attitude, that can never be the case.

We are all held accountable and managed by objectives and achievements and we celebrate every one of them, as it is in numbers of success stories that we can carry our message through and make a difference in our community and country as a whole.

The Small and Medium Enterprise Access to Finance guide is a first step towards many to come and this initiative will always be driven, updated and shared with entities who will add needed value to make it as effective and useful to both the financing as well as the demand sectors of the Egyptian market.

We thank CIPE's executive body for their integrated efforts and support.

Amer Elwy
Executive Director, EJB





PricewaterhouseCoopers Egypt (PwC) is very pleased to take part in the EJB/CIPE initiative supporting SMEs access to finance. We believe that SMEs are the engine for economic growth, especially in the current state of the Egyptian economy where the private sector is increasingly becoming the driver for economic activity. We at PwC around the globe are always keen to support the development agenda of the national economies we are represented in.

In Egypt, PwC continues to serve local and international clients, large and small, across economic sectors. PwC Egypt is a leading firm in providing professional advisory, tax and assurance services.

PwC is honored to have been selected as the consultant of choice by EJB and CIPE to develop and author this Guide. We have taken part in all the roundtable events organized by CIPE and EJB, in addition to attending additional relevant events organized by third parties. Our team has met with, or interviewed, representatives of the SMEs, the banking sector, the private equity funds, and the factoring and leasing service providers in order to collect hands on and practical data about the varying requirements of the different financing institutions. We have collected industry data, and leveraged global knowledge sources to derive content of relevance to the various sections of the Guide. We have attended extensive discussion meetings with EJB and CIPE team to ensure that all their expectations are met, and their valuable insights are reflected. We have also written this Guide in a language and sequence that we believe best serves the needs of SMEs for a tool and easy reference, providing practical steps to improving your access to finance.

I hope that you will find this Guide a useful and practical tool in your continued endeavors to enhance and grow your business enterprise. We are very eager to see this Guide making a difference in your ability to access finance in the near future.

Tarek Mansour

A blue ink handwritten signature of Tarek Mansour, written in a cursive style, is positioned above a horizontal blue line.

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PricewaterhouseCoopers, Egypt
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Why the Guide

By Mohamed Mohieldin, Head of Finance and Banking Committee, EJB

It all started with a shared belief amongst EJB members of the importance of Small and Medium Enterprises in the development of Egypt. This important segment has a tremendous unleashed potential to positively impact the growth of the economy, create job opportunities and realize the aspirations of many entrepreneurs who represent the back-bone of a healthy economy.

Growth of a business being an SME or a large enterprise is a multi-dimensional undertaking and we, as Banking and Finance Committee, chose the dimension by which we can help SMEs grow through ***“successfully securing appropriate financing means”***.

When analyzing the current situation of SMEs finance we came up with the following realizations: **First**, SMEs growth and finance is a responsibility shared by various stakeholders; regulators, financial institutions as well the SMEs themselves. **Second**, the various stakeholders had to engage in an open dialogue to candidly discuss their problems.

A team from the Finance and Banking Committee was formed, with the ultimate goal of spreading financing awareness among SMEs through the issuance of the first “SMEs Access to Finance Guide” in Egypt. We held six seminars, each addressing one of the fields of finance. The first seminar was truly remarkable, the SMEs were the ones speaking, and the finance people were the ones hearing their problems. Each of the following seminars hosted a group of financial experts tackling the various problems facing SMEs and their access to finance. SMEs companies were present, discussions were open, and the long waited for dialogue had started. Banking, leasing, Private Equities and Venture Capital, Factoring and the stock market (NILEX), were all discussed in those seminars and the outcome was used as the seed for the guide.

We aimed to write a manual that translate the language of finance professionals to SMEs and in doing so securing the financing needed for growth. A manual that would help SMEs pursue the most appropriate type of financing based on their industry and particular circumstances.

Acknowledgement

A special thank you is due to **Ms. Alia Soliman** EJB's board member and partner at AIT consulting, for her exceptional effort and tremendous dedication for this project in general and in the production of the manual in specific. I would like as well to thank all other "SMEs Access to Finance Guide" team members who had exerted significant efforts and contributions to get this guide to the light:

Mr. Ahmed Abul Dahab – Deputy Head, EJB Banking & Finance Committee & Director, CIB-Egypt

Mr. Ahmed Kafafi – Chief Executive Officer, MEPD

Dr. Basel Roshdy – General Manager and Chief Investment Officer, Nile Capital

Eng. Hassan El Khatib – EJB Board Member and Managing Director, Carlyle Group

Dr. Khaled Nagaty – CEO, Metropolitan Credit & Consulting (MCC)

Mr. Nader El Sayed – Managing Partner, Archer Consulting

Eng. Mohamed Osman – Managing Director, Sofico

Eng. Sherif Saleh – Managing Partner, ProSeed Advisory

Moreover, I would like to thank all the speakers who had attended our seminars and shared with their valuable knowledge, all EJB and non-EJB members who attended the seminars, PWC for their distinguished effort and writing skills, CIPE for their enthusiasm to participate in this unique project, EJB's executive team, specially **Ms. Yasmina Abdellatif** for her remarkable efforts.

Mohamed Mohieldin
Head of Finance and Banking Committee, EJB



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Section 1

Introduction to the Guide

Section 1

Introduction to the Guide

Small and medium enterprises in all countries are the engine of economic growth. They are dynamic organizations that capture innovative ideas and entrepreneurial spirit into formal business establishments providing goods and services. In the process, they provide significant opportunities for employment.

It is estimated that typically in any country, SMEs represent about two thirds of the economic activity, across sectors. All large global enterprises well known today have evolved from being a small business, perhaps over a hundred years ago or so.

SMEs in any country usually face many challenges as they aspire to grow. One of the key challenges is access to finance with reasonable cost and requirements. Now in Egypt, there is a strategic national focus on SMEs and improving their ability to access finance as a key driver for sustainable economic growth. This is in fact one of the primary goals of the financial sector reform undertaken by the Government for 2009-2013. Therefore, this Guide is designed to be a useful tool for SMEs in their pursuit of seeking additional financing for their business

It is important to recognize that there is no unified, global, or local definition of SMEs. Different criteria are used by different authorities and bodies to define SMEs. In Egypt, there are many definitions applied by the Central Bank of Egypt, the Tax Authority, and the Egyptian Accounting Standards, among others. Moreover, individual institutions, may even have individual definitions or criteria.

A. What is in this Guide

This Guide is designed to be a reference for small and medium companies on how to improve their access to finance. It provides information that clarifies and explains the different types of financing options now available in Egypt. It also relates the types of financing tools to the needs of your company at different points in time. The Guide aims to provide details of requirements of the different types of institutions as prevailing in early 2010. Where relevant, it provides action steps to be taken by your company in order to make matters easier when you approach a certain company or bank seeking finance. Additional details and sources of information or support can be found in the annexes of the Guide.

B. Who should use this Guide

This Guide is designed to be of relevance to any enterprise that can be seen as an SME by any of the concerned authorities or individuals. We believe this applies to all formally established businesses of any size or scale - excluding the large or corporate enterprises - that cannot or do not have sources, capabilities or access to finance tools and their proper pursuing.

Given its structure and design, this Guide is useful for any entity who has previously tried to seek financing and found the process and/or the requirements too complicated. It is also useful for any entrepreneur who is eager to start up his/her business in a formal way. For well established companies seeking to grow through public listing in the stock exchange, or seeking association or merging with a larger organization or an equity fund, this Guide is also useful for understanding the needs and demands of such entities.

C. How it is designed

This Guide is intended to be practical and useful, using language that is easy to understand. It also looks at the financial institutions and instruments that are formalized and regulated in Egypt, i.e. where the companies providing the service are licensed by the government and monitored by a regulatory body. Therefore, it will not refer to other alternatives that you may be aware of, but will touch upon them in an informal manner.

The Guide is written in five sections, each addressing a major area of relevance. It also includes annexes with additional useful links or details, such as key financial ratios that are easy to calculate, list of useful websites, and a glossary of key terms and definitions.

D. The Limitations

This Guide provides several tips and useful ideas for action that you can internally implement in your organization to improve your chances of gaining access to finance. Therefore, the Guide is expected to be a starting point for your company to take actions, rather than an end in itself. Additional information can be found from many sources such as the websites of the different regulatory bodies, banks, financial institutions, or supporting organizations such as the Industrial Modernization Center. Moreover, service providers such as financial advisors and consultants can always be sought if you feel a need for a larger scale intervention to improve your company's performance or readiness for the future.



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Section 2

Financial Sector Overview

Section 2

Financial Sector Overview

The Egyptian financial sector represents the group of institutions, public or private, that can help small and medium companies obtain access to finance. The discussion of the financial sector and instruments in this section will focus on the existing and emerging types of institutions and instruments that are operational in Egypt in a formal manner. That is, they are operating under license and are regulated by a certain authority or body. The objective of this section is to give you an overview of how the sector is organized as a basis for discussions in the following sections.

A. Introduction

While 30 years ago any Egyptian company seeking external financing had no option but to go to a bank for borrowing, or a new partner to join the business, the options now available are much more varied and the sector has evolved and matured significantly over the past few decades.

Different types of financial instruments prevail. Some are long term and others are short term. However, the focus of analysis in this Guide is on debt financing and equity financing.

Debt financing is presented as a liability on a company's balance sheet and represents a legal obligation on the company. It is paid back on regular intervals, in the form of installments of the principal taken, in addition to the applicable interest charges.

Equity financing is a contribution to the capital of the company and typically the provider retains ownership of part of the company.

The investors expect returns on the money they invested either in the form of profit distributions at year end, or dividends if it is a joint stock company. Equity financing does not require a pay back of the amount invested. However, Investors may be seeking a capital gain on their investment, when they sell their share of the business if they decide to exit or their stocks if the company is a joint stock

company. Capital gain is a multiplication of the value of the original investment, due to success of the business. The following sections will discuss in more detail different types of instruments under each category.

There are different types of financing institutions now active in Egypt that provide both equity and debt financing, in addition to banks. Therefore, we shall divide this sector in two parts; the banking sub-sector, and the non-banking sub-sector.

B. Overview of the banking sub-sector

The banking sub-sector in Egypt has gone through a number of stages and reforms. As of 2010, there are 39 banks operating in Egypt that vary in size and in range of products offered. And they collectively operate through 3107¹ branches across Egypt.

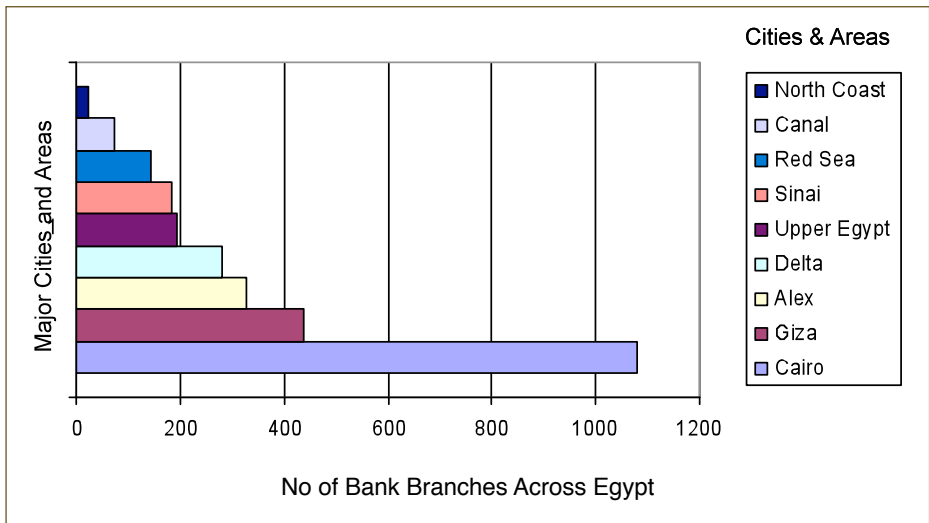


Figure 1 - Number of Branches Across Egypt²

Banks are regulated financial institutions that act as intermediaries between those persons and entities saving money (in the form of different types of deposits), and persons and entities borrowing this money (in the form of different types of loans). Therefore, banks are a crucial pillar of the economic cycle in any country.

Source 1: CBE & certain bank websites
 Source 2: Central Bank of Egypt

Traditionally, Egyptian banks had focused on serving corporate clients, who are typically well established businesses with a strong track record and collateral base, which makes them good clients for banks to serve, or “bankable” companies as commonly referred to by bankers. However, over the past few years the banking sub-sector has undergone significant change in the types of products offered and the strategic focus of banks. This change is partially a result of a well implemented reform agenda. As a result, nowadays we see banks expanding their operations into areas other than corporate banking, such as retail banking (focusing on the individual consumer) and SME banking, focusing on small and medium enterprises.

Banks offer short term and long term financing in many forms. Overdraft facilities, letters of credit (L/C) and letters of guarantee (L/G) are forms of short-term financing that are usually offered by the same bank that handles your business accounts, against reasonable commissions and fees.

Longer term financing from banks are usually in the form of loans, which extend for a period of 15- years. Agreeing on a loan takes some discussion and negotiations, after which the bank lends you money, with repayment over a set number of installments, in addition to a particular interest rate.

Banks may also require a guarantee, which is called collateral. This guarantee takes the form of assets, where the bank requests that the business would provide the bank some sort of contract or ownership of certain assets that would leverage the value of the requested loan. Normally this collateral is mortgaged in favor of the banks, so that the bank has access to a valuable asset that they can liquidate in case of default. The default happens when the borrower is unable to pay back the loan and cannot agree on a rescheduling arrangement with the bank. Therefore, the bank seeks collaterals as a way of managing its own risk and minimizing its loss in case their client fails to pay back the loan.

The banking sector is regulated by the Central Bank of Egypt (CBE), which sets the rules for the operations of the banks and oversees their performance.³ The CBE, supported by its training arm, the Egyptian Banking Institute (EBI), aim to encourage banks to increase the focus on financing SMEs. As a result, and as of early 2010, many banks have already set up a specialized unit to deal with SME clients, usually under the name of SME Unit or Mid Cap Unit, or a similar name. Those units have officers who are dedicated to dealing with SME clients, understanding their business needs, and are well trained to address their issues and problems. These units are also expected to have different decision making and evaluation criteria with regards to loan approval. Therefore, for any SME approaching a bank for borrowing, ideally they should approach the SME unit of that particular bank.

3- In January 2009, the CBE issued a directive that exempts banks from the reserve requirement of 14% of the deposits in relation to loans given to SMEs. What this means is that for banks, it costs them less to lend to small and medium enterprises than lending for larger corporate clients.

C. Overview of the non-banking sub-sector

Institutions included in this sub-sector are all the other types of financing institutions that are operational in Egypt providing either equity or debt. This sub-sector has evolved rapidly over the last few years. As of July 1st 2009, this sub-sector is regulated by the Egyptian Financial Supervisory Authority (EFSA).⁴

1. Major types of institutions in this sub-sector

This sub-sector includes many types of institutions, such as insurance companies and mortgage companies. However, in relation to this Guide, we will select the institutions that provide either debt or equity financing for SMEs.

1. Factoring Companies

Factoring is a new concept in the Egyptian market. Currently there exist only two factoring firms in Egypt but that number is expected to increase in the next few years. Factoring firms mainly perform a financial transaction whereby a business sells its accounts receivable (i.e. invoices) to a third party (called a factor) at a discount in exchange for money which can be immediately injected in the business. Factoring differs from a bank loan in three main ways. First, the emphasis is on the value of the receivables (essentially a financial asset), not the firm's credit worthiness. Secondly, factoring is not a loan – it is the purchase of a financial asset (the receivable). Finally, a bank loan involves two parties whereas factoring involves three.

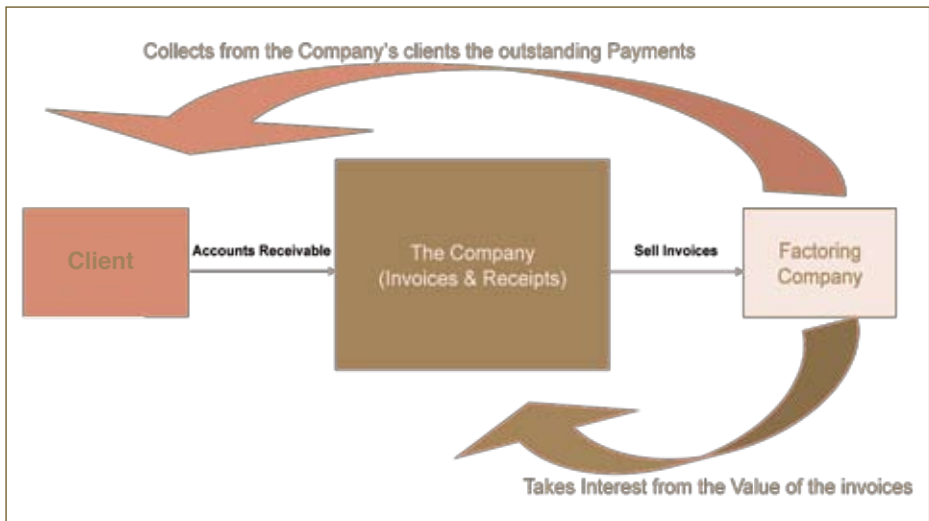


Figure 2- Factoring workflow

4- EFSA was established by Law # 10/2009. and is the result of the merger between the Capital Market Authority, the Egyptian Insurance Supervisory Authority and the Mortgage Finance Authority. EFSA oversees non-bank financial markets and instruments, including the capital market, insurance services, mortgage finance, financial leasing and factoring.

2. *Financial Leasing Companies*

Financial leasing is also relatively new, but rather more developed than the factoring services in the Egyptian market. Several financial leasing companies exist in the market and their structure is more mature. Financial leasing has been adapting and growing rather rapidly indicating increasing demand on its services.

Financial leasing is less complicated than banking loans, and takes less time. Active companies provide a wide range of leasing products and services, including vendor finance, direct leasing, small and medium-sized enterprise financing, and structured finance.

The leasing company buys the asset chosen by the end-user (your business). The leasing company (the lessor) then rents the asset to you (the lessee) over a certain period, generally one to five years (up to seven years for real-estate leasing). The lessee pays rents as agreed in the leasing contract (monthly, quarterly or semi annually). The rents can be fixed or variable, and can be in Egyptian pounds or in a foreign currency. Leasing gives you the advantage of avoiding a large cash outflow in the purchase of the assets. Rather, you pay for the asset in smaller installments (rents) over the number of years agreed with the leasing company, and this shows as a cost in your financial statements. At the end of the leasing contract, the leasee has the option to buy the equipment for the residual value stated in the contract.

3. *The Capital Market*

The Egyptian Exchange (EGX)-previously known as the Cairo & Alexandria Stock Exchanges, is the country's only securities exchange or capital market. The EGX represents the market where listed companies can access both equity and debt financing in the form of issuing stocks or bonds. Companies listed in the capital market are referred to as publicly listed companies. In the past two years, in an attempt to facilitate access to the stock exchange for smaller enterprises operating in Egypt, NILEX was set up as the market for smaller companies, whose capital ranges from LE 500,000 to LE 25 million.⁵

NILEX had its first filing for listing in June 2008. It is established with the purpose of providing medium and small fast growing businesses, including family-owned businesses, from any country and any industry sector, a clear access to capital and the benefits of being traded.⁶

In order to facilitate access to NILEX, the listing requirements and procedures were designed to be simpler than listing in the Egyptian Exchange.⁷ In addition, NILEX has identified a list of Nominated Advisors (or Sponsors) for the SMEs that act as coordinators between the company seeking listing and NILEX. There are a number of approved nominated advisors that you can easily pursue.⁸

5- As of the CIPE/EJB roundtable event on 22nd February, 2010, NILEX representative announced that there is a decision to increase the maximum capital to LE 100 Million, awaiting approval of the Board.

6- <http://nilex.egyptse.com/en/>

7- http://nilex.egyptse.com/en/download/pdf/Listing_Disclosure_Rules.pdf

8- http://nilex.egyptse.com/en/Nominated_Advisors_List.aspx

As defined by NILEX, the role of the Nominated Advisor is to:

- Advice and assist the applicant company on all its responsibilities during the application process and its responsibilities to maintain its status once listed.
- Help the listed companies to fulfill its ongoing disclosure obligations.
- Inform the EFSA in case of the company's non compliance with the rules and regulations.
- Help the company in its initial public offering of its shares.
- The advisor's obligations and responsibilities will be maintained for two years from the date of the company's listing.

4. *Equity Funds*

An equity fund is a pool of money contributed by a group of investors for the purpose of investing in high growth companies, on equity basis, and generating significant return on this investment in a matter of a few years as a result of the increase in the value of the company they invested in. Typically, the fund exits from this company through selling its share to the original owners, new owners, or the public if the company is listed. During the period of partnership, the funder, (which is a professional company composed of experts) is usually involved in the management of the company, supporting the original owners, in order to maximize the value of the company through growth and successful operations.

There are two types of equity funds operating in Egypt private equity funds and venture capital funds.

Private Equity (PE) funds are typically interested in investing in an existing company with a history or track record in place. There are more than 10 players in this domain that range in the size of their fund and in the type of company they are interested in. Most of those players have been previously focusing on large companies with significant capital and big operations, either in the public companies offered for privatization and in need of modernization, or in the private sector companies with significant growth potential. Recently, some of those PEs have set up dedicated funds and teams to invest in small and medium enterprises, working with different criteria for investment. However, most of those SME funds would still focus more on the medium rather than on a small sized company. Most PE definitions of medium depend on the annual turnover (sales revenue) of the company, ranging between LE 20 to 200 million.⁹

The other type is Venture Capital (VC) funds, which are funds that seek investment in start-up companies with very good success potential. They typically support entrepreneurs with innovative ideas that can be successfully commercialized. They are called Venture Capitals because they are taking higher risk by investing in new companies that have no track record or history hence;

9- CIPE/EJB PE Round Table event, 22 February, 2010.

they are getting into a venture. Currently, most VC activities in Egypt take place by the existing PEs as only very few funds are dedicated to start-ups alone.

Both VC's and PE's, look into the company's business to evaluate the profitability or expected return on investment (ROI), and negotiate a deal with your business on how much money or capital they will give you in return to the percentage of ownership or shares they will hold within your business. This transaction requires a lot of negotiation and preparation work. For example, if a PE is interested in your company, they will conduct a due diligence and/or valuation of the company.

This value determines how much your company is worth at the point of time they enter into a deal with you. It also determines how much their injected capital will represent as a share of your company.

Once a deal is agreed, the legal type of your company will have to be changed to joint stock status. PEs then act as mentors and coaches for the company's management, helping them identify growth prospects and take actions to realize the foreseen potential of the business. In a matter of few years, successful deals result in the value of the company multiplying as a result of real growth in operations and profits. This success is shared by both, the company's original owners and the PE, which might opt to exit from the business at this point in time, or buy out the original owners if they wish to exit.

D. Strategic Investors as a Source of Financing

While they do not fall within the financial sector, strategic or equity investors are key players in facilitating access to finance for SMEs. Strategic investors are larger companies that usually operate in the same industry sector of your company, either as suppliers, customers, or competitors.

They can be local or international companies, who have an interest in partnering in your business. Strategic investors would consider an SME only if they can see significant prospect for growth and high potential. They also may feel the SME can achieve this growth if a turnaround of operations and management style is achieved. They contribute capital to your company to help it expand and in return seek a share in the profit of the company. They also become equity investors, for the longer term, so they are in effect taking the risk of any loss of the company as well.

We can also add to equity investors what is termed as "Angel Investors". These are also individuals or companies that can finance an entrepreneur or a start-up company by contributing capital against a share of the business. They are usually friends or family members, or funds set up to finance new businesses.¹⁰

A deal with a strategic investor can be negotiated and agreed much along the lines of a deal with a PE fund. The key difference is that Strategic Investors are usually more involved in management or even perform an integration of the SME business into their larger enterprise (merger and acquisition activity). They also have a longer term perspective, as they may stay with the business indefinitely, while PE funds usually have a clear exit strategy in place.

¹⁰- There are no Angel investor funds neither in Egypt, nor outside Egypt. They are always individuals.

E. Benefits and Challenges

The following table summarizes the key benefits of seeking each type of financing institution and the related challenges that must be considered by the SME to have better access to finance.

Table 1- Financial Institutions Comparison

Financial Institutions	Benefits	Challenges
Banks	<p>Reliability - Loans are reliable and secure, you are assured the money for the duration of the loan (unless you violate terms and conditions), and the odds of a bank or major lender requiring immediate pay back is very small. You will also be fully aware of what you owe and your repayments (unless you choose a loan with a variable interest rate).</p> <p>Cost - Compared to many other forms of finance, a bank loan is reasonable in cost. Although loans are not cheap, they do not have the interest rates or charges of credit cards and overdrafts, and do not require you to give up a portion of your business as you would with investors.</p>	<p>Inflexible - Once payment terms have been set you need to stick to them, and if you borrow more than you need you could end up paying lots of extra interest needlessly.</p> <p>Security - If your loan is secured against assets, there will be the risks if you are in default. Having the loan secured does provide lower interest rates, but it means you need to be more careful about repayments; and also be very wary of borrowing more than you can afford to repay.</p> <p>Charges - Most large loans will have an arrangement fee when you first get the money, while many will charge you if you repay the loan before the end of the agreed period.</p>
Leasing	<p>Rates - leasing offers fixed rate financing; you pay at the same rate each month.</p> <p>Leasing is inflation friendly. As the costs go up over five years, you still pay the same rate as when you began the lease.</p> <p>There is less upfront cash outlay; you do not need to make large cash payments for the purchase of needed equipment.</p>	<p>Obligations - You have an obligation to continue making payments. Typically, leases may not be terminated before the original term is completed. The renting party is responsible for paying off the lease. This can create a major financial problem for the owner of a business experiencing a downturn.</p>

Financial Institutions	Benefits	Challenges
	<p>Utilization - Leasing better utilizes equipment; you lease and pay for equipment only for the time you need it (until the end of the lease). There is typically an option to buy equipment at end of the term of the lease.</p> <p>Upgrading - You can keep upgrading; as new equipment becomes available you can upgrade to the latest models each time your lease ends.</p> <p>It is easier to obtain lease financing than loans in most cases.</p>	<p>Lack of Assets - You have no or limited Asset until you decide to purchase the equipment at the end of the lease term, at which point the equipment may have depreciated significantly.</p> <p>Responsibility - Although you are not the owner, you are still responsible for maintaining the equipment as specified by the terms of the lease.</p>
Factoring	<p>Instant Cash - The main advantage of factoring is that you receive cash instantly without having to wait for your accounts receivables to be paid. In other words you do not have to wait for your various credit invoices to be paid, and this adds a significant advantage to business that work in industries with slow cash conversion cycles.</p> <p>Improving Cash Conversion Cycle This process improves your cash flow and depends on the number of outstanding collectable invoices you submitted to the factoring company you contracted. It will also allow you to make regular collection.</p>	<p>Credit Limits - the Factoring company will want to set credit limits for customers which may affect the way your company trades or conducts business.</p> <p>Terminating the Contract - Sometimes it proves hard to exit the agreement with the factoring company, due to accounts receivable difficulties.</p> <p>Disputes - Disputes over the invoices must be dealt with quickly to avoid them being re-coursed.</p> <p>Collections - In the case of factoring, you are reliant on the factor to collect the debt in a timely and efficient manner.</p>
NILEX¹¹	<p>Relaxed listing requirements More flexible listing rules compared to the main market, with respect to the minimum capital, number of shareholders, number of shares to be offered to the public as well as the company's financial track record.</p>	<p>Listing rules</p> <p>A. The applicant company must have a nominated advisor approved by the EFSA.</p> <p>B. The following conditions are required for the mid and small cap companies to list their securities on NILEX:</p>

¹¹ - Sourced from the website of NILEX: <http://nilex.egyptse.com/en/>

Financial Institutions	Benefits	Challenges
	<p>Lighter disclosure Rules - The mid and small cap companies are to submit their audited annual financials to the exchange and the Capital Market Authority, while quarterly and semiannual financials are to be approved by the company's management only before submission.</p> <p>Helping the company in the listing and offering process</p> <ul style="list-style-type: none"> • There is a nominated advisor who helps the applicant company in getting listed on the exchange and in the initial public offering of its shares. • The nominated advisor also helps the listed company to abide by the listing and disclosure rules and assists the company in preparing its financial statements and submitting them in due time. <p>Lower listing and trading fees</p> <p>The annual listing fees levied on medium and small enterprises are reduced to 0.5 per thousand of the capital with a minimum of L.E 500 and a maximum of L.E 30,000.</p>	<ul style="list-style-type: none"> • All listed securities must be deposited at the Central Depository. • The company's by-laws or the issuing terms should not include any constraints on the trading of the securities to be listed. • The issuing company must have financial statements for at least one fiscal year preceding the listing application. • Shareholders equity should not be less than 50% of the company's paid capital in the year preceding the listing application. • The issued capital should be fully paid at a par value ranging from L.E 1 to L.E 5 per share. • The number of issued shares to be listed should not be less than 100 thousand shares. • The minimum free float should be at least 10% of the total issued shares and the number of shareholders should not be less than 25. <p>Financial statements & reports</p> <p>The listed companies should submit their quarterly and semi annual financial statements, approved by the company's management, within 45 day from the end of the period and should submit its audited annual financial statement within 90 day from the end of fiscal year of the financial statement.</p> <p>The exchange will publish the companies' financial statements and financial results for only one day on the trading terminals. Moreover, the General Assembly's decisions concerning dividend distribution and dividend dates are to be published via trading terminals and the website of the stock exchange.</p>

Financial Institutions	Benefits	Challenges
<p>PE & VC</p>	<p>Raise Capital – PE and VC allow the business to raise capital without having to pay any charges or financial loans. This method allows the business to focus on its expenses and management rather than trying to finance loan payment on a set period of time</p> <p>Mentoring – PE & VC provide companies with ongoing strategic, operational and financial advice. They will typically have nominee directors appointed to the company's board and often become intimately involved with the strategic direction of the company.</p> <p>Alliances – PE & VC can introduce the company to an extensive network of strategic partners both domestically and internationally and may also identify potential acquisition targets for the business and facilitate the acquisition</p>	<p>Size - Most PEs operating in Egypt would focus on the medium sized enterprise, rather than the small enterprise.</p> <p>Pricing – PE & VC are typically more sophisticated and may drive a harder bargain.</p> <p>Intrusion – PE & VC are more likely to want to - participate in the strategic direction of the company. Although PE's are less likely to want to get involved in the business unless required.</p> <p>Control – PE & VC are more likely to be interested in taking control of the company if the management is unable to drive the business.</p> <p><i>Note: Most PEs are interested in gaining majority stake of the company, unless it is pursuing a specific strategy to allow the company it is acquiring to perform at the same level and standard.</i></p>

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Section 3

How to choose the right financing option for your company

Section 3

How to choose the right financing option for your company

Choosing the right financing option for your company is a major decision that will surface at many points in the life of your business.

There are 4 different factors to consider when facing a financing decision:

- 1. The reason for raising funds:** most start ups raise funds to acquire the needed resources to operate their business, such as machinery, material, and human resources. As time goes by, many expansion decisions such as expanding your sales or increasing your production capacity would require additional funding. The reason for requiring funding will influence the source of financing available to you and accordingly how easy it will be to obtain financing
- 2. The possible sources of financing:** self-financing is a suitable option when the business owners can afford to contribute the additional funds. In many cases, retained earnings from previous prosperous years are the best source of funding for expansion. When owners' additional funds or retained earnings are not available, seeking external financing would have to be undertaken, in the form of either debt or equity financing
- 3. The payback method:** debt financing requires regular payments of both installments and interest. While debt financing has a tax advantage, it creates the burden of regular cash outflows in paying back the principal and interest payments. In contrast, equity financing does not require regular cash outflow, but the new shareholders will typically need a share of the resulting net profits
- 4. The liability risk:** debt financing is a commitment on the company and an obligation to pay back regularly. The risk of default means the business can go bankrupt or the debt holder can seize the assets of the business, especially if they have been provided as collateral. Alternatively, equity financing represents a shareholding participation and the owners will not take the company to court if no profits are distributed.

Accordingly, the choice of the most suitable financing option has to be thought through very carefully.

A. Aspects to consider before approaching a financing institution

Financing institutions that were discussed in Section 2 are profit seeking enterprises. Therefore, and depending on the financing instruments they have to offer, they are all seeking to generate profit from their business, as much as you are. Therefore, most financing institutions always assess the risk involved before providing money to a company.

This section aims to achieve two objectives. On one hand, it provides a perspective of what financing institutions may be concerned about when looking at SMEs, in particular focusing on the aspects of risks and sustainability. On the other hand, it offers a discussion of aspects you have to consider before selecting a certain type of financing institution, as each type of institution will be more suitable at a certain point in time.

1.Risks

Any type of business, whether the world's largest multinational companies or the smallest start ups, faces risks on a daily basis. The financing institution is very keen to assess and evaluate the risks that your company is facing in order to make a decision to provide you with finance. The riskier your business turns out to be, the higher the return the bank would require in the form of higher interest rate, or the higher the return your equity financier will require, in terms of higher return on their invested money. Therefore, risk is a crucial factor considered by any financing institution.

Types of risks

There are many types or risks that the financing institutions will always see when you apply to them. We discuss here the major types that are usually considered:

- a. Sector risk:** this is the risk associated with the sector or industry you are operating in. Some sectors are more risky than others due to many reasons. For example, the tourism sector is perceived as high risk due to its high dependence on security and stability of the country. This applies to any country in the world. Other sectors that are highly dependent on evolving technologies are also very risky, because technology seems to change faster than we can imagine. For example, computer chip manufacturers are faced with the challenge that their industry is changing very rapidly due to the advances in the computer processing technologies, hence making their business highly risky. Sector risk

may also arise from factors that relate to the regulatory or political conditions within the country you operate in. What is most important is that sector risks will be the same for all companies operating in the same sector. So, it is evaluated in the same way for you and your competitors.

- b. Company risk:** this type of risk will be particular to your company. It will be evaluated based on many factors such as the history of your company and whether you have succeeded before, and for how long. It will depend on your management team and their capabilities and experience. It will also depend on how your business is structured and organized in the sense that the longer your business is operating in a formal and organized business manner, the better it will be perceived. (See Section 5 for more details). Therefore, this type of risk will be evaluated differently for your company compared to your competitors. More importantly, different financing institutions will evaluate your company differently on this dimension.
- c. Project risk:** this type of risk will be very specific to the project that you are raising financing for. This risk will also be evaluated differently by different types of financing institutions, and also from one institution to the other. For example, if you are raising funds to buy a production line for a completely different product you will be working in for the first time with no track record of success, it will be seen as more risky than if you are raising funds to extend the production line of your current product, which you have been producing and selling for years. The financing institutions will see the second case as less risky than the first and be more willing to finance the second case.
- d. Foreign exchange risk:** if your business trades internationally, and parts of your costs or revenues occur in a foreign currency, the risk of the fluctuation of the price of foreign currency represents a concern for your business, and the financing institutions that you approach for funding. When foreign currency represents a significant portion of your transactions, you are expected to account for the foreign exchange risks through taking measures to hedge against their fluctuation, in order to minimize your losses.
- e. Operational risks:** those are risks very particular to your business which will be considered by a financing institution. Those include aspects such as the expertise of your management team, and whether your business depends on one person alone or is well organized and can run as an independent entity. Other aspects include dependence on a certain technology and how fast this technology may be obsolete. If your business is a high tech company, internal plans to overcome this must be in place. Businesses that are based on unique ideas have the risks of those ideas being stolen or copied, which wipes your competitive advantage overnight. Therefore, it is important for those types of businesses to protect their intellectual property through patents and registration of intellectual assets. Alternatively, businesses that heavily depend

on tangible assets run risks of failure due to loss, breakdown, or fire for example. Insurance against those types of losses, and measures to protect the integrity of the physical assets such as maintenance are important to overcome those risks.

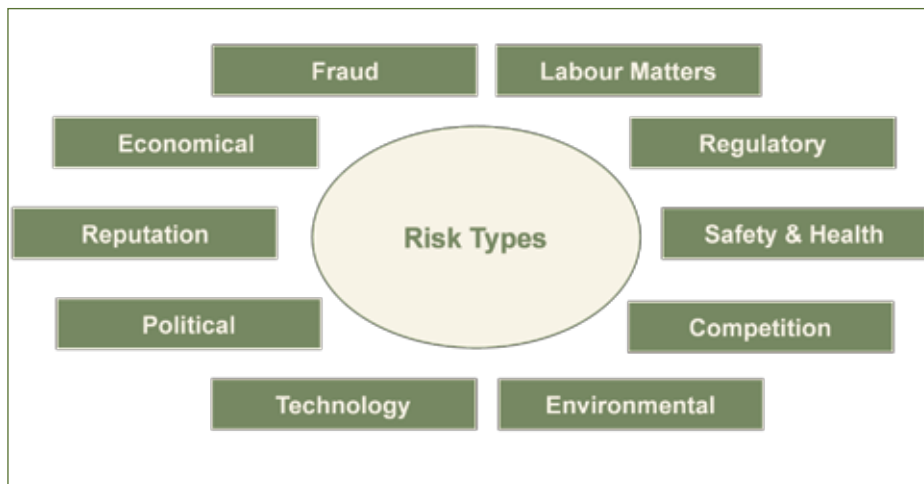


Figure 3- Selected Types of Enterprise Risks¹²

There are additional types of risks as illustrated in the above diagram.

Therefore, before approaching financing institutions, you need to understand the different types of risks associated with your request for funding because this will help you approach the type of institution that will be more willing to finance you.

2. Sustainability

Any financing institution will be looking at your business with one key question: is this company here to stay or not? This is simply sustainability, which is your company's ability to continue to exist, operate, and hopefully grow in the face of any risks related to your business environment.

Therefore, the different financing institutions will look at your business sustainability for different reasons:

- a. **Debt financing:** debt financing institutions will care about the sustainability of your business because they want to ensure that you pay back the amount of money you owe them, in addition to interest which will make their business with you profitable. If your business is bankrupt tomorrow for any reason, they would incur a loss.
- b. **Equity financing:** equity investors are seeking longer term return on their investment in the form of profits from the business. If your company continues to make loss or shuts down, they will incur a loss.

Therefore, all institutions will look at your business with an eye on the future. They will seek to know if your business can continue to operate, has the potential to grow or not, and will be profitable or not. They will look at aspects such as whether your product or service can continue to be sold in the future, which means they will check if there is enough market demand for your product or service in the markets you operate in, locally or internationally. They will also look at the management structure and the skills of the management in your company. More importantly, they will look at aspects of how your business is organized and formalized. For example, if your business is dependent on one person for its success, and you don't have any management staff in place, and you don't have any tools to make this business sustainable if this one person is absent, the financing institutions will be reluctant to fund your business. Also, if your business is dependent on one product and one client, the financing institution will be worried what your business will look like if your client leaves for a competitor. Therefore, aspects of the sustainability of your business are crucial to all types of financing institutions. (See Section 4 for more details).

B. Selecting a suitable financing option

To choose the right financing option you must evaluate many aspects of your organization's environment, both internally and externally. You also need to evaluate your company so that you can take a more informed decision on whom to go to for financing. There are many aspects you should look into:

The Industry and sector you operate in may make some institutions more or less willing to finance :

You must understand that financial institutions may consider your sector or industry as risky to deal with. For Example, if you work in a certain industry that has been performing badly over the past years, with little or no growth, and many failure stories, some institutions may not prefer to extend finance to this sector until circumstances change.

Industry performance can be viewed from different perspectives. The most important perspective is growth over the past years, and the potential for more growth in the future. The term "booming industry" is usually used to describe an industry enjoying growth over the years. These industries would be appealing to many types of institutions. Alternatively, an industry that may be stable, or in the maturity stage with little potential for growth, may be appealing to the lending institutions, such as banks who would see this industry as stable. Equity investors who are seeking growth will be less willing to finance a company in an industry in the maturity, or stability stage.

More specifically, there are some key indicators that can be applied to all industries in order to assess their attractiveness to the financing institutions. We have selected two of the most commonly used indicators:

- 1. Cash Conversion Cycle (CCC):** A metric that expresses the length of time, in days, that it takes a company to convert resource inputs into cash flows. The cash conversion cycle attempts to measure the amount of time each net input pound is tied up in the production and sales process before it is converted into cash through sales to customers and collection of receivables. This metric looks at the amount of time needed to sell inventory, the amount of time needed to collect receivables and the length of time the company can afford to pay its bills without incurring penalties.

(Calculated as: CCC= DSO+DIO-DPO)¹³

$$= \frac{\text{Receivables conversion}}{\text{period}} + \frac{\text{Inventory conversion}}{\text{period}} - \frac{\text{Payables conversion}}{\text{period}}$$

$$= \frac{\text{Avg. Accounts Receivables}}{\text{Revenues} / 365} + \frac{\text{Avg. Inventory Days}}{\text{COGS} / 365} - \frac{\text{Avg. Payable Days}}{\text{COGS} / 365}$$

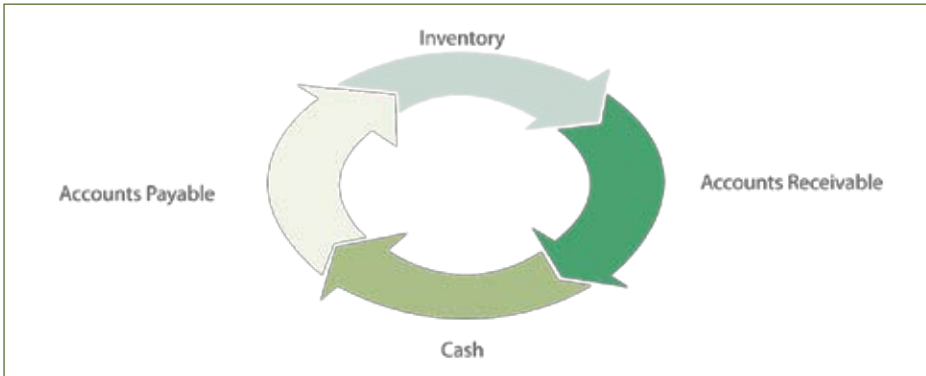


Figure 4- Cash Conversion Cycle

2. Tangible assets: An asset that has a physical form such as machinery, buildings and land and gives its owners a definite set of financial rights .

Each of those two perspectives has its audience. For example, if you have strong tangible assets linked to your company then you may find that financial institutions such as banks are more inclined to deal with you, as they would normally use the tangible assets as associated with the type of industry you deal with. Additionally, banks may also look at your cash conversion cycle to see if you are able to pay the loan installments and related interest.

Financial institutions such as leasing companies will mainly look at the CCC to ensure you are able to pay the installments required to finance your asset. Unlike banks, leasing companies do not take collateral from the company; this is because they already retain ownership of the assets that they lease to a company until the end of the leasing period.

¹³- D IO: represents days inventory outstanding
 DSO: represents days sales outstanding
 DPO: represents days payable outstanding

Most financing institutions may look at the cash conversion cycle as an indicative measure of how quickly a company can convert its products/services into cash. The shorter the cycle, the less time capital is tied up in the business operations, and thus the better for the company's bottom line. This generally attracts financial institutions of different nature, such as equity investors. More specifically, the forecasted cash flow from operations would be particularly important for institutions such as private equity firms who are generally interested in the returns from investing in a certain company.

Private equity funds and other equity investors would also look beyond the CCC and asset base of your company. They will focus on value creation within your business. Value creation derives from the company's ability to grow and generate more revenues and profits in the future. This is because they usually seek to exit from the business within a number of years, after having achieved greater return on their investment, when the value of the company has multiplied.

C. Your company will attract certain institutions at certain times

All companies, small, medium or large, or even global multinational companies, go through the same stages of evolution, usually referred to as the life cycle. Each stage of the life cycle, as indicated in Figure 5 diagram, has different characteristics for the company. Therefore, in each stage the company may find access to financing easier from certain institutions versus others.

There are five stages in the life cycle. You should always be clear on where your company currently stands and how you plan to take it to the next stage. Each stage has different implications for your business and also has different requirements for success than the previous one. Those requirements can be financial, strategy related, management related, or governance related.

The Five stages of the Life cycle:

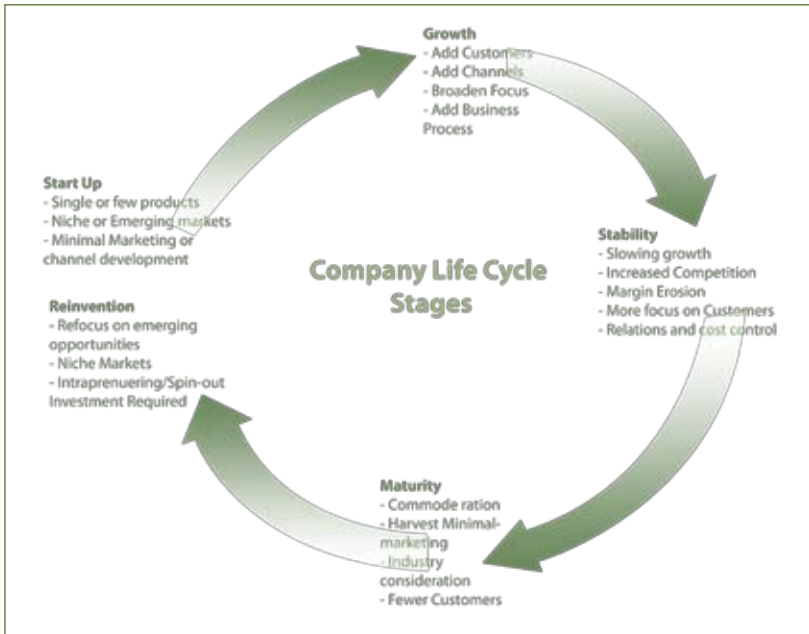


Figure 5- Life Cycle Stages¹⁴

1. The first stage is called establishment or start up. This is when a person, usually called an entrepreneur, comes up with an idea for a business that makes use of a good opportunity in the market place. This entrepreneur may decide to start a business on his/her own or in cooperation with others, usually friends or colleagues, and sometimes family members. This stage requires two very important inputs: the capital needed to set up the business formally and the flexibility and hard work of the entrepreneur or founder to make the business succeed. At this stage, the founder(s) must also be very clear on how their business idea will benefit from the market opportunity that they see, in order to make a success story out of it. This stage is expected to last for a year or two, and sometimes more, after which the business should be recognized as a success or a failure.

At this stage, most of the financing needed for your company will come from the founder(s) in the form of capital invested in the business. External financing needed will be easiest to obtain from a public authority or government fund that is dedicated to support entrepreneurs, such as the Social Fund for Development. Similar initiatives may be provided by other development organizations or donors. An alternative source of financing will be a Venture Capitalist (VC), which is either a fund, a company, or an individual investor who has a strategic focus to invest in start-up companies. However, the VC will invest only when he/she is sure that the business ideas you have present serious success potential and can generate the required returns (profits)

14- Churchill, N., and V. Lewis. "The Five Stages of Small Business Growth." Harvard Business Review 61, no. 3 (May/June 1983): 30-50. Adapted by PricewaterhouseCoopers

Financing choose the right financing option for your company

in the near future. They will be keen to see a business plan with clear forecasts of sales and cash flows. At this stage, few or no banks will be very keen to invest in your company because you neither have a track record of success nor the necessary level of tangible assets that can be used as collateral. Your business is viewed as risky in this stage and accordingly, only high risk taking investors will be willing to finance you.

2. The second stage is growth. Once established and the business idea proved viable in a matter of a year or two, the company should now start to focus on generating greater revenues through expanding the customer base and the range of services/products sold. This growth is measured by a number of criteria, such as the number of employees, the number of activities taking place inside the company, and changes in the organization culture into an evolving business with somehow formal operations and structure. Two important factors of success at this stage will be access to finance to grow the business more and the maturity of the company's management and decisions making process. At this stage, the founder(s) would have started recruiting professional specialists to manage the different functional areas within their business, such as marketing, sales, and production. The founders are now focusing on expansion and growth as strategic issues, rather than managing the day to day activities of the business as they did in the start-up stage.

At this stage, equity investors such as private equity funds or VC funds, and individual investors will be most interested in your business. This is because your business will be on a rising curve and would be expected to generate higher revenues and profits in the coming few years due to the growth of operations, provided that your industry is also in a growth phase as well. In this stage, you are also performing better than competitors and you are expected to continue to increase your market share, all factors appealing to equity investors. Lending investors or banks will be selective in financing your business very much depending on their evaluation of the riskiness of your company and industry, and whether they are interested in your sector as a whole, and in the case of banks the type of facility you are asking for. At this stage, you would have a track record of success and also a number of tangible assets to provide as collateral to lending institutions, which should make your position easier to get debt financing than in the previous stage. An alternative financing mechanism at this stage would be to raise growth equity or expansion capital, through the existing owners or external equity financing institutions, or strategic investors. All equity investors would be keen to assess the viability and future value of your business before making a deal.

3. The third stage comes in the form of stability. Where normally a company would have come out from the growth stage with a lot of lessons learned and have settled into a more stable mode of operations and structure. This stage is when the company decides on what and how to stabilize itself in the market and at this point the fears of inexistence and instability should be erased, in other words the company's long term future should be secure. At this stage the most important requirements are monitoring the market changes and the competitors, and improving the internal company operations and activities to respond to market opportunities and threats, in order to ensure sustainability of the business in the long term. Most companies in this stage would have been operational for a few years already. Internally, the company should by now be well organized and institutionalized to a large extent.

At this stage debt financing is much easier to obtain for expansion projects requiring either capital investment or working capital growth. Banks would have better appetite for providing financing because your company has a solid history and clear future plans by this time. Again, this does not preclude the assessment of the sector and project risks as discussed earlier. On the other hand, this is when a company can benefit the most from public listing in the stock exchange. Listing provides the benefits of raising additional equity financing through issuing new shares to the investing public, or debt financing through issuing bonds. At this stage of its evolution, the company should be very well organized internally and has structured business processes, decision making capability, and a formalized business and operation structure and activities that enable it to effectively meet the requirements of public listing, such as regular reporting of performance and financial results (see Section 4 for more details)

4. The fourth stage is maturity. Where the business is now stable enough to survive most unforeseen circumstances or financial difficulties. At this stage, the company would have accumulated enough experience and earnings that it can sustain itself during hard times, such as an economic recession or slowdown which can last anywhere between a few months to a couple of years. During this stage, many companies that had been unable to adapt and “organize the house internally” will have already died or ceased to exist. In terms of financing, the company should at this stage have a solid capital structure, including a reasonable debt to equity ratio, combined with a strong base of operations and enough backing to ensure that even if the market becomes unstable, it can pull through the hard times. By this stage, companies can also revise their overall business strategy and rearrange the managements plan, deciding on what parts of the business to keep or replace (in terms of products sold and markets served). Most companies would be classified as large in this stage. Management buyout by new equity investors or funds may take place at this stage, when the founders can capitalize on their success, and exit from the business having achieved considerably high returns on their original investment.

During this stage, debt financing is again the easiest option to obtain for non-listed companies. For the listed company, a mix of debt and equity financing can be obtained through the stock exchange. Additionally, companies at this stage may be the target of mergers and acquisitions by other larger companies, who could be from within the same sector (customers or suppliers, or competitors of your existing company), or a different sector, from the same country, or international players. Mergers and acquisitions are a form of equity financing as the acquiring company usually replaces existing shareholders through a hostile or a friendly bid. Alternatively, private equity companies or investment funds of large scale may be interested in the company at this stage only if they see untapped potential that can be utilized to increase the value of the company. In this case, they would seek to change management in order to affect a turnaround in the business.

5. The fifth stage which is the final stage in Figure 5 diagram could go two ways. If the company manages to reinvent itself by innovating into new markets or products that can reestablish it into the growth phase, this stage can be the reinvention stage. However, if the company maintains its business as usual and remains in the same markets and product range, it is likely that it may face decline due to the overall industry decline, or being overtaken by more innovative players. A classical example in this case would be a typewriter producer, whose main product was widely replaced by the emergence and widespread use of the personal computer and word processing software. Any company in this business that has not shifted to a different product in due time, will face decline and death. In addition, decline in this stage can also be seen in terms of the speed of growth, which means the company will no longer be stable or growing at a stable rate as the previous stages, but may be facing declining returns. For many small businesses this stage can lead to death of the company if they haven't coped well with the growth and stability stages. At this point, if all has gone well and the company has survived all unexpected difficulties and has matured into a rather large organization, the company might start to redevelop itself and find new opportunities and markets. It may also revive the entire lifecycle again but in a more intelligent and mature way.

At this stage, access to external finance may be the hardest to obtain unless the financing institution can clearly see the potential for reinvention. Most founders and owners at this stage may even choose to divest and exit from the business. In family business companies, usually the second or third generation would be managing the business at this stage, and may be either disinterested to continue in the same line of business, or lack the required experience or willingness to reinvent it. Any debt financing may be provided at high interest rates to compensate for the high risk associated with the decline. In addition, equity investors would only be interested in the company if they see untapped potential like in the maturity stage. If the company has good intangible or tangible assets that can be leveraged in a different business, the company at this stage may be a suitable target for acquisition.

Therefore, the conclusion of this discussion is that before approaching a financing institution of any type, you need to be clear on which stage your company is in and accordingly choose the type of institution that would be most interested to support your business.

D. What a company must consider for each stage of the life Cycle

Opportunities to find financing options are limited for small business in the SME sector. Therefore, it is crucial that you do all the right things to secure access to finance. While Section 4 will address this point in further detail, what is discussed here is a focus on having a clear financial strategy to start with.

For any business, a clear business plan must be in place at any point in time. Based on this business plan, you should evaluate what type of financial backing you need over the next year or few years to come (short to medium term financial needs).

In general such financial needs will be related to one of two types:

I. Capital Expenditures (CAPEX) Requirements: those are expenditures for creating future benefits for the business. Capital expenditure occurs when a company spend money either to buy fixed assets or to add to the value of an existing fixed asset with a useful life that extends beyond the taxable year.¹⁵

Examples of Capital Expenses / Expenditures are:

- acquiring fixed assets
- fixing problems with an asset that existed prior to acquisition
- preparing an asset to be used in business
- legal costs of establishing or maintaining one's right of ownership in a piece of property
- restoring property or adapting it to a new or different use
- starting a new business

II. Working capital requirements: working capital represents the amount of financing that you need to operate your business, usually in the form of cash. As an accounting ratio, it is the difference between current assets and current liabilities. From a financing perspective, it is the amount of money you need to operate the business from purchasing the material used for production, to covering your operating expenses until you collect the price of your products from your customer. Therefore, most businesses would require to carefully manage their working capital and may need to raise short term financing to cover it.

To help your company evaluate which types of financing is needed; you must develop **a Capital budget** to determine whether your company's long term investments such as new machinery, replacement machinery, new plants, and research development projects are worth pursuing. Capital budgeting includes a final decision of what type

15- CAPEX: Is commonly found on the Cash Flow Statement as "Investment in Plant Property and Equipment" or something similar in the Investing subsection. For tax purposes, capital expenditures are costs that cannot be deducted in the year in which they are paid or incurred, and must be capitalized.

of financing to undergo, whether debt financing or equity financing or maybe both.

Financing projects through debt can result in a liability or an obligation that must be serviced, and would have implications on the cash flow and therefore have an impact on the project's success. Equity financing is less risky with regards to the cash conversion cycle of your company; however it has other implications in the form of ownership and control and participation in earnings. Other factors to consider would be the cost of the capital to be raised. Typically, the cost of debt in the form of interest rate payment should be less than the cost of equity in the form of required return on investment by the equity investor. However, where interest payment is an obligation, profit sharing is subject to agreement with the shareholders and can be deferred for the future if the company is in need to reinvest its earnings.

E. Difference between Debt Financing and Equity financing

Debt Financing: Takes the form of loans that are repaid over time with a certain additional percentage in the form of interest. Usually businesses can borrow money over a short term period which is classified as less than one year, or long term for more than one year. The main sources of debt financing are:

- Banks
- Leasing companies
- Factoring companies
- Issuing a bond, if the company is listed. This however, requires that the company is sizable and has strong credit rating, and generates significant cash.

Debt financing offers businesses a tax advantage, due to the fact that interest paid on loans is tax deductible as a business expense. But using debt financing can sometimes prove difficult especially with small business, where they can struggle to make regular loan repayments if they have irregular cash flows. Therefore, and to avoid this problem, it is very important for the SME to have a very good and realistic cash flow forecast for its business before approaching the debt provider. This will contribute in structuring the payback arrangement based on this cash flow, and avoid facing any difficulties in the future.

Moreover, carrying too much debt can also create a big problem because it increases the risks associated with the business overall. It increases the leverage ratio of the business. This may make the business unattractive for equity investors and therefore reduce your capability to raise capital in the future.

Essential things to consider before taking the decision to raise debt financing for your business:

- Your Cash Conversion Cycle
- Your Debt to Equity Ratio
- Interest rates applied by the debt financing institutions
- Forecasts and feasibility analysis of your capital project

Equity financing: Takes the form of money obtained from investors in exchange for a share in the business. At the early stages of a business such funds may come from friends or family of the business owners, and through venture capitalists.

For Equity financing, financial institutions include:

- Private equity funds
- Venture Capitalists
- Individual investors
- Stock issues (for companies listed in NILEX)

The main advantage of Equity Financing is that there are no obligations to repay the money, but the equity investors obtain a corresponding share of the business, based on the agreed value of the company. The investors gain their money back through future profits. Note that the profile of the investor may help in increasing the credibility of a new business, which would help the company raise capital in the future.

Essential things to consider when finding investors for your business:

- Strategy and Business plans
- Type of investors, (specialized in your field, or general)
- Forecasts and feasibility analysis

Using Equity Financing requires a company to be willing to open up to new partners who will participate in the strategic management of the business. Those partners usually bring in more experience, a fresh perspective, and professional management practices to the business. Their financial support and coaching can help the original founders of the company achieve much better results for the business, hence increasing the value of the company. In return, the equity investors take a stake of the business and the future returns, as pay back for their invested capital.

By now you should have a clear idea of what it is that your company needs financing for, and whether they are long term finances or short term finances, and choosing the most suitable type of financing (debt or equity) in order to seek the right type of institution.

Section 4

How to get that money

Section 4

How to get that money

A. Requirements by Type of Institutions

As discussed, it is important to select the most suitable financing option for your company before approaching an institution. This section provides guidelines about the types of requirements and documents usually requested by each type of financing institution that you must have ready before approaching them. However, we wish to emphasize that while the below are the general requirements, each individual institution may have a variation of this list, depending on their internal strategy, risk appetite, and how keen they are to get your business. What is most important to know is that as a company, you are the client of those types of institutions and you have the ability to go from one provider to another, depending on what they have to offer you. For example, if you apply for a loan from bank X, and assuming all your paper work is complete and you are eligible for the loan, you can approach several banks to get the best offer suitable for your business (with the most suitable conditions). The point is, as a customer you have a choice.

Starting 2010, most institutions, especially banks, will have SMEs high on their agenda as priority clients. This is because there is an overall government strategy, supported by the regulators, to improve access to finance, especially to small and medium companies, as a mechanism for driving economic growth. So, even if you have tried in the past few years and did not find your case appealing to several institutions, you may find your position much better now, especially if you are better prepared.

1. Banks' General Requirements

Banks mostly provide debt financing in the form of overdraft facilities, letters of credit or guarantee (short term and long term) or loans (long term). Many banks would typically require a list of documents to be submitted along with your application for a facility. Those documents must in all cases be complete, up to date, and accurate.

Banks have varying strategies and risk appetites. Therefore, approaching a certain bank with a complete file is the first step. Their response will depend on their strategy. As a customer, you are entitled to clarifications for the reasons for rejection so as to make your efforts more fruitful in the future. This type of discussion will give you better clarity about the perception of your business by the banking sector, and also will show the financing institutions that you are a client aware of your rights and how the financial system operates.

The introduction of credit rating systems within Egypt to track an individual or a company's debt track record has given financial institutions a tool to have an informed decision before giving a loan or investing in a company. Each bank or other type of financial institution runs a query about the applicants' credit history as an individual, even if you are applying for a loan for your company, in order to track the performance of your previous credit deals and whether you had any problems.

In 2007, iScore started operations as Egypt's first credit bureau. The company provides services to banks and other financial institutions related to the credit scoring and rating of individuals and companies, upon obtaining an authorization of the individual approaching the bank. Each individual have their credit history on record on information databases with the Central Bank and the credit bureau. This means that as an individual, you will have a record of your previous dealings with the financial sector (for example for the regularity of your credit card payment and for personal loans). This is a confidential record kept with the scoring company, and released to financing institutions only if you authorize it. If you personally have had problems, and maybe legal cases, regarding a personal loan or a credit card, this may affect your scoring and credit rating as a company when you are applying for a loan for the company, and may reduce your chances of getting an approval. Therefore, you always have to make sure that your personal as well as your company's credit history is clean, which means having regular payback and settlement of previously taken loans or other facilities.

Preparing for Approaching Banks

Typically, you should have a bank that you deal with in your day to day business activities, which has your company's accounts. Your bank should be the first choice if you are applying for a loan or another type of facility, such as a Letter of Credit (L/C), or Letter of Guarantee (L/G). You are their client, and ideally they should be willing

to extend most of their services to you. The emphasis here would be on you as a company, rather than you as an individual. This would mean that your bank accounts for the business, should be separate from your personal bank accounts. Applying for a loan for the business differ from applying for a personal loan, even if you will spend it on the business (please see later parts of Section 4 regarding further details). Financial institutions evaluate business differently and check the business performance through certain ratios and financial calculations. Below is some of the ratios banks look at when they evaluate the business.

$\text{Quick Ratio} = \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$
$\text{Debt-to-equity Ratio} = \frac{\text{Debt}}{\text{Equity}}$
$\text{Debt-to-Value Ratio (Leverage)} = \frac{\text{Debt}}{\text{Debt} + \text{Equity}} = \text{Debt-to-assets}$
$\text{Interest coverage ratio} = \frac{\text{Earnings before interest \& Tax}}{\text{Interest}}$

On the other hand, if you currently do not have regular dealings with any bank, and you wish to start by requesting a loan, then the following steps may be useful:

- Inquire from friends or colleagues who operate within your sector on who are the banks that work mostly with companies within your sector. You can also achieve this objective by requesting a cheque rather than a cash payment.
- Ask about the typical terms of the loan, such as tenure (number of years for pay back) and interest rates.
- Check the website of the bank and explore if they have a unit, or certain branches, dedicated for SMEs.
- Explore the types of facilities offered (types of loans and other services) for small and medium companies. If this information is not available on the website, then a visit to the nearest branch may be useful, and you should approach the Customer Service desk in the branch.

Once you have collected some background information about the bank you are seeking to approach, make sure to have a discussion with the responsible officer, ideally within the SME unit, about their specific requirements.

List of Required Documents

While the following list is seen as general requirements, each bank may request additional items or detailed documents, depending on their internal procedures and their perception of your business.

1. Your commercial register, completed with accurate information and up to date (not older than three months).
2. Updated company contact information such as address, phone numbers and fax, contact persons.
3. General Assembly meeting resolution, for joint stock companies that hold general assemblies.
4. Tax registry or Tax Card.
5. Social Insurance Receipt (paid).
6. National ID cards of the owners of the company.
7. Accountant certificate to validate regular payments of tax and social insurance obligations.
8. Three Financial statements for the last 3 years. Many banks may require that the financial statements are audited by an auditor registered with the CBE.
9. A feasibility study of the proposed project or expansion plan.
10. Business Plan (not less than one year) for a new business.
11. Managements' CVs stating their relevant experience in the field of the business of your company.
12. Loan request form filled with accurate details.
13. Authorization for querying about your company with iScore (filled) and with the CBE.
14. Bank transaction declaration.

2. Leasing Companies General Requirements

Leasing firms have more or less the same requirements set forth by the banks. However they are more flexible in the timeline for pay back and the terms and conditions of the agreements they sign with you. The leasing company's decision to deal with your company as a client is dependent on their evaluation of your company and your business, and it is a case-by-case scenario.

Preparing for Approaching Leasing Companies

You must have a preselected asset that you need to purchase before approaching the leasing company. You also must be clear on how much this asset costs if bought on cash basis now, versus on installments over a number of years if this is an option offered by your vendor or supplier. Once you have clarity about the associated cost and decided that you need leasing services for procuring this asset, you should turn to the choice of the leasing company.

You must also calculate the leverage of your company before you approach a leasing company, as they require that your debt to equity ratio is no more than 1. Leverage is a commonly used term in the financial industry and it is a measure of how heavily indebted your company is. If you have a debt to equity ratio of one, this means your company has on the balance sheet an amount of total debt equal to the amount of total equity. This means you have borrowed from external parties as much as the owners of the business have invested in it. Highly leveraged companies have higher debt components on their balance sheet and this makes their ability to pay back their debt obligations harder and therefore are viewed as more risky clients than others.

While this means that carrying all equity business may seem like the least risky, in effect, this is not the most effective capital structure because having a debt component on the balance sheet reduces your cost of capital because interest paid on debt is tax deductible, hence provides an advantage in the form of a tax shield. There is also a tax advantage from leasing because under the Unified Tax Law, No 91 /2005 the lessee's rental payments are fully tax deductible, and there are no capital-gains taxes on asset acquisition at the end of the lease period.

There aren't many leasing companies in Egypt yet, so the choice is limited. Before deciding which company to approach, it is always useful to check their website for details of their services and which types of assets they usually finance. It may also be useful to ask friends or colleagues about previous experience with the company. Once you have narrowed your choices to one or two companies, you should directly approach them.

List of Required Documents

Note that these are just the basic requirements because each Leasing company may have additional requirements during or after you have requested financing. Also, the criteria of complete, up to date and accurate documents apply:

1. Commercial register.
2. Updated company contact information.
3. General Assembly meeting resolution.
4. Tax registry or Tax Card.
5. Social Insurance Receipt (paid).
6. Accountant certificate to validate regular payments of tax and social insurance obligations.
7. Three Financial statements for the last 3 years.
8. Feasibility study.
9. Business Plan (not less than one year).
10. ID of the owners of the company.
11. Managements CVs stating experience (for startups).
12. Authorization for querying iScore (filled).
13. Leasing transaction declaration.
14. Audit reports.
15. Financial forecasts.
16. Cash sales Vs. Credit sales.

3. Factoring Companies General Requirements

There are even fewer factoring companies operating in Egypt. However, their services are very useful in providing you with liquidity for your business if you sell against credit. Meaning, you receive payment from your customers after 3- 9 months of delivery of goods. Factoring services can help you manage your working capital efficiently and taking off the burden of longer collection cycle from your company's shoulder, against fees.

Factoring companies define SMEs as companies with sales from LE 10 to 150 million¹⁶ annually. They also have minimum capital requirements for the clients they deal with. They do not deal with start-ups, so your company must be well established before you approach a factoring company.

While factoring companies also check the leverage of your business, they do not have a certain ratio requirement compared to leasing companies as discussed above. Additionally, they evaluate your business based on the relation between your current assets and your current liabilities. In financial terms this is referred to as the quick ratio and is a measure of how liquid your business is. This means that when you

¹⁶- Factoring SME Sales Definition: This was mentioned and quoted from the EJB CIPE Seminar for Factoring and Leasing.

have a high quick ratio, which happens if you have more current assets than current liabilities, you can easily pay back your current obligations from the existing liquid assets you have, such as cash, receivables, and easily sellable financial assets.

Factoring companies also query about the credit history of the owners of the company using iScore services. Eventually, factoring companies can finance up to 80 - 90% of your receivables, if all the conditions they set forth apply to your business.

4. General Requirements for Venture Capitals & Private Equity Companies

As providers of equity financing, Venture Capitals and Private Equity firms both have the same requirements. Their requirements will focus more on the validity of your business as an investment opportunity that can generate high returns over the coming 3- 5 years or longer. Therefore, they are keen on getting a level of confidence about the commercial potential of your product or service, the ambitions and abilities of the management of the business, the experience of the management in this field of business, and the way the company is organized and operated, in aspects such as compliance with regulatory requirements and laws.

Before approaching a certain PE or VC, the SME is advised to turn to the funds that are interested in investing in the industry sector you operate in. It may also be useful to inquire about success stories of the fund in similar business, from fund officers or managers that you may interact with in public events. The websites of such funds are also a very useful source of information.

Because their strategy is to invest their funds in high growth companies for only a few years and exit from the investment after meeting the expected return, PEs and VCs are always involved in the management of the business and provide guidance and mentoring to the original owners and managers in order to increase the results of the business, fundamentally in revenue and profits. Therefore, it is important that as a company you are willing to accept the cooperation level of involvement the PE or VC will have with your business. You must also be clear that having a deal with a PE always indicates two very good things about your company:

- a) it has a lot of growth potential, that you, other founders, and the PE can financially benefit from,
- b) that your company is well organized and operated which means it is on the right track for future growth and maturity as discussed in the life cycle in Section 3.

After having a deal with a PE or VC, your company may be more appealing to other financial institutions to deal with you, such as banks and other investors. In the longer term, your company may be also more ready for public listing in NILEX, or the Egyptian Stock Exchange if it is large enough in a few years.

List of required documents

Initially, the PE or VC will need to see an information flyer, usually referred to as a Teaser, about your company or business idea. If they are interested, they will sign with you a non-disclosure agreement (NDA) that protects the confidentiality of the information you will exchange with them. Afterwards, they will need to see the following documents:

1. The company must be a joint stock company, or incorporated company.
2. Financial statements for the last 3 years (or management accounts). Those may be required to be audited by a registered auditor.
3. Business Plans.
4. Forecasts and predictions.
5. Reports on the industry of relevance to your company.
6. Management reports and tools used.
7. management CVs and track record (it is actually part of every set of requirements and by all financial institutions).

5. General Requirements for Listing on the Stock Exchange

Listing in the capital market indicates that your company is mature and formally operated, or in other terms well institutionalized. The listing brings many benefits such as ease of raising debt and equity through issuing bonds and stocks. However, there are also many obligations for being a listed company.

Listing in NILEX

All companies that are seeking to list in NILEX must find an advisor also known as Nominated Advisors¹⁷ (NOMADS), to help them fulfill all the requirements. They may also help your company raise the funds required to be listed.

¹⁷- A list of the NOMADS registered with NILEX can be found on the website at http://nilex.egyptse.com/en/Nominated_Advisors_List.aspx

The below general requirements also apply (please check NILEX website www.nilex.com.eg for more details):

1. The company must be a joint stock company or incorporated company, i.e. the owners must be shareholders. If the company had traditionally been a proprietorship or a partnership, the nature of the company must be changed with the General Authority for Investment prior to preparing for listing.
2. All listed securities must be deposited at the Central Depository.
3. The company's by-laws or the issuing terms should not include any constraints on the trading of the securities to be listed.
4. The issuing company must have financial statements for at least one fiscal year preceding the listing application.
5. Shareholders equity should not be less than 50% of the company's paid capital in the year preceding the listing application.
6. The issued capital should be fully paid at a par value ranging from L.E 1 to L.E 5 per share.
7. The number of issued shares to be listed should not be less than 100 thousand shares.
8. The minimum free float should be at least 10% of the total issued shares and the number of shareholders should not be less than 25.

Financial Statements & Reports

- The listed companies should submit their quarterly and semi annual financial statements, approved by the company's management, within 45 days from the end of the period and should submit its audited annual financial statement within 90 day from the end of fiscal year of the financial statement.
- The exchange will publish the companies' financial statements and financial results for only one day on the trading terminals. Moreover, the General Assembly's decisions concerning dividend distribution and dividend dates are to be published via trading terminals and the website of the stock exchange.

Section 5

**Taking your Company to the Next Level
Formalizing Operations and Applying Corporate
Governance**

Section 5

Taking your Company to the Next Level- Formalizing Operations and Applying Corporate Governance

The science of management and organization behavior indicates that for any business to evolve, mature, and grow to be successful. Certain measures have to be taken in order to formalize the business and change it from being a small venture of an entrepreneur or a few founders, to a well recognized formal enterprise. This section discusses some of those key measures to be taken, especially in relation to facilitating your access to finance.

A. From idea to business plan

As you are reading this Guide, you are most likely already an owner of a business that you started based on an idea that you thought may work. All entrepreneurs have ideas, some are worth pursuing and some are simply not destined to succeed. This is also the view of any financing institution. While you may think your idea is so good and would surely succeed, they may see it differently because they look at other aspects of your idea, and in a wider business context. Therefore, and in order to speak the same language, you need to convert your great idea into a business plan.

A business plan is a formal document that you can submit to a bank or any other financing institution in order for them to support you financially. Therefore, it is a document that puts together the details of your business vision in a manner that is realistic, convincing and scientific. Also it helps owners, managers and employees know and achieve the set targets and identify the required resources needed to achieve those targets.

A business plan will be accepted by the financial institution if it presents the following dimensions:

- a) **The project concept:** a detailing of your idea and how it can sell in the market. This includes a detailed description of the product or service that you are planning to offer, and how you plan to produce it. While you may think this level of detail may risk your idea being stolen by others, it is the professionalism of the financing institution you approach that guarantees the protection of the confidentiality of your idea .
- b) **The market you will serve:** this section should clarify the estimated size of demand for your product or service. It should convince the reader of why you think your product or service will sell and achieve revenue and profits. It should clearly indicate the extent of market gap between supply and demand and why your own company can successfully fill this gap.
- c) **Marketing strategy:** this section details your understanding of how you will approach your customer. It will start with a clear definition of who is the customer of your business according to the demand-supply analysis you presented in the previous section. It should also clarify why your customer will pay for your product/service.
- d) **Management structure:** this part of your business plan explains who will be involved in the management of your company and which roles each person will be responsible for. The most important aspect of this section is detailing the profiles, or previous experience of the management team which should include relevant experience in the field of business you are planning for. If the entire team does not have any related experience, this makes your business plan weak. Developing a document that highlights your management's capabilities and key experiences in the industry would add to the credibility of your company.
- e) **Revenue and cash flow forecast:** this section should detail the expected revenues your business is expected to generate over at least 3- 5 years and the related costs. This forecast should be done based on reasonable historic data or factual information about the market and your business production capacity and reasonable additional assumptions. It should be generated in a scientific method that can be explained and clearly understood by the financing institution representatives. In this section, the use of financial models and spreadsheets to demonstrate the forecast would be most relevant. The forecast should also detail the expected cash inflows and outflows during the same period, in order to give to the reader a good sense about your business ability to pay its obligations, especially if you are seeking debt financing of any form.

- f) **Financial feasibility:** this section should indicate the financial analysis of ratios such as the expected return on investment in the business, and the internal rate of return for the project of the idea.

B. Regulatory Compliance

While it may be possible for someone to start a small business and operate it out of their home away from the scrutiny of many regulatory authorities, all financing institutions operating in Egypt are well regulated by very keen regulatory authorities (as discussed in Section 2 above). Therefore, when you approach any financing institution of any type, they will stretch their hand back to you only if they can be sure you are also a well regulated client they can trust their reputation with. All financing institutions will look into many aspects of regulatory compliance to check your company's situation:

- a) **Commercial and industrial registry:** those authorities represent the government in recognizing your business as a formal enterprise and the Commercial and/or Industrial Register of your company need to be up to date and reflect the most recent and real data about your company. Should any of those documents be outdated, or reflect false information, you should expect the financing institution you are applying for to reject your application.
- b) **Tax compliance:** the new tax law of 2005 has redesigned the tax system applied in Egypt to make it more attractive for all investors, particularly after the rates of corporate and personal income taxes were significantly reduced. The Tax Authority has also reduced the minimum capital requirements for different types of companies, to allow all types of business, including the smallest shop, to formalize and set up as a company of a suitable type. In addition, many steps have been taking to facilitate companies' registration and incorporation. In return, the government has applied more stringent punishment of non-compliance. Therefore, it is crucial that your business is both formalized and also in compliance with the tax law before considering approaching any financing institution.
- c) **Labor law and social insurance:** the labor law protects the rights of a company with respect to its employees and also the rights of the employees under their employer. The Labor Office and Social Insurance Authority are the organizations responsible for validating your compliance with the labor law and social insurance requirements. If you are in violation in any shape or form, any financing institutions will not be willing to do business with you. On the other hand, formalizing your relation with all staff involved in your business provides you with the sustainability and continuity of staff that you need to make your business able to evolve over time. A contract with your staff gives you the right to punish them if they behave inappropriately and also protects your investment in them if they decide to leave you today without early notice.

- d) **Specialized authority(ies) compliance:** this entirely depends on the nature of your business and which ministries and authorities need to authorize your operations. Examples include health authority regulations if you are in the food business, industrial safety and civil defense regulations if you have any high risk industrial operations of any size. This is in addition to approvals and authorization from a number of other entities and organizations that may be required depending on your nature of business. As long as your papers are complete and up-to-date and you are working formally with the approval of all concerned parties, a financial institution of any type would be willing to cooperate with you.

- e) **Environmental protection:** as Egypt has a specialized environmental protection agency, compliance to regulatory requirements regarding the environment, waste management, and polluting activities is increasingly becoming key to success. The Egyptian Environmental Affairs Agency (EEAA) is very active in ensuring compliance by all business, large and small and charges significant fines for violators. Such compliance is also important for financing institutions, especially strategic investors who have serious corporate social responsibility agenda. This is also important for any international companies, or institutions, which may have strict environmental regulatory requirements for all businesses they deal with even internationally.

C. Financial Management and Reporting

With the evolving tax regime in Egypt, and the increased listing of companies in both the Egyptian Exchange and NILEX, financial reporting and external auditing are becoming more important to be done more formally and according to Egyptian and International Standards. What is more relevant to your business is the fact that any type of financing institution providing either debt or equity financing will not even consider your company's request unless they are able to see valid and well-structured financial statements of your business, verified by a respected and known auditor. Now finding the right auditor is very important, because the better the auditing firm's reputation is, the more likely your financial data will be trusted.

The Ministry of Finance regulations define the years of experience required by an auditor, to be authorized to audit certain types of companies. Joint stock companies require auditors with a minimum of 8 years of experience, or members of the Egyptian Society of Accountants and Auditors if they have less years of experience. The Central Bank of Egypt also has a list of auditors registered with it. Those are usually well perceived by banks and other financial institutions if they audit your company. However, it is not a regulatory requirement that your auditor is registered with the CBE.

While banks and other lending institutions may not require financial reporting from your company after providing you with a loan, as long as you continue to meet your obligations, equity financing institutions, be it private equity funds or the investing public in case of listed companies, will require regular financial reporting according to accepted standards and up to levels of details as required by the regulator. These reporting requirements, while they represent a bit of a burden on the business, in fact they give you and other owners the opportunity to see the business in the spotlight on regular basis. This also provides an early warning system to correct any problems before they become catastrophic. The deployment of a well reputed auditor will ensure that your financial reports are well received by the intended audience. It will also ensure that any problems are flagged early in the auditor's report, who is obliged by the standards and regulations of their own industry.

D. Separation of Management and Ownership

While it is accepted that at the start of the life of your business, the business and you can be one in terms of both financial resources and time, as your business grows into an enterprise (i.e. after you have successfully passed the start-up stage and your venture turned out to be successful), it is important that you implement effective separation between ownership and management. This separation takes many forms and stages:

- a) **Separate financial records:** any financing institution will not be willing to put its money into accounts that are not solely owned by the enterprise, and used for expenses relevant to the enterprise. In many cases, business owners mix their personal accounts and expenses with the company's accounts and expenses, which is unacceptable for all financing institutions who wish to ensure the integrity of their funds. Therefore, it is crucial that from day one of your business, you have separate accounts and books for the business to manage cash and record income and expenses. Your personal drawings from the business should be recorded either as salary, or owner's drawings to be deducted from the year-end net profit that is due to be paid to you as a shareholder. Any other business expenses should strictly relate to the business activities and be recorded accordingly.
- b) **Separate management from ownership:** while this is a regulatory requirement for publicly listed companies, under the Egyptian Code of Corporate Governance, it is a preferred arrangement for any type of business especially when it grows in size and operations. Particularly if the business grows to an extent where the founder(s) are unable to solely manage all aspects effectively.

Separation of ownership from management provides a number of benefits to the business:

1. Dedicated and specialized managers who are responsible for their respective parts of the business will bring specialized experience and professional skills to the enterprise. It will also ensure that their area is run effectively to achieve the desired business objectives.
2. As the business grows, more responsibilities of decision making should be delegated to the management based on the areas involved.
3. Separate management will protect the best interest of the business and the rights of its owners, especially the investing public for listed companies.
4. Where owners are not involved in day-to-day management, they provide strategic longer term plans and objectives for the business and oversee the enterprise's performance towards achieving those objectives, which again serve their financial interest.
5. Management can always be replaced if proven inefficient, but it is difficult to fire an owner from his/her business.

c) Apply the standards of good governance: Financial institutions look at the governance of the business as an indicator of how well the business can effectively utilize the money given to it. There are different types of corporate governance, and it continues to be an evolving subject. But once you have selected a suitable corporate governance methodology, it is essential that the organization adopts all the regulations and standards set by that methodology (please refer to EJB Guide on Corporate Governance for Family Business for more details).

d) Critical Success factors for any organization to consider:

- Protection of trademarks, copyrights, and Intellectual Property Rights
- Technology development and tracking – this can possibly include innovation and R&D importance at a later stage
- Shareholders communications and reporting
- Focusing on creating short-term and medium-term values
- Regular updates of business plans and budgets
- Proper working capital management and cash management
- Paying attention to cash flows and profitability targets

E. From Management by Intuition to Strategic Management

While most businesses in the first few years of existence operate without any formal strategic plans or performance measurement tools, most business founders typically have a clear strategy in their mind that drives their day-to-day running of the business. Once the company has grown in size and number of staff and managers, it becomes sensible to have a formal business strategy documented and shared with the responsible managers. The purpose of this is to make sure each person is clear on what the business needs to achieve and how their individual role and responsibility contributes to achieving this objective. While this may not be a formal requirement from a financial institution, having a clear and well devised strategic plan for your business and clear performance objectives will increase the value of your business for any equity financing institution. It will also give more confidence to any debt provider. More importantly, it will give the business owners clarity about where the business is going and how those plans are intended to bring in better results.

As a starting point to preparing a good strategic plan is completing a SWOT analysis of your business. To do that, you need to analyze your company internally in order to identify the most important points of strengths and areas of weakness, hence the S and W parts of the matrix. Next, you should analyze the market you are operating in, as an industry sector and in the country(ies) you operate in. This should result in identifying the most important market opportunities and threats, O and T.

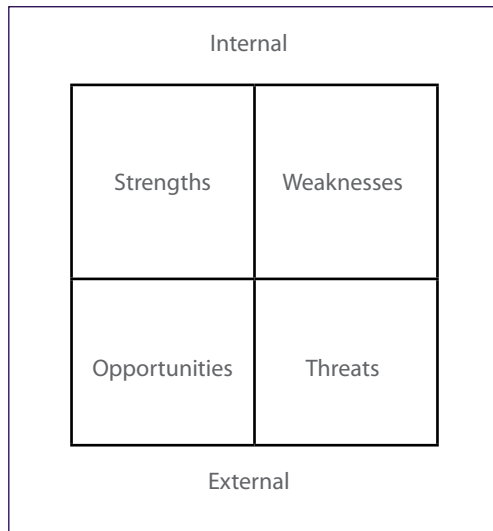


Figure 6- S.W.O.T Analysis¹⁸

Section 5
Taking your Company to the Next Level

18- SWOT Analysis: Were developed by ; Learned, Edmund P., Christensen, C. Roland, Harvard University, & redeveloped by Andrews, Kenneth R. and Guth, William D. and also from Harvard University.

Once you have completed your S.W.O.T analysis, this is a good starting point to defining your business goals and objectives for the longer term, which together constitute your business strategy.

A manifestation of the business strategy is a clear **Vision** for the business which identifies a future state of your company that will be achieved in the longer term. This vision should also be combined with a **Mission Statement**, which explains what your company is all about and how you do business, to achieve the future vision. This is then supported by the details of the business **goals** and **objectives**, which should range between customer and product objectives, financial objectives, operations and quality objectives, and employee and internal organization objectives. Once those are detailed, you can clearly define targets under each objective and assign those targets to a certain timeframe and a person or group within your organization.

Upon this, the role of the owners of the business will be to monitor progress towards achieving those goals and the performance of the enterprise against the set targets. In this manner, management of the company and its performance becomes more formalized and strategic in nature, rather than based on the intuition of the owner/founder. The extent of the analysis taken to formulate those strategic long term plans can range in size and complexity depending on the needs of the business, the nature of the industry, and the level of maturity of your company. For the large corporate enterprise, this approach takes the form of multi-layers of strategies as can be seen below:

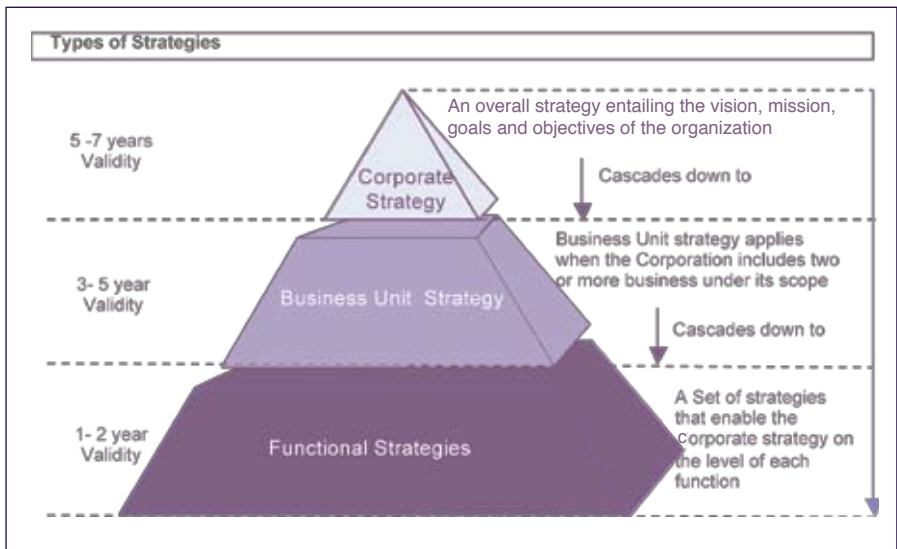


Figure 7- Types of Strategies¹⁹

19- Types Of Strategies: PwC's Types of Strategy development and Management methodology

Developing management plans or functional/operational strategies :

Once you have defined your business strategy and set certain targets and initiatives, you should also define some functional strategies to help you achieve the business strategy. Some functional strategies include:

- **Marketing strategies:** is a strategy that focuses on the business efforts to concentrate its resources on opportunities to increase its sales and achieve sustainable competition in the market the business operates in.
- **Human Resources strategy:** is a strategy used to manage your human assets and provides the business with ideas on how to develop the quality and level of employees managed by organizations.
- **Financial strategy:** is a strategy that addresses the financial implications of corporation and identifies the best financial course. The financial strategy attempts to maximize the financial value of a firm.
- **Operations strategy:** is a strategy that determines how and where products will be manufactured, it is involved in the production process and the deployment of physical resources.
- **Supply chain strategy:** is a strategy that addresses the management of a network of interconnected businesses involved in the delivery and provisioning of products and services required. It consists of handling the movement and storage of raw materials, work-in-process inventory and finished goods from the point of origin to the point of consumption.
- **IT strategy:** is a strategy that focuses on how to manage the technologies and the people who manage those technologies used by the organization. It also defines how it can help all parties of departments in the organization to deliver on the corporate strategy.

These strategies should resemble the departments that are within the business that operate as support or backbone of the business. Naturally those functional strategies are more detailed and come from the vision and mission of the business.

1. From Tacit Knowledge to Formal Processes

Another step in the formalization of your enterprise as it grows over time would be when the size of the organization and people involved becomes too big to the extent that responsibilities become confused and the way of doing things start differing from one group to the other based on their individual preferences. This is normal when an organization is still small and the methods it uses to carry out certain tasks they used to do before are shared and communicated informally from one group to next. Once the business becomes bigger and the size of work and employees' increases, the simple and old ways of doing things may be inefficient or too slow to respond to the new requirements of your customers or suppliers. Therefore, it becomes important at this point in time that you formalize your way of doing things, using items such as internal manuals and policies in each department. Those should also be supported by forms and may also require some aspects of the business to be automated, such as accounting and financial reporting activities. This formalization while helps adapting to the increased work load, it also introduces standards of operations into the business which reduce errors and help improve efficiency.

More importantly, they make your business less dependent on certain individuals, who know best, and more institutionalized, in the sense that the company's systems and processes would be the point of reference, rather than certain staff members.

Important note

While the last two parts are not necessarily formal requirements of financing institutions, they are particularly relevant to companies that seek listing in the stock exchange, or seek equity participation from institutional funds. More importantly, those measures of formalization become key indicators that you are evolving into a sustainable formal business enterprise that is worthy of funding, either in equity or debt financing options.

Annexes

Annexes

A. Glossary of terms

Accounts Receivable	Is one of a series of accounting transactions dealing with the billing of a customer for goods and services received by the customers.
Auditor	The general definition of an audit is an evaluation of a person, organization, system, process, enterprise, project or product. Audits are performed to ascertain the validity and reliability of information; also to provide an assessment of a system's internal control.
CAPEX	Are expenditures creating future benefits. A capital expenditure is incurred when a business spends money either to buy fixed assets or to add to the value of an existing fixed asset with a useful life that extends beyond the taxable year.
Capital	Refers to money used by entrepreneurs and businesses to buy what they need to make their products or provide their services or to that sector of the economy based on its operation, i.e. retail, corporate, investment banking, etc.
Cash Conversion Cycle	A metric that expresses the length of time, in days, that it takes for a company to convert resource inputs into cash flows. The cash conversion cycle attempts to measure the amount of time each net input EGP/Dollar is tied up in the production and sales process before it is converted into cash through sales to customers and collection of receivables.

Collateral	In lending agreements, collateral is a borrower's pledge of specific property to a lender, to secure repayment of a loan.
Credit Scoring	Is a numerical expression based on a statistical analysis of a person's credit files, to represent the creditworthiness of that person. A credit score is primarily based on credit report information typically sourced from credit bureaus.
Debt	Is that which is owed; usually referencing assets owed, but the term can also cover moral obligations and other interactions not requiring money. In the case of assets, debt is a means of using future purchasing power in the present before a summation has been earned.
Defaults on Loans	Occurs when a debtor has not met his or her legal obligations according to the debt contract, e.g. has not made a scheduled payment, or has violated a loan covenant (condition) of the debt contract.
Economic Cycle	Shows short-term fluctuations in macroeconomic activity, for example the annual rate of growth of real national output (GDP).
Economic Recession	Is a business cycle contraction, a general slowdown in economic activity over a period of time. During recessions, many macroeconomic indicators vary in a similar way.
Egyptian Financial Supervisory Authority	Established and became operationally effective as from July 1, 2009. The new EFSA replaced three major Authorities, viz. the Capital Market Authority (CMA), the Egyptian Insurance Supervisory Authority (EISA), and the Mortgage Finance Authority (MFA). Merging those Authorities under a unified umbrella aims at fostering the Egypt's financial sector.
Emerging	Newly formed or just coming into prominence; emergent: emerging markets or emerging needs.
Entrepreneur	Is a person who has possession of a new enterprise, venture or idea and assumes significant accountability for the inherent risks and the outcome.

Equity	Equity is the residual claim or interest of the most junior class of investors in assets, after all liabilities are paid. If valuations placed on assets do not exceed liabilities, negative equity exists. In an accounting context, Shareholder's equity (or stockholder's equity, shareholder's funds, shareholder's capital or similar terms) represents the remaining interest in assets of a company, spread among individual shareholders of common or preferred stock.
Founder(s)	A person who founds or establishes some institution or company.
Intermediaries	Is a third party that offers intermediation services between two trading parties. The intermediary acts as a conduit for goods or services offered by a supplier to a consumer. Typically the intermediary offers some added value to the transaction that may not be possible by direct trading.
Letter of Credit	A standard, commercial letter of credit is a document issued mostly by a financial institution, used primarily in trade finance, which usually provides an irrevocable payment undertaking.
Letter of Guarantee	A type of contract issued by a bank on behalf of a customer who has entered a contract to purchase goods from a supplier and promises to meet any financial obligations to the supplier in the event of default.
Leverage	Refers to the use of debt to supplement investment.
Long Term Financing	Long term financing is a form of financing that is provided for a period of more than a year. Long term financing services are provided to those business entities that face a shortage of capital.
Manifestation	Outward or perceptible indication; materialization.
Negotiation	Is a dialogue intended to resolve disputes, to produce an agreement upon courses of action, to bargain for individual or collective advantage, or to craft outcomes to satisfy various interests.
Non Performing Loans	A non-performing loan is a loan that is in default or close to being in default. Many loans become non-performing after being in default for 3 months, but this can depend on the contract terms.

OPEX	A company's expenses related to the production of its goods and services. Examples of operating expenses include wages to employees, research and development, and costs of raw materials.
Privatization	Process of transferring ownership of a business, enterprise, agency or public service from the public sector (government) to the private sector (business).
Regulatory body	A regulatory body, in the context of Financial institutions, is an external organization that has been empowered by legislation to oversee and control the Financial process and outputs abide to it.
Residual Value	Is one of the constituents of a leasing calculus or operation. It describes the future value of a good in terms of percentage of depreciation of its initial value.
Return On Equity	Measures the rate of return on the ownership interest (shareholders' equity) of the common stock owners. It measures a firm's efficiency at generating profits from every unit of shareholders' equity (also known as net assets or assets minus liabilities). ROE shows how well a company uses investment funds to generate earnings growth.
Return on Investment	A performance measure used to evaluate the efficiency of an investment or to compare the efficiency of a number of different investments. To calculate ROI, the benefit (return) of an investment is divided by the cost of the investment; the result is expressed as a percentage or a ratio.
Settlement	Is the process whereby securities or interests in securities are delivered, usually against payment, to fulfill contractual obligations.
Shareholders	Is an individual or company (including a corporation) that legally owns one or more shares of stock in a joint stock company.
Short Term Financing	Short term financing is normally used to provide money that has to be paid back within a year. The period may be shorter than one year as well.
Tacit Knowledge	Is knowledge that is difficult to transfer to another person by means of writing it down or verbalizing it.

Tangible Assets	An asset that has a physical form such as machinery, buildings and land & give the holders definite set of financial rights.
Tax Advantage	Refers to the economic bonus which applies to certain accounts or investments that are, by statute, tax-reduced, tax-deferred, or tax-free.
Track Record	The record of the performance of a person, organization, etc. as in some activity or on some issues.
Transaction	Is an agreement, communication, or movement carried out between separate entities or objects, often involving the exchange of items of value, such as information, goods, services, and money.

B. Important financial ratios (those mentioned throughout the Guide)

Liquidity Ratios

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Quick Ratio} = \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$$

$$\text{Net Working Capital Ratio} = \frac{\text{Current Assets} - \text{Current Liabilities}}{\text{Total Assets}}$$

Assets Ratios

$$\text{Inventory Turnover Ratio} = \frac{\text{Total Sales}}{\text{Average Inventory}}$$

$$\text{Fixed Assets Turnover Ratio} = \frac{\text{Total Sales}}{\text{Fixed Assets}}$$

$$\text{Asset to Equity Ratio} = \frac{\text{Total Assets}}{\text{Owners' Equity}}$$

Profitability Ratios

$$\text{Return on Assets Ratio} = \frac{\text{Net Income}}{\text{Average Total Assets}}$$

$$\text{Return on Equity Ratio} = \frac{\text{Net Income}}{\text{Average Owners' Equity}}$$

Debt Ratios

$$\text{Total Debt Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

$$\text{Debt/Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Owners' Equity}}$$

C. List of Acronyms

CAPEX	Capital Expenses
CBE	Central Bank of Egypt
CCC	Cash Conversion Cycle
CMA	Capital Market Authority
DIO	Days Inventory Outstanding
DPO	Days Payable Outstanding
DSO	Days Sales Outstanding
EBI	Egyptian Banking Institute
EFSA	Egyptian Financial Supervisory Authority
EGX	The Egyptian Exchange
LC	Letter of Credit
LG	Letter of Guarantee
NOMADS	Nominated Advisors
NPL	Non Performing Loans
PE	Private Equity
ROI	Return on Investment
SME	Small Medium Enterprise
SWOT	Strengths, Weakness, Opportunities Threats
VC	Venture Capital

D. List of useful websites

1. EJB Programs for aid to SME's <http://www.ejb.org.eg/>
2. CIPE Arabic Website: www.cipe-arabia.org
3. Efhm website: www.efham.net
4. USAID program for small and micro organizations <http://egypt.usaid.gov/>
5. Some of the internal task you may want to undertake to increase your chances of gaining access to finance may require some expenditure in order to complete. Web link: <http://www.imc-egypt.org/pgmfinance.asp>.
6. EBI: The year of Access to finance program www.ebi.gov.eg
7. NILEX website: www.nilex.com.eg
8. The General Authority for Investment (GAFI), is the principal governmental authority concerned with regulating and facilitating investment, and stands ready to assist investors worldwide. www.gafinet.org
9. Ministry of Finance, SME unit : <http://www.mof.gov.eg/>
10. CIDA/PSU programs to help SME's <http://www.egyptpsu.com>
11. Euro Money, financial year books, specific reference to leasing year book and Egypt leasing section: <http://www.euromoney.com/>

E. SMEs Events held By CIPE & EJB

1ST EVENT: “EXPLORING FINANCING NEEDS BY SMEs & THE DIFFICULTIES FACED IN SECURING IT”. CAIRO, JANUARY 11, 2010

- MR. MOHAMED MOURAD EL ZAYAT, MANAGING DIRECTOR - PHARAOH-TECH
- MR. YASSER EL BENDARY, CHAIRMAN - MOM'S FOOD
- MS. HEBA EL-SERAFY, DEPUTY DIVISION HEAD FOR R&D - THE EGYPTIAN EXCHANGE
- MS. NIHAL BADAWY, HEAD OF SME'S CREDIT RISK – CIB
- DR. BASEL ROSHDY, CHIEF INVESTMENT OFFICER & GENERAL MANAGER – NILE CAPITAL

2ND EVENT: “SMEs ACCESS TO FINANCE GUIDE – NILEX CHALLENGES & OPPORTUNITIES”. CAIRO, JANUARY 20, 2010

- DR. MOHAMED OMRAN, VICE CHAIRMAN - THE EGYPTIAN EXCHANGE (EGX)
- MR. HESHAM ISSA – SENIOR ACCOUNT OFFICER, EFG HERMES

3RD EVENT: “SMEs ACCESS TO FINANCE– NON BANKING INSTITUTIONS FINANCING”. CAIRO, JANUARY 27, 2010

- MR. AHMED DEIF, GENERAL MANAGER - AL TAWFEEK LEASING EGYPT
- MR. AHMED SHAHIN, GENERAL MANAGER – EGYPT FACTORS
- MR. AYMAN EL SEROUGI, CFO - MO'MEN GROUP
- DR. SHAHINAZ ABDELLATIF, ASSOCIATE VICE PRESIDENT FOR CREDIT & MARKETING - INCOLEASE

**4TH EVENT: “SMEs ACCESS TO FINANCE GUIDE – SMEs FINANCING BY BANKS”
CAIRO, FEBRUARY 10, 2010**

- MR. TAREK EL SAYED FAYED, ASSISTANT SUB GOVERNOR, BANKING SUPERVISION - CBE
- MS. MAY ABOUL NAGA, ADVISOR, REGULATION UNIT HEAD - CBE
- MR. YEHIA EL AGAMY, HEAD OF RETAIL BANKING DIVISION & SMEs - BANQUE MISR
- MS. NIHAL BADAWY, HEAD OF SMEs RISK GROUP - CIB
- MR. WALIE EL DIN LOTFY, HEAD OF SMEs UNIT - CREDIT AGRICOLE EGYPT
- MS. LAILA EL OTEIFY, SMEs UNIT MANAGER - EGYPTIAN BANKING INSTITUTE
- MR. KHALED EL AMMARY, DIRECTOR & HEAD OF SMEs BANKING DIVISION - EXPORT DEVELOPMENT BANK
- MR. BASSAM AZAB, HEAD OF SMEs UNIT - HSBC

5TH EVENT: “SMEs ACCESS TO FINANCE GUIDE - PRIVATE EQUITY & VENTURE CAPITAL”. CAIRO, FEBRUARY 22, 2010

- MR. HANY TAWFIK, CHAIRMAN - ARAB PRIVATE EQUITY ASSOCIATION
- DR. ABDEL MON'EM OMRAN, MANAGING DIRECTOR - BELTONE FINANCIAL
- MR. KARIM HELAL, GROUP CEO - CI CAPITAL HOLDING
- MS. DINA KHAYAT, MANAGING DIRECTOR – ARAB AFRICAN INVESTMENT MANAGEMENT
- DR. BASEL ROSHDY, CHIEF INVESTMENT OFFICER & GENERAL MANAGER – NILE CAPITAL
- MR. HOSSAM HEIBA, CHIEF INVESTMENT OFFICER – ENERGIA HOLDING

**6TH EVENT: “SMEs ACCESS TO FINANCE ... AN INTRODUCTION TO THE GUIDE”
ALEXANDRIA, MARCH 13, 2010**

- MR. AHMED SHAHIN, GENERAL MANAGER - EGYPT FACTORS
- MS. HEBA EL SERAFIE, DEPUTY DIVISION HEAD FOR R&D - THE EGYPTIAN EXCHANGE
- MR. MOHAMED AMIRI, VICE PRESIDENT MARKETING & CREDIT- INCOLEASE
- MR. WALIE EL DIN LOTFY, HEAD OF SME UNIT – CREDIT AGRICOLE EGYPT

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