

Chapter 3

The Influence of Specific Criteria of Emerging Markets on SME Financing in MENA Markets

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ABSTRACT

In this chapter we are interested in the impact of specific microstructure criteria of emerging markets in the financing of SMEs especially in risk measures. The main risk measurement tool is the Value-at-Risk (VaR) which is recommended by the Basel II Committee on Banking Supervision (BCBS). The recommendations of the Basel II committee give financial institutions the freedom to develop their own Value-at-Risk model of risk measurement in order to calculate their capital requirements for financial risk. The Basel II committee recommends the use of back testing in order to validate the choice of the best method. In order to finance SMEs enterprises in emerging market we must consider the specific microstructure criteria of these emerging markets such as low liquidity, very pronounced asymmetric information, over predictability and high volatility how affects the risk estimation.

INTRODUCTION

Small and Medium Enterprises (SMEs) are considered as a backbone of the economy in any country. They contribute to job creation, innovation, competition, productivity and economic growth. Meanwhile, SMEs implied in the whole supply chain create the potential to promote international trade and mobilize the domestic demand (Shinozaki, 2014).

Focusing on the SME development is essential for encouraging sustainable and balanced economic growth, employment as well as social stability. Even though SMEs play a crucial role in national economy, SMEs suffer from poor access to finance which is considered as obstacle to SME development. Access

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to finance helps SMEs to make productive investments, develop their businesses and provide the latest technologies implying their increased competitiveness (Abereijo and Fayoumi, 2005).

Constrained access to SMEs financing is partially assigned to the relatively greater risks related to investing in the SMEs, poorly functioning systems, raising banks risk aversion when extending debts and the important financial regulatory reforms after the 2008 global financial crisis. The perceived supply-demand gap in SME finance is highly related to the availability and accessibility to finance options, the nature of the business, management experience and marketing abilities. From academic standpoint, many researchers report that SMEs struggle with access to finance and highlight the shortage of finance resources (Masonaudkwok, 2010; North et al., 2010; Hughes, 2009; Guijarro et al., 2009; Bruns and Fletcher, 2008; Mason and Harrison, 2004a). SMEs have widely relied on banks for financing which have recently reluctant to provide debts to SMEs after the 2008 financial crisis.

Rupeika-Apoga (2014) reports that “recent financial crisis has affected ability of external financing for SMEs more dramatically than large enterprises, in the form of higher interest rates, shortened maturities and increased request for collateral”. According to Benink and Winters (2016), banks tend to finance generally SMEs which existed since several years and require high interest rates for bank loans. Rupeika-Apoga (2014) points out that Batlic firms impede to provide bank loans, in particular long term debts due to a lack of collateral, obstacles to prove creditworthiness, small cash flows, inappropriate credit history, high risk premiums, high transaction costs and underdeveloped bank-SME relationships.

The need for obtaining long-term financing as well as strengthening of prudential regulation in the banking system- including the emergence of stringent capital requirements for banks associated with Basel III- lead SMEs to examine alternative financing channels. Increasing funds through an organized, transparent, well-regulated and reliable capital markets could be an interesting alternative source of finance for SMEs. The existence of capital markets allows narrowing the supply-demand gap in SME finance as well as investors to diversify their portfolios. Although capital markets are a financing tool and have distinguishable advantages over banks loans, SMEs are reluctant to access to capital markets because of their fear of losing ownership, relatively high regulatory costs, inexperience with capital markets and financial educational gap.

The financing of Small and Medium-Sized Enterprises (SMEs) has been a subject of great interest of researchers because of the significance of SMEs around the world and the perception that these firms are financially constrained. Emerging market has specific microstructure which should be taken into account in financing of SMEs. There is no universal definition of emerging market; Morgan Stanley MSCI Market classification framework uses the following criteria: economic development, size and liquidity as well as market accessibility. According to the classification of the World Bank and S&P, emerging and frontier markets are markets that belong to the economies of low and middle income with low investable market capitalizations relative to GDP. Frontier markets are smaller and less liquid than emerging ones.

In this chapter, we attempt to examine the impact of specific criteria of emerging markets (i.e. microstructure) in financing of SMEs, especially in terms of risk measures. The main risk measurement tool is the Value-at-Risk (VaR) which is recommended by the Basel II Committee on Banking Supervision (BCBS). According to Basel II committee, financial institutions are able to develop their own Value-at-Risk model of risk measurement in order to calculate their capital requirements and handle financial risk. The Basel II committee also recommends the use of backtesting to choose of the best method.

More specifically, we try to identify the specific criteria to the microstructure of emerging markets and study the impact of these emerging markets features on the market risk. The literature review on developing equity markets shows that these markets are characterized by the following overlapping fea-

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