Research Paper

Distressed SMES in Morocco: Study on Common Characteristics

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Abstract: *Moroccan SMEs may confront a different kind of difficulties and risk to go bankrupt, business failure doesn't happen in one shot, but it results in a process that takes place over time. This paper pinpoints the profile of a distressed SME in Morocco from a crossing and financial point of view. A case study of five Moroccan liquidated SMEs allow highlighting the principal lineaments of a company in difficulty, using a combination of financial and non-financial elements, and mainly get a deep comprehension of common general and financial tendencies of companies in difficulty.*
Key words: *Moroccan SMEs, distress, common characteristics, financial characteristics, profile, bankruptcy*

I.   INTRODUCTION:

Small and medium-sized companies represent around 93% of the Moroccan economic tissue, 64% go to the very small companies and 29% go to small and medium ones (following the results of HCP investigation). SMEs are considered as a pillar of the Moroccan economy through the creation of job opportunities and added value, and participation in the economic growth. Nonetheless, this category of companies is sensitive; it has its own peculiarities which mean it has specific needs to survive.

The barriers of growth could be related to the weak structure of the company, the under-capitalization, the irrational management methods, or the insufficient access to new technologies… the list is not exhaustive and the barriers are tremendous and transversal, which makes the Moroccan SMEs more vulnerable to failure.

It is true that the business failure is a normal step in the life cycle of a company; entrepreneurs fail likely because of internal inattentiveness (company's profile, adopted strategies, management methods, the manager knowledge, the operations efficiency, the financial structure …) or totally external constraints (funding difficulties, the term of payment delay; economic juncture, legal and administrative obstacles …)

In Morocco, the number of bankruptcies is constantly evolving. Indeed 8 439 firms went into bankruptcy over the course of the year 2019; this represents a positive variation of +5, 1 % according to the previous year 2018. The phenomenon of bankruptcy primarily affects small and medium-sized firms that represent the majority of the Moroccan economy landscape. The percentage of bankrupted SMEs in 2019 is 99,7% and the remainder goes to large companies. (Inforisk 2019 investigation)

Understanding business failure among SMEs in Morocco represents an important challenge, so far, all investigations around the question cover the legal perspective, and the existing writings about business failure from a financial and economic perspective are dominated by strategies to turnaround bankruptcy. *Moroccan company in difficulty: what curative banker approach? (N. BOUAYAD et al),* prediction; *Early prevention of companies in a situation of financial distress (E. ELAKRY) the difficulties of SMEs in Morocco: A failure warning (F. ANAIRI)   Modeling and analysis of business failures: application to Moroccan SMEs (S. EL KHARRAZI et al) Prevention of business failure (M. HASSAINATE)* and the analysis of business failure *in Morocco: Qualitative approach (A. IBOURK et al), Business failure: A theoretical and empirical literature review (A. AZZAB et al), the failure of Moroccan SMEs: fragility indicators analysis (W. Nokairi)*

From this point, the existing contributions are settled to understand the phenomenon of distressed SMEs'. First, previous empirical studies tend to show the theoretical aspect of the subject, second, given the economic and financial consequences of difficulties, drawing a typical profile of a distressed company will fill the shortage of predicting strategies of distressed.

The required purpose of this study is the census of the common characteristics of distressed companies at two levels: general level and financial level, the analysis of these elements allow drawing a profile of a company in difficulty. Once done, it's mandatory to present financial decisions to take by a distressed company to decrease the weightiness of difficulties and relieve the economic and financial situation of companies.

The originality of this paper lies in its goal which is from one side, Present the common characteristics and from another side determine a typical profile of Moroccan SMEs in difficulty.

The rest of this paper is organized as follows; a first part devoted to the exploration of the literature review toward brings the theoretical aspects related to our problematic and construct hypotheses. A second section will be dedicated to the methods and data, a third part explains and interprets the empirical results and the last section concludes and discusses our findings.

II. LITERATURE REVIEW

1.   Official definition of a Small and medium-sized company in Morocco
The official definition of an SME in Morocco according to the small and medium-sized and very small companies' first charter article, published in 02/15/2002 is based on three criteria:

- The administration or management must be ensured directly by a physical person (owner, co-owner or shareholder)
- Capital ownership or voting rights which cannot be more than 25% owned by a company or a group of companies that do not meet the definition of SME.
- The size and there is a difference between:
o   Existing companies that have more than two years of seniority (which must have a workforce of fewer than 200 employees and an annual turnover excluding tax which does not exceed 75 million dirhams, and or a limited balance sheet at 50 million dirhams.
o   Companies recently created (must have an initial investment program of less than 25 million dirhams, and respect an investment ratio by the employment of less than 250 000 dirhams.

2.   Common characteristics of distressed companies
The normal life cycle of a company is dynamic and evolutive by nature, starting by launching phase, growth phase, maturity and decline phases. As a consequence of a consolidated decline, fires corporate crisis. It is an evolutionary process that starts from (1) Incubation, a decrease of financial and economic balance, (2) significant recorded losses during periods of time, (3) low profitably and higher difficulty of borrowing (4) crisis explosion and impact on the managerial, financial and economic levels (Pozzoli & Paolone, 2017)

Once in trouble, firms try to undertake turnaround actions, because they are obliged to:

- Repay creditors
- Retain customers
- Preserve some fraction of worker's job

a.   General characteristics
- CEO Turnover

Bad management decisions and weak governance lead to financial distress, injecting new blood in the company may preserve its continuance. So that changes in management and governance are sometimes symptoms of the company's difficulties. Besides, within four years after the onset of financial distress 47% of the old director keep their seats in the company, 8% of the entire board is changed and important restructuration decisions are done following to distress situation. (E. I. Altman, 1999)

It is clear now that changes in management and governance is a specification of distressed companies

- Strategic reorganization :

Financial distress emphasizes a change in the firm's economic activities and the way these activities are organized, the sought objective of strategic organization is to increase the value created, by refocusing on the more profitable strategic business units and the way these activities are organized. (E. I. Altman, 1999)

(Djama, 2002) demonstrated while studying distressed companies that one of the most observed lineaments is strategic reorganization, by all means, that companies used to work on multiple activities, but within a context of difficulty they fold over the most profitable activities.

- Restructuration

Restructuration operations are the operations done in order to streamline costs such as decreasing production components, cutting labor costs, reducing R&D spending, minimizing sales and administrative costs… (Denis & Kruse, 2000)

The investigation accomplished by (Santana et al., 2017)on the companies in crisis shows that around 60% of executives choose to downsize as a management tool when the company experienced a decline. Restructuration decisions are symptoms of difficulties.

- Seeking new partners

Following the systematic approach, a company is a part of a system where it interacts with other stakeholders. In the decline process, companies are obliged to call the other stakeholders in particular financial ones in a hope of recovery. (Djama, 2002)

Seeking new partners or asking the existing partners for support is another feature of distressed companies.

b. Financial characteristics

Tremendous are the aspects of a company in difficulty, however, liquidity, solvency, profitability and working capital level still the most expressive signals of companies' financial health.

• Liquidity

Healthy SMEs have a high level of liquidity than that of failing SMEs which can go up to twice. This is an obvious reality since distressed companies find it difficult to honor their commitments, in particular, due to a lack of liquidity. (Nokairi, 2015)

A company's liquidity position is the most important factor to know if the company is likely to file bankruptcy because it will not be declared as truly distressed until it is unable to continue financing its operations (E. Altman, 1999).

• Solvency

The first signs of financial difficulties are emitted voluntarily or involuntarily, they take various forms. The first category of signs regroups together financial signals directly perceptible by bankers such as overdrafts, unpaid deadlines, payment defaults. A second category regroups signals which have only an indirect repercussion on the commitments of companies with regard to banks, for example, internal conflicts within the company, conflicts between the company and a creditor or a third party, default payment from a customer or supplier… (Bloch et al., 1995)

The increase in debt and the record of a high level of debt rate in the short, medium and long term lead to financial fragility which becomes unfavorable over time, which increases the profitability of business failure. (Nokairi, 2015)

• Working capital

A significant amount of working capital shows that companies are running risks since it refers to the difference between assets and liabilities; a high working capital means that the company can't meet its engagements by the available resources. Also, high working capital leads companies to increase sales while it burdens extra charges that lead companies to bankruptcy (Kieschnick et al., 2013). Besides, the research of (Baños-caballero et al., 2014) proved a negative correlation between the corporate performance and working capital level, in other words, the more working capital's level is high the more its corporate performance is low.

To wrap up the previous research findings, Working capital sold is an indicator of less performed companies and it is a sign of a distressed financial situation.

III. RESEARCH QUESTION AND HYPOTHESES

Despite the growing interest of researchers on predicting financial failure of companies, the work of drawing a typical profile of a distressed SME in Morocco is a topic that attracted the interests of scientific committees and managers to avoid or at least reduce the severity of business failure.

This paper aims to answer a central question which is about the common criteria of a distressed SME in Morocco while focusing on General facts and financial facts. As there are empirical findings on the general factors and financial ones, the following hypotheses are formulated and tested:

➢ Hypothesis 1: A distressed Moroccan SME goes across at least one judicial event classified as a general factor of business failure.

➢ Hypothesis 2: All distressed Moroccan SMEs express a financial regression

➢ Hypothesis 3: A junction of financial indicator's regression and general feature of business failure allows judging a company as in a distressed situation.

IV. METHODOLOGY

1. Study conceptualization

Our methodological approach consists of a case study, which is "*A methodological tool particularly suited to examine the plausibility of a theoretical gird which suppose the existence of complementarity within a complex and dynamic system*" (Wirtz, 1999) the usage of a case study allow to observe over a long period the causes and consequences of the studied subject.

The sought objective of using a case study is to query or reduce the scope of certain hypotheses or explanatory factors. Concerning our research, the legitimacy of case study usage allows a dynamic analysis to determine common general characteristics and financial characteristics of companies in difficulty.

To draw the profile of distressed companies, we study the performance evolution over five years before opening legal proceedings of a sample of five Moroccan SMEs, by following the steps below:

➢ **Step 1:** Analysis of observed facts, we focus here on general significant events sanctioned by a statutory amendment, and we follow the judicial event's evolution

➢ **Step 2:** Analysis of financial variations, we focus on the solvency, liquidity, working capital, and profitability.

The financial analysis is issued applying ratios, the latter's express relative quantities as relationships between values, and these values can be economic or financial depending on the applied framework type. Ratios were selected in accordance with logic and methodological perspective to constitute an obvious list, which allows presenting the financial tendencies of distressed companies. We attempt to assess the financial sustainability even considering liquidity, solvency, profitability, and working capital evolution.

Concerning the methodological aspect, we calculate the average of every single ratio of the five studied companies. And then we observe the variation of this average over the period of study.

➢ **Step 3:** Analysis of the financial adopted options, such as Assets, leasing, long term loans, creditor's accounts ….

2.   Data collection:

To shed the light on the common symptomatic of distressed Moroccan SMEs, we were brought to look for information from journals of legal publications, we selected around 78 companies which declared bankruptcy and submitted liquidation reports in 2019 and 2020.

We did our registration in INFORISK "the Moroccan specialist in commercial information on Moroccan and Maghreb companies", and associate of Altarès one of the principal European actors in information treatment, also INFORISK Altarès Africa has an open access to the American giant Dun & Bradstreet, which manages a database of over 250 million data.

The registration gives access to the ANALYTIX Platform, which gathers all kind of information about Moroccan companies, and then we started filtering by:

•   Legal information availability: legal status
•   Number years of existence: Minimum five years of existence
•   Size: only SMEs were selected
•   Employees number less than 200 permanent worker
•   Financial statements availability: for the last five years

We constituted a final sample of 5 Moroccan SMEs.

Sample:

Company 1: SYNTONE

SYNTONE is a limited liability company, created in 2006 with a capital of 1 000 000 DHS, It belongs to the sector of IT consulting and programming, SYNTONE offers services of information system consulting, business consulting and business administration.

Company 2: SOLIGLASS

Created in 2010 SOLIGLASS is a limited liability company with one member, headquartered in Mohamedia-Morocco, it operates in shaping and processing of flat glass, this company had increased her capital in 2011 in order to reach a 1 500 000 DHS of equity. During the last 4 years, the company recorded negative incomes.

Company 3: Code arabesque

Headquartered in Casablanca; Code arabesque is specialized in the wholesale, retail of books, advertising, communication, and management consulting… The business was launched in 2008 and new activity was added in 2016. Income losses were recorded in two previous years.

Company 4: JAAHIZ IT

JAAHIZ IT is a company specialized in information system consulting, It was created in 2009 with a capital of 10 000 DHS in Casablanca. JAAHIZ IT recorded losses in the last five years, also, changed the name and transferred shares to new shareholders.

Company 5: UAE exchange Morocco

The object of UAE exchange Morocco is the financial intermediation. It was created in 2009 and in 2013 the capital was raised to 75 000 000 DHS.

The table below summarized the information of these groups:

	SYNTONE	**SOLIGLASS**	**Code Arabesque**	**JAAHIZ IT**	**UAE Exchange Morocco**
Legal Form	Limited liability company	Limited liability company with one member	Limited liability company with one member	Limited liability company	Anonymous society (S.A)
Branch of activity	Service	Industry	Commerce	Service	Service
Number of consecutive years of loss	4 years	4 years	2 years	6 years	8 years
Date of bankruptcy	2020	2020	2020	2019	2019
Capital	1000 000 DHS	1 500 000 DHS	10 000 DHS	10 000 DHS	75 000 000 DHS

Last Turnover	0	0	472 419,75	0	3 333 734,30
Number of employees	<200 employee	< 200 employee	<200 employee	<200 employee	< 200 employee

V. RESULTS

1.   Analysis of general facts

The observation and the track of the legal event's evolution during the period of study (last 5 years) show certain common facts of distressed companies, which are about: Strategic reorientations and internal restructuration, divestments, new partners inclusion, changing managers, capital structure…

❖   Changing managers:

The common factor of our companies' sample is the declaration of liquidation during whether the year 2019 or the year 2020. We observe that two studied companies Jaahiz It Maroc and Syntone have proceeded to legal representative turnover years before they go bankrupt.

❖   Divestment:

The financial difficulties of the studied companies are clearly evident on their liquidity level, at the time; it goes to the companies the decision of looking for financial resources to face their needs. A common spotted fact for two companies is a divestment, which consists of assets disposal.

Adopting the same framework of relieving the treasury and emphasizing the financial situation, four companies from our sample have decided to increase their capital on average 3 years before liquidation.

❖   Restructuration:

The restructuring is defined as the modification of the framework and the organizational structure of the company, the finality of a restructuring plan is spending cuts. This purpose is obvious through downsizing, for our sample three companies namely: code arabesque, soliglass, and UAE exchange morocco have proceeded to reduce the number of workers; this fact is clearly illustrated by the drop in wages and salaries during the study period.

❖   Strategic reorganizations:

When the difficulties become persistent, one observed fact in the case studies is about making in question the adopted general strategies, normally companies opt for diversification in order to multiply the sources of revenues but they may lose control of their core activities.

We note that for the company code arabesque a supplement new activity was added to the portfolio of current activities and for the other four companies Jaahiz IT Maroc, Soliglass, Syntone and UAE exchange Morocco with no exception the panel of activities has changed following to statutory amendments.

One supplement observation was recorded according to the company Jaahiz IT Maroc; this one has changed its corporate name (denomination) 2 years before declaring liquidation.

2.   Financial analysis :

The analysis of each single ratio over the period of study (5 years) liberates the significant financial tendencies of SMEs in difficulty.

In the following, we will present the results of our ratios calculation in the form of illustrative graphics, based on five previous years of liquidation.

●   Structure ratio

Structure ratios relate stable elements of the balance sheet; their evolution reflects changes in the company's structure.

❖   Financial self-sufficiency

Financial self-sufficiency compares the weight of the short and long term in equity, also this ratio indicates the distribution of owner's capital and long term debts.

The financial self-sufficiency ratio average of the five companies varies as indicated in the graph.
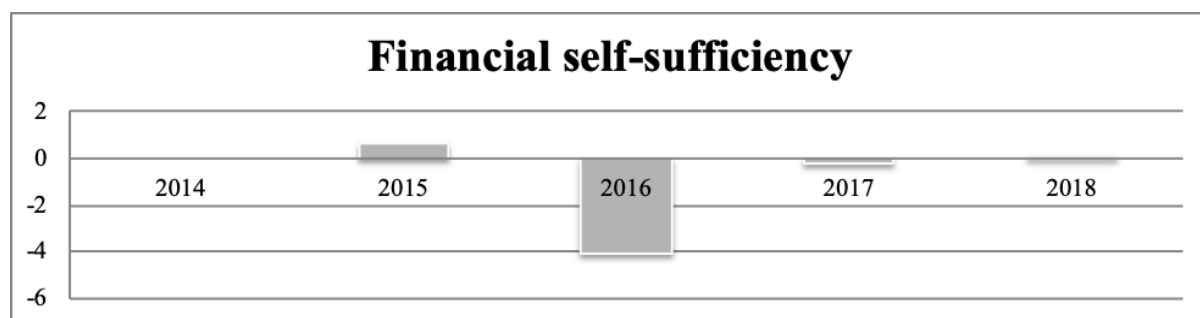
Graphic1: Evolution of financial self-sufficiency

Financial self-sufficiency of the studied companies shows negative values in progress, which let us conclude that the equity amount is negative over the years of study, and let's also say the companies are not able to cover their needs.
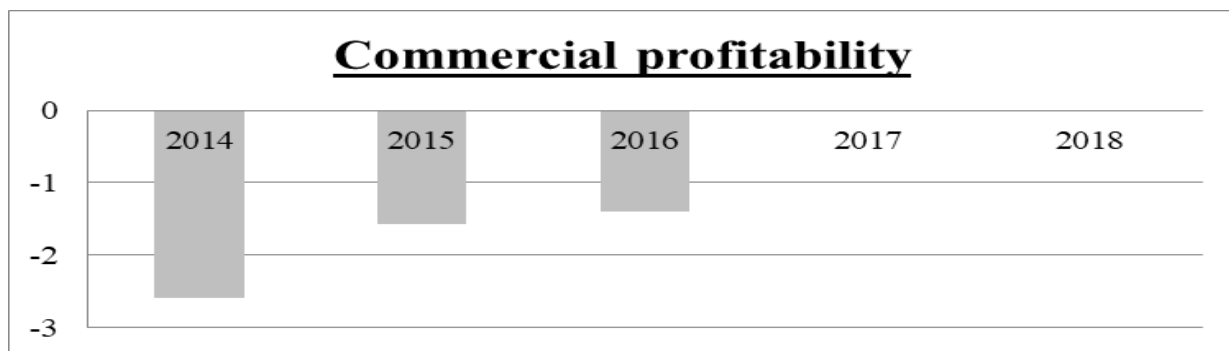
Profitability ratios
Profitability ratios measure the company's ability to generate profits from its resources (assets)
❖   Commercial profitability
It is the share of the net profit contained in the operating revenues; this ratio measures the capacity of the company to realize profits from its activity.
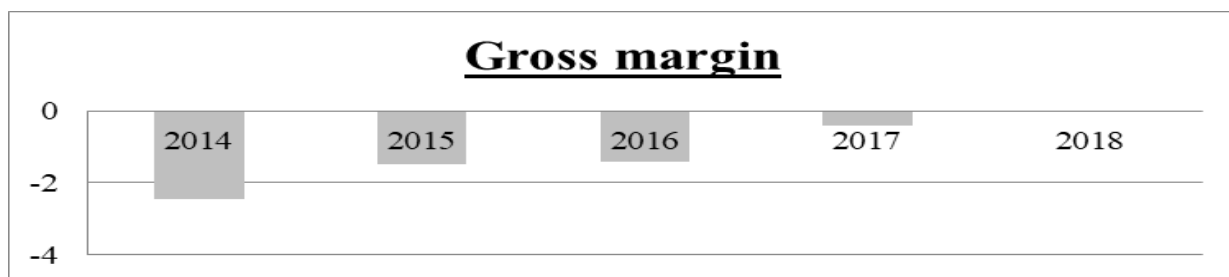The commercial profitability ratio average of the five companies varies as indicated in the graph.

Graphic 2: commercial profitability's evolution

The commercial profitability of distressed companies still shows negative values over three years before the companies' go bankrupt.
❖   Gross margin
Earnings before interests and taxes measured by operating profit/ operating revenues, it makes possible to assess the operating profit sensitivity to changes in economic conditions, regardless of tax charges, financial policy, and non-current charges.
The gross margin ratio average of the five companies varies as indicated in the graph.


Graphic3: Gross margin evolution

The gross margin of distressed companies is very weak; it presents negative values during the four years before the failure.
❖   Return on assets
The indicator Return on assets ratio ''ROA'' informs on how much a company's profitability compared to its total assets, in other words, it informs on the percentage of income generated thanks to its assets.
The return on assets ratio average of the five companies varies as indicated in the graph.
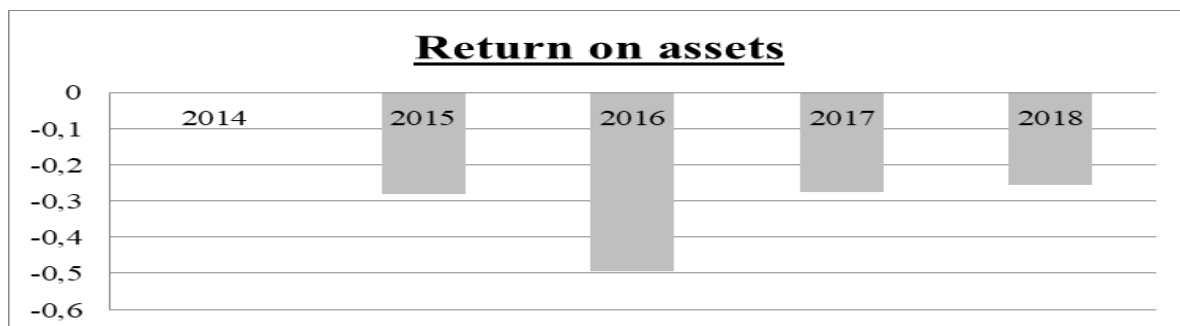
Return on assets

Graphic 4: Return on assets evolution

Failed SMEs don't get back profits from their committed assets. The return on assets is negative years before bankruptcy.

Defaulting Moroccan SMEs find themselves unable to honor their commitments, following a drop in activity or profitability this situation may result either from a strategic choice to seek market share or from an unfavorable development of costs.
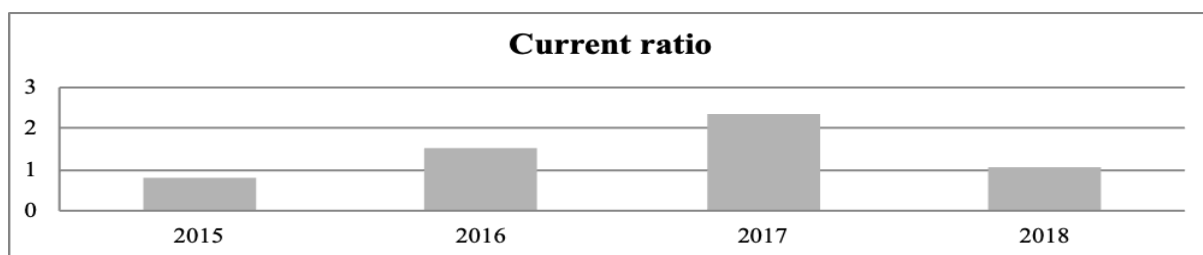
Liquidity ratios

Liquidity ratios measure the company's ability to honor its short term engagement with the available progressive current assets.

❖ Current ratio

The current ratio provides information on the company's ability to repay its most due debts with its most available assets. A current ratio higher than 1, means that the company has a positive working capital.

The current ratio average of the five companies varies as indicated in the graph.
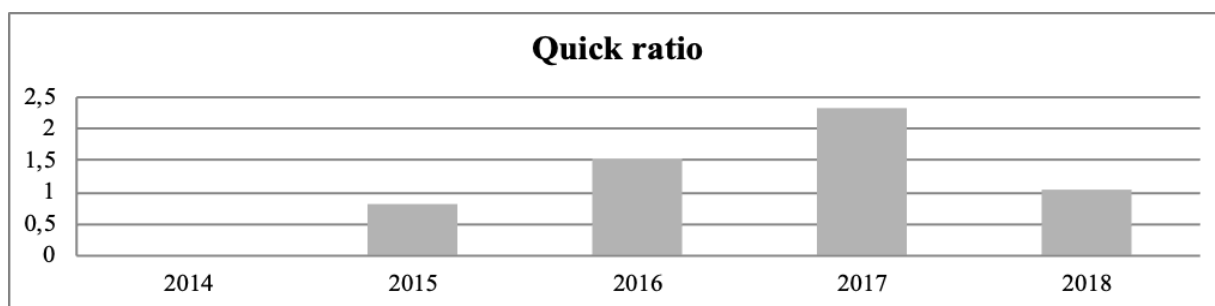
Current ratio

Graphic5: Evolution of current ratio

The current ratio shows a downward trend in the last previous year before the companies' go bankrupt, this means these companies' liquidity is sufficient to honor short term engagements.

❖ Quick ratio

Quick ratio indicates the firm's ability to instantly assets that can be converted immediately into cash to pay down its current liabilities.

The quick ratio average of the five companies varies as indicated in the graph.

Quick ratio

Graphic 6: Evolution of quick ratio

We observe that the quick ratio is equal to the current ratio since our sample companies' don't keep inventory. This means, their current assets turn back directly to account receivables.

VI. DISCUSSION AND CONCLUSION

In this study, the adoption of case studies as a methodology and the usage of different tools such as observation and ratios for determining a typical profile for a distressed company, the following conclusions are derived:

• The observation of the evolution of judicial events for companies constituting our sample proves that at least one of the following events happens: downsizing, changing denomination, changing managers, change in activity, divestment or increase in capital.

• The financial analysis, which consists on analyzing the evolution over the time of the average ratios of the five companies which constitute our sample, let conclude the profile of a distressed company manifests by a regression of the followings: Net income, profitability, low liquidity level, and negative self-financial solvency.

• The results of the observation and the financial follow up over the five years, let say that a junction of financial indicator's regression and general feature of business failure allow judging a company as a distressed one.

As stated in the hypotheses building part, "a deterioration of the distressed companies' situation leads to some decisions which constitute general common characteristics", added to "a regression of financial situation on a minimum of three consecutive years" **shape a distressed company**.

Typical profile	Company's characteristics
General common profile	Restructuration: Downsizing, changing denomination
	Reorganization: change in activity
	Control profile: changing managers
Financial profile	Increase in capital
	Divestment
	Losses recurrence on minimum three years before liquidation
	Decreasing tendency of profitability
	The negative tendency of the most significant ratios

This study builds on the previous works of C.djama et al (2002) that utilized non-financial variables in drawing a typical profile of a distressed company in France and W.Nokairi (2015) that utilized financial variables to determine the indicators of business fragility of Moroccan companies and did a benchmark between the profile of distressed companies and non-distressed ones.

This study improves upon the existing results from the literature of Moroccan distressed SMEs in various ways. In addition, the study presented new empirical findings of financially distressed SMEs in Morocco for the period between 2014 and 2018. It also explores the value-added of non-financial variables. Generally, the variables examined in this study were chosen to capture some important Moroccan SME's characteristics.

This paper is a contribution of the understanding of a phenomenon that is very little called down in Moroccan academic circles, the existing works on the topic are related more to the theoretical aspect and very few are the works that proceed to an empirical verification applied in the Moroccan context.

This scientific contribution looks to build a profile a defaulting SME adjusted to the Moroccan context. To do, we opt for a case study methodology and adopt as far as possible available tools, which tackle financial and non-financial aspects.

The obtained results attest to a decline in the economic and financial situation of distressed SMEs. At the end of this examination, it would be profitable to affirm that anticipating a difficulty using several available tools such as: "*scoring method, profiling method, logit model or psychological methods*" would be of a great help but the global conjuncture still not predictable and it may question all the previous findings. Here it comes to the company to take the right decision and constitute a competent crisis unit to go out of the new situation. However, this study has certain limitations related to:

• A shortage of additional qualitative information, indeed the available information gives a partial representation of the dropping situation for companies, may other elements give supplement information and let have a more clear vision.

• A limited sample, because of the information cost and access

• The financial information may be less accurate, because of the manager's passive behavior, which matches with either the information manipulation for a concealment reason or the ignorance of financial information potential. ((Lacombe-Saboly, 2001)

• The ratio method may also be criticized by Scientifics for the followings (financial information is subject to a critic, accounting methods may differ from a company to another one, inflation may limit the utilization of ratios since the historical cost will change, there is no one way to calculate a ratio).

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