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Research Article

SME Financing in Morocco: Issues and Alternatives

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Abstract

Small and medium enterprises, which are the key element to the development of the economy of a country like Morocco, are involved in varied activities related to trade, agriculture, crafts, tourism… It is clear that they require funds to start their activity first and then work on improving it. However, SMEs face some difficulties related to financial needs due to the quantitative and qualitative rationing imposed by the traditional financial system against them. Therefore, SMEs look for financial means that meet their specific liquidity needs, such as participatory banking which could be a credible alternative to classical financing of SME.Therefore, this article is dedicated to the presentation of different theoretical reflections and the results of the first exploratory study based on the interviews with business account managers in several Moroccan banks about the issue of the specificity of SMEs and their financing by conventional banks.

Keywords: SME - Information Asymmetry - Conventional Bank - Participatory Bank.

Introduction

Although SMEs remain the foundation of Moroccan economic growth and are often considered as an essential factor in promoting employment and wealth sharing, they face a number of barriers which limit their growth and financial strength.

SMEs often have some difficulties in having access to bank loans, contrary to big companies which obtain personal and financial tools which facilitate their recourse to conventional banks loans with more flexible conditions. These difficulties are generally linked to the phenomenon of information asymmetry between the SMEs and conventional banks.

Indeed, according to the literature, SMEs are informationally opaque, a fact which explains the credit rationing behaviour of classical banks towards the financing of small and medium size companies (Psyllaki, 1995). These banks are based on

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the credit rationing in order to alleviate the risk of SMEs.

The present article aims at investigating the problems facing SMEs in the process of financing their activities by traditional banks in the Moroccan territory, and clarifying the extent to which the participatory bank could be a credible alternative to the solution of these problems.

Our paper is also devoted to the study of the relationship between classical banks and SMEs, characterized by an informational asymmetry which limits the access of these companies to bank financing. In order to understand the specificities of banking practice in the SME financing process, we carried out an exploratory study on the informational asymmetries management measures and their impact on SME financing conditions, and the credit rationing determinants applied by the different Moroccan banks. We have limited the study to the city of Oujda in Morocco by targeting a single business account manager of each bank (8 different banks) who is directly involved in the processing of SME credit files.

Moreover, the paper suggests the devices of improvement of this relationship and the financing of SMEs at the national level.

The present paper is organized as follows; the first section will deal with the specificities of an SME and its development constraints in Morocco. Then, the second section analyses the heart of the financial matter of Moroccan based SMEs by presenting the complications that these companies go through to obtain the necessary financial resources for their activity and exposing the different improvement mechanisms of the relationship conventional bank /SME, by focusing on the dialogue maintained by the literature and the results of the semi-structured interviews carried out. Finally, we will introduce the participatory bank as a financial alternative for SMEs in Morocco.

Small and Medium Enterprises: A Specific and Compellable Business

SMEs represent 95% of all businesses in Morocco, according to the statistics of the SMEs' confederation. There is no one precise definition of an SME. It varies according to the field of activity and application.

The first research studies underlined the size-effect to distinguish between the different structurings of the organization (Aston, 1970). But the idea of categorizing companies on the basis of quantitative factors (company size, turn-over, share capital, added-value…) has been questioned by the existence of qualitative criteria which allow the identification of the SME compared to other types of organizational structures.

Moreover, there are other factors which affirm that the SME is not a large company in miniature, does not use the same management tools and does not have the same organizational strategic and environmental characteristics. Indeed, the SMEs are specific (Julien et Marchesnay, 1988).

Nevertheless, another current, namely that of diversity, stipulates that SMEs are heterogeneous and it is impossible to englobe them within the same single model due to the high diversity of SME configurations.

Furthermore, the thesis of the specificity of SMEs has been modulated by the synthesis current, which indicates that the specific characteristics of SMEs are flexible (Julien and Marchensay, 1987; D'Amboise, 1993)

Starting from the nineties, the idea of denaturation of the SME emerged to allow raising questions on its identity not in relation to a classification in terms of size, growth in comparison to a large company but in terms of its own properties (Torres, 1997).

Julien (1996) suggested a factual model which provides five "concrete" features of the SME: [1]

- The small size identified by a lower hierarchical distance and informal work relationships: *Spatial proximity*.
- Centralized management: the centralization of the owner-manager decisions means that the strategic choices of SMEs depend on the psychological profile of the firm owner –manager: *Hierarchical proximity*.
- A low-level specialization of management, staff and equipment: SMEs are generally typified *by the intra-functional proximity and the coordination mechanisms*.
- A sensitive and little formalized strategy: policies adopted within the company in agreement with the director are not essentially formalized in writing because the relationship between the leader and the employee is familiarized. This characteristic can be interpreted as a *temporal proximity* of the SME.
- Little complex and less organized information systems: oral communication is more favorable than the written one in SMEs: *Proximity information systems*.

In fact, the denaturation trend shows that the SME may, in certain contexts, function as a large company. Indeed, the differences between firms of the same size and the same sector are attributed to their belonging to different production worlds (Salais and Storper, 1993) and consequently to a difference in financial needs.

In this respect, Torres (2005) made it explicit that the specificity of the SME management appears in its proximity. Every characteristic of SMEs presented by Julien (1996) constitutes a form of proximity.

According to a study conducted by Torres on 240 French SMEs, he deduced that this proximity is an uncertainty reduction factor by consolidating interpersonal relations within the company, hence increasing the flow of information. Proximity is also a performance factor since it plays the role of trust guaranty.

The specificities of SMEs explain their fragility and constraints in comparison with large companies. In Morocco, SMEs face several obstacles:

- At the administrative level: the complexity of fiscal and administrative formalities, the unclear regulations set on the activities of SMEs… However, the leaders' ethics and morality play a fundamental part in the managerial laziness characterizing the legal system, which can lead to adverse consequences on the development of SMEs in Morocco (Mourji, 2001).

- At the managerial level: The centralization of the owner-manager decisions, the deficiency of modern and reliable methods of management, the unclarity of the leaders' strategic vision, the non-synchronization between the company's divisions and the lack of management structures. Moreover, the personality of the owner-manager certainly influences the firm's management mode.

- At the financial level: Like any entity, SMEs need funding for their development. Nevertheless, in Morocco, these companies face barriers which limit their access to bank financing, namely, the business leaders' unawareness of the available financial products and alternate sources of funding, the maladjustment of bank products to the SME needs and the opacity of the financial information presented by these companies.

Finally, these aspects show the difficulty of assessing the quality of SMEs through conventional banks due to the phenomenon of asymmetric information which justifies the effects of credit rationing.

SME Financing by Conventional Banks in Morocco

The leaders of SMEs prefer to finance their activities by internal sources rather than external ones, which is explained by the differences in bankruptcy costs, control and fiscal disparities according to the pecking order theory (Myers and Majluf, 1984). When the SME's needs exceed its internal capacity, the enterprise applies for loans first from the conventional financial institutions, and then it issues shares.

Moreover, the signal theory, according to Ross (1977), stipulates that the more the company's level of debt is high, the more it exhibits a signal of good quality and it undertakes profitable projects of investment.

As a result, bank loans dominate in financing small and medium size businesses. The financial statement proved that a small business does not have sufficient reputation to have direct access to market. At a Moroccan level, SME access to capital and debt markets is limited by strict conditions demanded by these markets. In this respect, SMEs have recourse to banks to get financed and to contribute to the creation of information about their solvency in order to gain more notoriety.

However, Moroccan SMEs face many constraints which destabilize the process of granting bank loans. On the basis of the results of the interviews, we found that, on the one hand, the regulation affects the policy of distributing credits to SMEs, since the bank is obliged to respect the key rate demanded by the central bank and to take into account affected or risky sectors of activity. On the other hand, the insufficiency of means of SME risks assessment by banks influence the decision of the bank due to the strong information asymmetry and the incapacity of these enterprises to create sharable and transparent information.

Moreover, According to the agency theory by Jensen and Meckling (1976) and to Gasse and D'Amours (2000), this risk assessment creates interest conflicts between banks and SMEs. While SMEs try to control profitability with a fixed risk level, banks tend to control risk by focusing on profitability. Both sides stick to the achievement of the objectives and reach the desired profits (Sarasvathy and al, 1998).

The bank–SME relation is considered as an agency relation transfused by oppositions and issues related to latent information, which increases the risk and cost of SME credits (Joseph and Sinkey, 1998). However, the financing of SMEs is considered by traditional bank as being more dangerous than that of big companies.

This is affirmed by the central office of balance sheets of "La Banque de France", which reveals that the risk of failure decreases with the size of the company. When establishing an SME financing contract, the firm worries are directed towards the profit of the capital returns while the bank concentrates its concern on the solvency of the borrower.

The asymmetry of information covers two types of situation the bank faces. Firstly, when an SME applies for funding, the bank is unable to distinguish between "good" and "bad"[2] projects; this phenomenon is called "the adverse selection" developed by Stiglitz and Weiss (1981). According to Akerlof's study (1970), it was concluded that starting from a certain interest rate, the effect of adverse selection becomes stronger and stronger and the balance of the credit market is no longer done through prices (i.e. Interest rate) but through quantities. Thus, SMEs face a rationing of bank loans based on the risk level of their project, and this is because of the opportunistic behaviour of the leader and the short-term based management strategy of the SME. The business account managers interviewed confirmed that most SME leaders try to hide information about the financial and organizational structure of their business, which makes the task of the

[2] The projects which are risky.

bank more difficult, since it cannot assess the quality of the company and its projects.

Secondly, after establishing the contract, the bank may have to face the phenomenon of moral hazard, in other words, the hidden behaviour. This involves a yield diversion by the SME leader. This asymmetry situation creates an excessive cost of controlling the activity of the company. It is the kind of monitoring that occurs when the debt is not paid thoroughly (Yan, 1997). In fact, the interest rate represents an inciting mechanism, that is to say, when the firm gets a loan at a high rate, it prefers to invest in a more risky project and it changes its attitude into an opportunistic behaviour (Williamson, 1986). But, according to the outcomes of interviews conducted, we have found that this phenomenon is not present in the banking practice, as the financing of the contract is set up by a notary where the purpose and details of the funded project are clearly identified. So, the purpose of the loan is strongly controlled by the bank and the project changes can be made only after the bank's agreement.

In Morocco, in 2015, more than 7.700 companies went bankrupt[3]. This number keeps on increasing every year by 15%. This is due not only to the chilliness of conventional banks to finance SMEs because of information asymmetry, but also to fiscal reasons and the delays in payment deadlines opted for by the SMEs.

In this respect, we can conclude that SMEs are the most exposed entrepreneurial structures to the credit rationing phenomenon. In fact, many are the determinants of the decision to grant credit to SMEs, each bank has a specific evaluation form that allows it to analyze the quality of the project and the company. In accordance with the results of the study, it turned out that the evaluation of financial statements (Balance sheet ratios, internal rate of return, turnover…) and the analysis of the company's sector of activity remain the major decisive elements in the treatment process of SME funding applications.

Furthermore, the literature has highlighted some instruments which allow the reduction of the informational asymmetry risk characterizing the lenders – borrowers' relations. Among the mechanisms implemented by Moroccan banks to manage SME financing, the demand of high guarantees to incite the SME leader to launch safer projects in order to preserve the guarantees made available to banks (Williamson, 1983) and also to reduce the loss of funds granted to companies.

Nevertheless, SMEs do not have solid guarantees and waive the credit contract even if the project proves to be safe, as pointed by Stiglitz and Weiss (1981) who show that the demand of higher guarantees can incite the SME leader to undertake riskier projects to compensate for the opportunity cost of obtaining the company's assets. According to the survey conducted, the nature of the guarantees requested by the bank generally depends on the amount and the nature of the loan, but also on the banking relationship, the extent to which the bank holds private information about its client -SME. However, when the SME's project is deemed viable, feasible and profitable but the company doesn't have the actual guarantees sufficient to cover the amount of credit requested, the bank recommends the project to be guaranteed by the guarantee fund (between 50% and 80% of the credit amount).

In addition, the funding of an SME by a conventional bank for a long period allows the acquisition of an important informational capital which leads to cost reduction of the monitoring of the activity linked to the requested credit. Customer relationship development ends up at gathering information about the history of refunds and improving the portfolio quality of the SME by gradually eliminating risky businesses.

In this sense, SMEs enjoy a reputation capital and master an ease of access to

[3] According to a study by the firm specializes in business information - INFORISK

loans under the best conditions (Diamond, 1989).

On the basis of interviews, the customer relationship is one of the most important determinants in the processing of loan applications by SMEs. The strength of the relationship between the bank and the SME induces the generation of up-to-date private information about the company, future projects and its environment. This reduces the asymmetry of information and, consequently, increases the chance of granting credit for SMEs. The customer relationship also represents a reliable signal of the borrower's creditworthiness and the credibility of the summary statements presented.

According to the several empirical studies, there is a negative link between the customer relationships and the credit cost[4]. In other words, customer relationship incites banks to focus on the refinancing conditions of SMEs, taking into account their solvency and the reduction of the loan cost.

In fact, in contracts of loan grant for SMEs, Moroccan banks demand strict clauses to minimize risks and opportunistic behaviours. These clauses may involve the level of indebtedness, the use of financing the issuance of periodic financial reports, the payment of dividends, the increase of executives' salaries, etc. Indeed, the inciting effect of excessive clauses, on the one hand, dissuades the leader of the SME to try actions or strategies which are hostile to the bank interests, and on the other hand, commits the bank to monitor the borrower and exploit the available information effectively.

Otherwise, there are other variables which can alleviate the problem of SME financing, for instance, the training of the owner – manager to improve his capacity to convince the financial institution to grant him a loan. He can, alternatively, be assisted by viable and feasible skills in accounting and finance which can analyze different business summary financial statements in order to make the adequate and appropriate information available to conventional banks. Needless to mention that the profile of the SME's manager-owner has a strong impact on access to bank financing (Cavalluzzo et al., 2005, Han, 2008). This was confirmed by the results of the interviews, as the majority of the case managers interviewed expressed the importance of analyzing the quality of the manager of the SME and its associates.

In short, the bank is obliged to develop its specific expertise in the acquisition / production of information. However this knowledge is not perfect when monitoring costs are high or the establishment of sophisticated evaluation procedures is ineffective.

Participatory Banks: A Credible Alternative for SME Financing

The presented solutions, however, do not solve the problems of SME in the starting up or growing stage since they do not have an attractive debt history to conventional banks and represent a significant risk to financial institutions. Thus, the economic conditions and the obstacles facing SMEs when applying for funding to conventional banks have pushed them to consider another made of financing: participatory banking.[5]

A participatory bank is defined as a financial intermediary essentially based on the principle of participation in losses and profits (PLS). For this reason it is called "participatory" because investors entrust their money to an entrepreneur, sharing profits following a pre –determined proportion, and assuming the losses together. It is a translation of the famous rule "Al Ghonm Bel Ghorm".

Furthermore, the principles of Islamic finance are encouraging these banks to invest in projects of small-size businesses,

[4] Petersen et Rajan (1994) et Berger et Udell (1995), Leeth, Scott et Dunkelberg (1987) Finaldi et Rossi (2001)

[5] Islamic banks

hence boosting economic growth (Iqbal and Mirakhor, 2013). In the case of a country like Morocco, the establishment of participatory banking in the financial system aims at creating competition between conventional and Islamic banks and alleviating the problem of SME financing. Therefore, the Morocco's Central Bank approved recently five requests to open participative banks and allowed three banks to sell participative products with the aim to start business in the second semester of 2017.

While conventional banks provide rigid conditions to SMEs for grating credits, participatory banks are, on the contrast, trying to alleviate the conditions for these companies by an ease of collateral in favour of the entrepreneur's reputation, a possibility of rescheduling loan granted repayment period, coaching and advisory support in management and implementation of the investment and a rigorous study of the project feasibility.

Beyond the services offered by participatory banks to small and medium enterprises, suitable financial products are suggested for every situation experienced throughout the life of the companies.

In fact, SME financing by Islamic financial institutions can be studied according to three criteria: investment, profitability and risk. These criteria summarize the features of participatory banks compared to the conventional ones.

As a whole, the Moroccan SMEs generally have a structure which calls for a lot of efforts in terms of managing and financing the activity, and in this respect, the participatory financial institution targets the financial and structural back-up in favour of these companies.

Conclusion

Having analysed the different theoretical aspects dealing with SME financing by conventional banks, we deduce how information plays an important role in the relationship between the SME and the conventional bank. In other words, information asymmetry decisively weighs in the funding relationship.

Indeed, SMEs are facing not only a lack of tools, strategies and support, but also an inability to produce the necessary information for conventional banks to assess their credit applications.

Therefore, the small and medium size companies based in Morocco face a number of barriers which limit their access to bank financing and are obliged to search for other ways to meet their specific liquidity needs.

Certainly, participatory banks may be seen as a credible option for the financing of domestic SMEs, since they are financial intermediaries that generate hybrid funding arrangements between the loan and the investment and seek to consolidate not only the capital but also its yield.

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