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FINANCING MICRO BUSINESSES IN MOROCCO: CASE STUDIES

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ABSTRACT

The presentation is a part of a vision on the situation of Moroccan micro business. A renewed interest is given to it because of its dominance in the national economy. It faces several constraints related to surviving, sustainability and growth. While the academic research in financing target large companies, small businesses interest a limited number of studies. This research focuses on funding conditions of multiple case studies of Moroccan micro businesses; it aims to explore firstly their funding sources, their preference in funding and finally choice of their habitual bank. Results show that the owner personal reserves are the primary source of funding for studied micro businesses. Internal financial resources are preferred over external as so in the context of the pecking order theory. The majority of studied micro businesses have revealed that the choice of its habitual bank is based on the condition of the relationship component showing thus the importance of this determinant in the relationship micro business-bank in Morocco.

Résumé :

La communication s'inscrit dans une optique de mise au point de la situation des micros entreprises marocaines. Au Maroc, un regain d'intérêt est remis à la micro entreprise vu son importance au tissu économique national. Les micros entreprises se trouvent face à plusieurs contraintes de survie, de pérennité et de croissance. Au moment où la recherche académique au domaine de financement cible amplement les grandes entreprises, les petites entreprises intéressent un nombre limité d'études. Ce travail de recherche s'articule autour d'un état du lieu du financement de multiples études de cas de micro entreprise marocaines, il vise à explorer en premier lieu leurs sources de financement, leur préférence en financement et finalement le choix de leur banque habituelle. Les résultats démontrent que les réserves personnelles du manager constituent la première source de financement des micros entreprises étudiées. Les ressources financières internes sont préférées à celles externes s'inscrivant ainsi dans le cadre de la théorie de financement hiérarchique. La majorité des micros entreprises étudiées ont dévoilé que le choix de sa banque habituelle se base sur le critère de l'aspect relationnel montrant ainsi l'importance de ce déterminant dans la relation micro entreprise-banque au Maroc.

Keywords: *Micro business, financing sources, pecking order theory, banking relationship*

Introduction:

The micro business manages operation and investment activities with continuous constraints of restricted availability to access to appropriate forms of finance, which explain certainly inhibit micro business growth. (Binks & Ennew, 1996; Harding & Cowling, 2006) According to Hamilton et al., Bhidé (1992: 110) argued that the biggest challenge for entrepreneurs is not raising money, but 'having the wits and hustle to do without it' (Hamilton & Fox, 1998).

Micro business dominates Moroccan economic structure; it constitutes a significant proportion 97.7% of firms and employs 64.7% of the labour force [15]. Extensive structural adjustment, trade liberalization and increase of unemployment are circumstances that affect the development of micro businesses in Morocco (Hamdouch & al. 2006).

The problems of micro business financing have greatly limited their role in the overall performance of the Moroccan economy. This situation remains deeply. During the last decade, Morocco has significantly improved the implementation of several policies to promote entrepreneurship and micro business support. This has been accomplished through developing a strong institutional framework for a micro business policy, and improving the quality of the institutions. Morocco has introduced a wide range of support systems covering all segments of micro business: new entrepreneurs, established companies, and high growth companies (OCDE, 2014).

The purpose of this study is to identify funding sources used by very micro business, to investigate their capital structure, and their relationship with their habitual banks. Studied funding sources concern basically personal funds, relative funds, and banking funds. Bank financing is not usually reachable for micro business. Thus, financing decision is not as simple for micro business owners.

The paper is initiated by outlining research questions and the methodology used to response these questions. The sample of micro firms composed the study is eight profiled. This sets the scene for a discussion of replies about financing preferences, capital structure and banking relationship revealed by micro firm owners before concluding the paper.

1. **Research questions**:

Micro Business development has become increasingly important in recent years, in both developed and developing countries (Ray & Hutchinson, 1983). they improve employment, industry competitiveness and innovation, and contribute in economy growth (Cassar, 2004). Policy makers, regulators, and academics provide a particular interest to micro business especially to micro businesses financing (Berger & Udell, 1998).

The financial capital invested by a firm correlates positively to his sustainability and growth (Alsos, et al. 2006; Chandler and Hanks 1998). Though, the majority of micro businesses are not able to have financing they seek for from banks (Hamilton & Fox, 1998). Hence, Access to external finance is identified as a development constraint for many micro firms (Harrison et al. 2004; Atherton 2012)

The capital structure issue for the micro firms differs from the large firm in terms of sources for financing, equity contributions and funding pecking order (Ang, 1992a). This issue has been the subject of several studies. The aim is to explore the sources for financing, financial capital decisions, and the key determinants of capital structure, in line with banking relationship.

[15] Haut-Commissariat au Plan (2004), p.44

According to Ang, micro businesses use different sources for financing. high agency costs, reduced costs of business transaction related debt, owners' risk aversion and the lack of enough lenders, are factors that limit financing sources in owner's own savings and, family and friends, suppliers and advances from customers (Ang, 1992b).

Gartner et al. tested hypotheses about the relationships between expected and acquired funding sources, founder and firm characteristics, and success at starting a business. They analyse a sample of 146 respondents from a Panel who initiated their firm start up process within two years of the first interview. By generating a descriptive and simple comparative statistics on individual and firm characteristics that influence the type and amount of financing expected to receive by the entrepreneurs. Measured firm characteristics concerned industry, business legal form, expected growth rate, expected size; and measured individual characteristics are: education, industry experience, age, gender, and income. Nearly all entrepreneurs use personal funds. Founders using external financing used less of their own money as a proportion of overall funding (Gartner et al. 2008):

- *Question 1: are owner's savings, family and friends, and then banks the main sources for micro business?*

Berggren al. tried to identify under what circumstances micro and medium sized firms are prepared to accept outside control, by using private equity by the business firm in order to grow, using a sample of 281 Swedish firms which have less than 200 employees. Results approve information asymmetry characterises relationships between SMEs and their financiers. Also they agree that control aversion may limit improving relationships with external financiers, posing accordingly a long term problem for the firm. Other factors can encourage business firms to accept external finance such highly turbulent industries: the character of the industry affects financing attitudes more than type of firm owners. The size influences also outside control aversion: larger firms are less averse to the change in control (Berggren et al. 2000).

Another study aims to shed light on start-ups financing and the existence of credit constraints that may negatively affect their activity. Findings support the view that the credit market is imperfect and there exists a financing hierarchy. In fact, only a minority of firms resorts to outside financing, and especially to bank debt (Colombo & Grilli, 2007)**.**

Kon & Storey discuss in a research paper the existence of 'Discouraged Borrowers' from SME financing marking. These borrowers are defined as good borrowers who do not apply for a bank loan because they feel they will be rejected. A range of conditions typifies financing market and generates a discouragement in economy. Discouraged Borrowers can appear under specific conditions, it is about the screening error of the banks, the scale of Application costs and the extent to which the bank interest rate differs from that charged by the moneylender. The authors conclude the impact of policies which governments might implement to minimize discouragement of the entrepreneurs (Kon & Storey, 2003).

Ang confirmed financing hierarchy in micro business decision. Basing on sources of financing used, there seems to be a pecking order for funds financing this type of business (Ang, 1992a).

Scherr et al. (1993) interested to start-up capital structures of micro firms by investigating about 49,000 firms upon characteristics of both owner and firm from characteristics of business owners survey that were founded after 1980. Results show owner's characteristics, industry, firm size and more other variables are correlated to the capital structure (Scherr et al. 1993).

Hamilton et al. research about the financing preferences of a sample of micro firm owners argued that supposed gaps in the supply of finance to micro business might not be the cause as partially the consequence of financing decisions of the owners. Financing preferences depend relatively on consequent financial structures. Also, internal funding sources are the most preferred by the owners, they include cash savings of the founders and then prolong to retained earnings. (Hamilton & Fox, 1998)

Aktas et al. investigate the capital structure choices of very micro businesses using a sample of French firms during the period 1998–2006. By using pecking order theory as a framework to explore their capital structure decisions, 393,662 firm-year observations from 56,605 individual French very micro businesses are studied, to show that the pecking order theory can explain most of their financing decisions. Firms with a positive deficit rely almost entirely on debt for financing, whereas firms with an excess of financing behave more conservatively and are less likely to repay their debts spontaneously in advance (Aktas et al. 2011).

To approach financing decision, there is no universal theory but several conditional theories. The decision of financing depends on balancing tax advantages, information asymmetries and agency costs. Pecking order theory states that the firm, excepting when internal cash flow is not sufficient to finance capital expenditures, prefers not to borrow: Firms prefer internal to external finance (Myers, 2001)**.**

- *Question 2: to what extent can pecking order theory approach capital structure of micro business?*

Empirical studies of micro business lending from banks are often reliable with the importance of strong relationships (Berger & Udell, 2002). Berger and Udell examined the economics of financing micro business in private equity and debt markets. They determine borrowers with longer banking relationship pay lower interest rates and give fewer guaranties (Berger & Udell, 1995). Degryse and Cayseele tested the possibility of inter temporal rent shifting by banks through investigating detailed contract information of very micro firms obtained from examining nearly eighteen thousand bank loans. The empirical evidence shows the length of a bank-firm relationship increases the loan rate, and widening of the relationship by buying other information sensitive products from a bank decreases the loan rate (Degryse & Cayseele, 2000).

Relationships between banks and micro businesses inclined to be long outstanding. They are based on the accumulation of multidimensional information over time through contact with the firm, its owner, and its local community. This category of relationships, called relationship lending, uses opaque informational without strong financial ratios, guarantees, or credit scores so that micro businesses obtain bank financing by augmenting relatively weak hard information with soft information gained through contact over time, unlike transactions-based lending which involve hard information that may more easily be observed, verified, and transmitted such asset-based lending, and credit scoring are based primarily on quantitative financial ratios, collateral ratios, and credit scores (Berger & Udell, 2002):

- *Question 3: is selecting the habitual bank of the micro business based on the relationship component?*

2. Methodology:

Selecting a methodology is an important step in research process. Methodology of case study permits a deep understanding of phenomena, processes the component and people taking part (Gagnon, 2012). It is suitable when for examining a particular phenomenon, especially for Micro firms which are characterized by the feasibility of access to decision makers (Chetty, 1996). Eisenhardt argued that multiple-case studies encourage the researcher to study patterns common to cases and theory and to avoid chance associations. There is no ideal number of cases to choose for the sample, a number between 4 and 10 cases usually works well (Eisenhardt, 1989).

Before introducing case studies, it is important to introduce the notion of very micro business as it is considered in the sample. A very Micro business is defined in Morocco as a business with annual average turnover does not exceed 3 million Dirhams. A total of 8 very micro businesses were interviewed, during the period of June and July 2014, based in three Moroccan cities: Agadir, Casablanca and Rabat, operating in different industries (Table 1). In all firms the person interviewed was the founder.

Micro businesses	*Business sector*	*localization*	*Age*
Case 1	Caterer	Rabat	11 years
Case 2	Printing & publishing	Rabat	2 years
Case 3	Toy manufacturing	Casablanca	3 years
Case 4	Textile	Casablanca	9 years
Case 5	Construction industry	Casablanca	5 years
Case 6	Agriculture	Casablanca	7 years
Case 7	Industrial electricity	Agadir	11 years
Case 8	Trade	Agadir	7 years

Table 7: Case studies presentation

3. Results:

Beside business sector, case studies vary also in term of size. Among the sample micro business with less than 5 employees (cases 1, 2, 4, 6), between 5 and 10 employees (cases 3, 8), then there is between 10 and 15 employees (cases 5, 7). Business age is not an indicator of growth: some micro businesses grow rapidly than others (case 5 and 1). The objective of the study is to identify micro business which is more disposed to seek out financial resources in the process of holding business sustainability. Sample of firms having different ages provide possibility to identify time changes in owners' financing preferences.

Choice of geographic localization is not decided randomly. The region of Greater Casablanca contributes the most to GDP. It is 18.5% on average over the period 1998-2011, followed by the Souss-Massa-Daraa (12.3%), Rabat-Salé-Zemmour-Zaer (9.6%)[16].

In all cases, founders of the companies still manage their business. This circumstance allows asking very micro businesses leaders about creation financing as like as about current financing (Table 2):

	Sources of used funds			
Cases	Founder savings	Family and friends	Bank financing	Micro business related sources
Case 1	X	X		
Case 2	X			
Case 3	X		X	
Case 4	X	X		
Case 5	X		X	
Case 6	X			
Case 7	X		X	
Case 8	X		X	

Table 8: Sources of used funds by micro businesses

[16] Projet de loi de finances pour l'année budgétaire 2014, Rapport économique et financier, Ministère de l'économie et des finances, Royaume du Maroc

- *Case 1:*

The founder is a woman having between the 30 and the 40 years old, with a high school level and no precedent professional experience. The only financing source for this firm since the creation is totally from family's and savings owner. The firm deals with one bank which is selected for the reason that is less demanding in collateral. Relation with the selected bank is limited; the credit card is the unique service that the firm uses and in rare frequency. The founder confirmed never asking for a bank financing, she supposed that repayment terms are heavy.

- *Case 2:*

The owner is a man, between the 30 and the 40 years old, holds a graduate degree in law. He has 14 years as professional experience. He manages requisition financing for his firm from his personal savings. The business deals with one bank. The choice of the bank is based on the relationship component. For banking services, the firm uses very often the credit card; sometimes the checkbook is also used. Bank financing is never required, the founder expresses that this type of financing is difficult to get access.

- *Case 3:*

The owner is a man between the 30 and the 40 years old with a high school degree. He had 5 years of professional experience in the industrial sector before creating his firm. He financed investment needs since the creation from his savings. The firm is costumer of one bank which is selected basing on the relationship component. The firm benefits from many banking services; the credit card is very often used, the checkbook is used sometimes, other services are rarely taken such as overdraft facility, short and medium term loans, and leasing. Hence, bank financing is required for the firm; financing requests are very often accepted. However, the founder reveals that in cases of rejection the reasons given concern: insufficient cash flow, bad credit report, and that the firm is too young. Further, the firm mentioned the financer bank lending is chosen because other banks refused funding application.

- *Case 4:*

The owner is a woman who did a vocational training and worked one year in sewing, before creating her own business. Her age is between 25 and 30 years old. She financed the creation of this business by borrowing from family and choosing a partner. However, the founder finances currently funding needs from her own savings. About banking relation, the firm deals with one bank because of related relationship, and uses just a credit card. The owner has never applied for a banking loan, constrained by difficulties to access to that financing.

- *Case 5:*

The founder has between 50 and 60 years old; he holds a graduated degree in management and has 19 years of professional experience in auditing. The firm is established based on founder savings. The relationship component is the reason that he introduces to explain the choice of firm's bank. Besides, main services used by the firm relate to overdraft facility, checkbook, credit card, discounting transaction, deposit and investment operation, short and medium term loans, and leasing. Applying for funding is very often accepted by the bank since it is the habitual financial institution for the firm.

- *Case 6:*

The owner has between 50 and 60 years old, with a basic level in education and 20 years of professional experience in agriculture. He finances his business with his personal savings. The relationship with bank is very limited; the firm does not use any banking service.

- *Case 7:*

The founder is man between 40 and 50 years old, has a master's degree. He was a teacher for 10 years before creating the firm with a partner by sharing their own savings. The firm financed operational needs from one bank by the overdraft, supplier credit and the discount credit. Yet funding firm investment is done by banking loans and leasing. Also, the founder noted other used financial services as overdraft facility, checkbook, and bank guarantee. He confirmed that funding requests are always accepted by the bank which is chosen for relationship component reason.

- *Case 8:*

The founder is a man between 30 and 40 years old, has a high school degree. He was a commercial agent for 13 years before creating his own business. About business creation, the founder financed 15% of capital with his savings, 15% provided by a partner, and 70% is from banking loan. Operating activities are essentially financed by overdraft, supplier credit, discount credit and cash desk. This firm deals with two banks chosen for their flexibility and less collateral exigencies.

4. Discussion:

The most common sources of finance across the 8 cases are owners' personal savings. Banking services are less common, among woman owners particularly. The majority of firms deal with one bank, credit card is the most used, banking funds were used by four firms in form of loans and leasing (cases: 3, 5, 7 and 8), these use moreover various services like: overdraft, discount credit and cash desk, overdraft facility, checkbook, and bank guarantee. Transaction service as supplier credit is used by two cases (7 and 8). Relationship between cases and banks is visualized by financial services they use. Except cases 5, 7 and 8, other cases have limited relationship with their bank, more than this case 6 does not have any links with banks. The most common reason for choosing the bank revealed by firm is relationship component followed by less collateral exigencies. Firms do not apply for bank funding, indicate reasons for this decision which are: difficulty to get access and repayment terms are heavy.

Question 1 explores owner's savings, family and friends, and then banks are the main sources for micro business. The sample shows that main financing sources are owner's savings then banks; family funds are in the last place. Cosh et al. explained profitable firms and firms with stronger growth objectives are much more likely to seek external finance, and firms started by females, tended to be less likely to seek external finance. This last finding joined cases of the sample, businesses founded by women do not seek for external finance on the pretext of difficulty to get access and repayment terms are heavy (Cosh et al. 2005). Women entrepreneurs face difficulties in financial markets (Chaganti et al. 1995).

Question 2 concerns to what extent pecking order theory approaches capital structure of micro business. Internal finance is preferable to external funding: personal savings are more common than bank financing. Internal funding sources are the most preferred since they preserve the independence of the owner (Hamilton & Fox, 1998). Cosh et al. added firms seeking external funding are able to secure their requisite financing from at least one of the many different available sources (Cosh et al. 2005). Indeed two of cases using external funding combine bank financing and supplier credit.

Question 3 is about selecting the habitual bank of the micro business based on the relationship component. Findings highlighted that relationship component is the most given reason by firms to choose a habitual bank.

Research finding suggests that founders with strong background experience may be able to start businesses that survive with less financial capital than their less experienced counterparts (Chandler & Hanks, 1998). Across the sample there is no clear result about the importance of background experience.

Conclusion:

This paper has investigated, across multiple cases, the main sources of micro businesses financing, explored their capital structure, and banking relationship. It shows that the micro firm finances its activities firstly by the owner savings, secondly by bank and finally by family funds. Findings indicate that micro businesses prefer internal to external financing confirming thereby the pecking order theory. They confirm also that only a minority of micro firms resorts to bank debt as an outside financing. The case studies prove that selecting a bank for a micro firm consists essentially of relationship component.

It is therefore appropriate to conclude the rights of creditors have to be more strengthened to reduce the warranty obligations, and to diversify the sources of external funding for micro businesses. Banking relationships should take more attention as a valuable variable in access to bank financing.

This study includes some limitations proposing opportunities and perspectives for further research. It cannot be generalised to other countries, it is a study of Moroccan micro businesses. Additional research can aim to explain financing preference by determining micro business capital structure.

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