

Financing SMEs in Africa: Challenges and Options



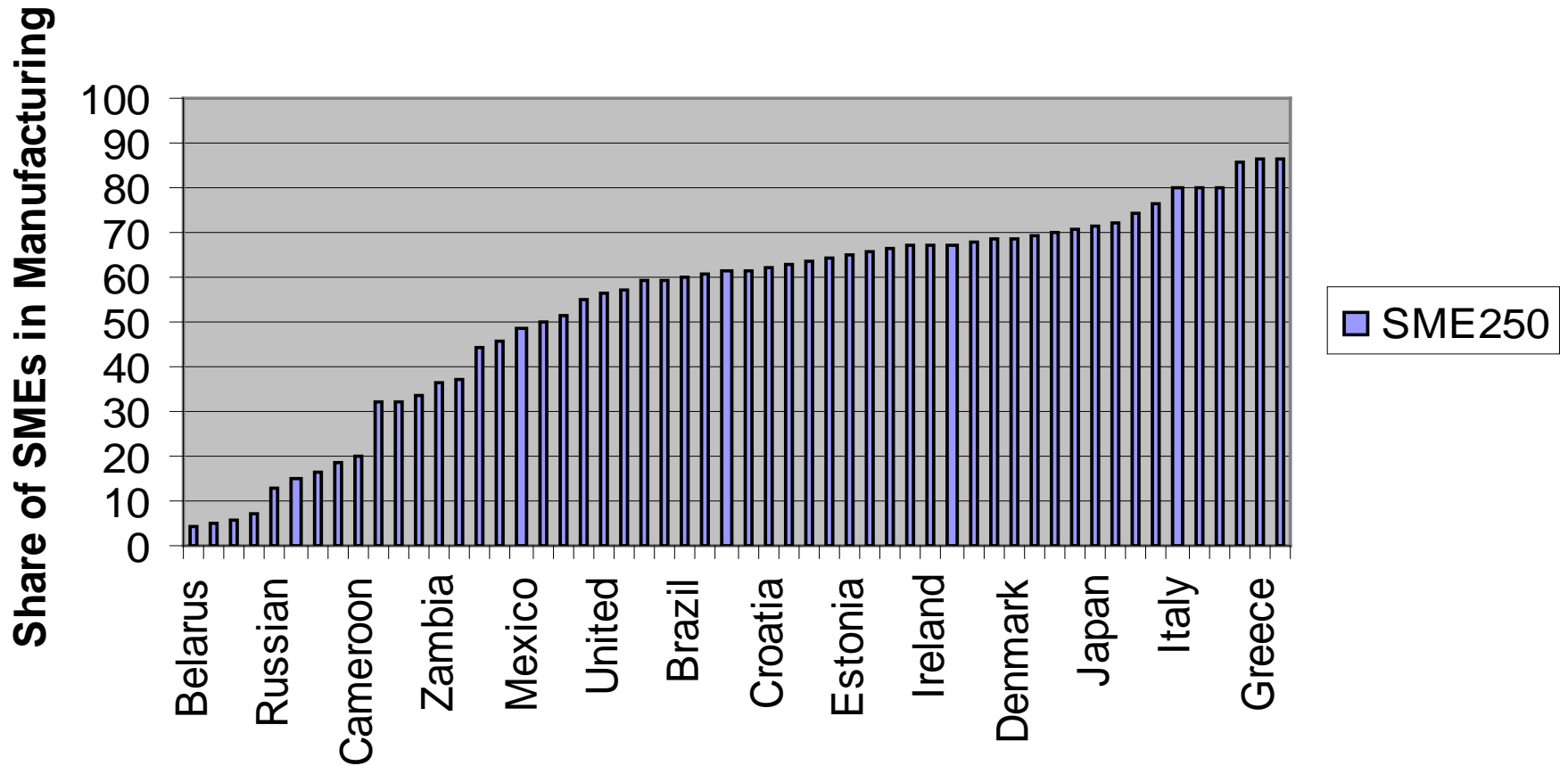
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Do SMEs matter?



Share of SMEs across Countries



SME Finance and Growth



- Financial deepening allows more entrepreneurship, firm dynamism and innovation
- Financial deepening allows better exploitation of growth and investment opportunities and achieving optimal size
- Financial deepening allow better resource allocation, more efficient corporate organization and more formality

What is an SME?

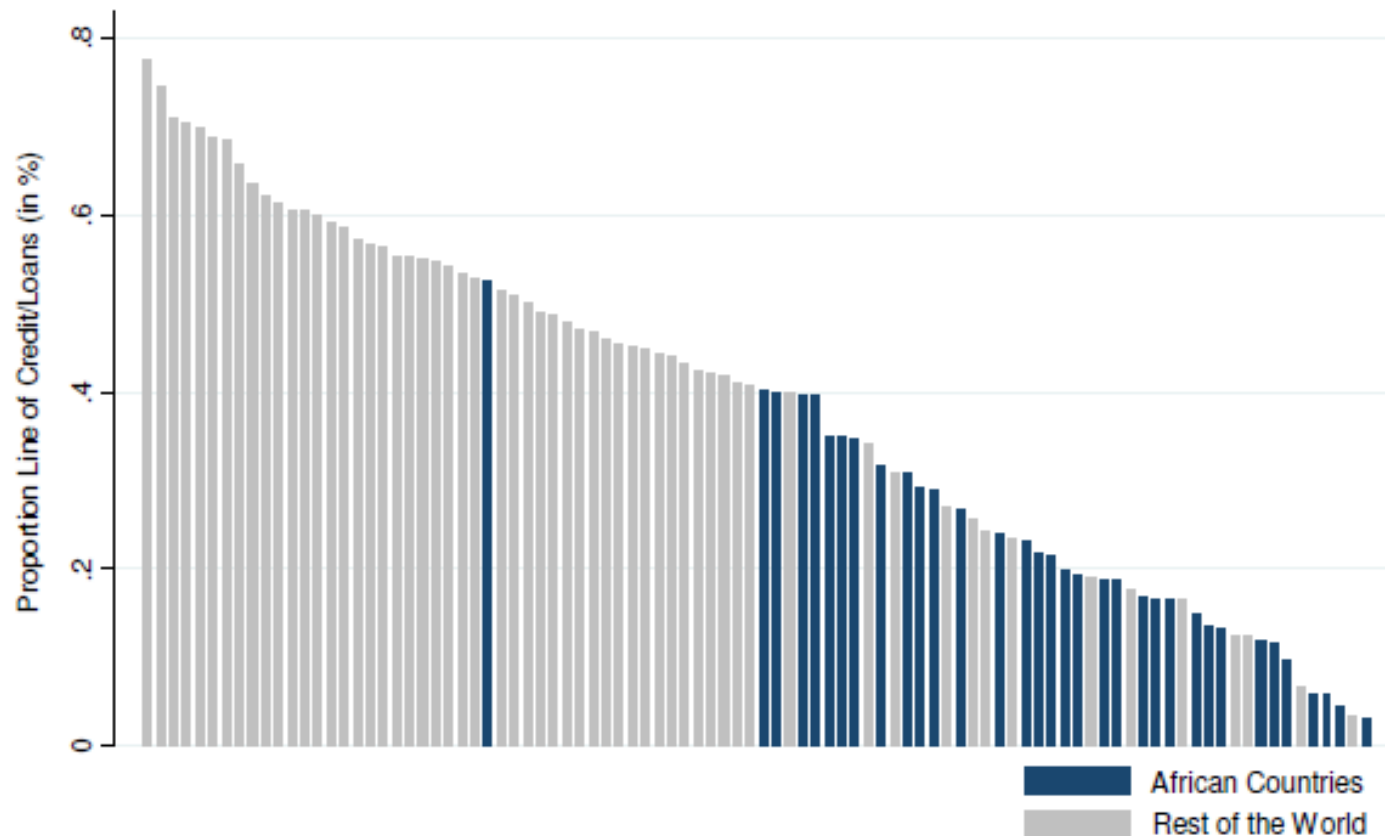


- Different segments to be distinguished
- Microenterprises: informal, household- or family based
- Small enterprises – formal; often “missing middle”
- Medium-size enterprises: aspiring, export-oriented etc.
- Different segments, with different needs and challenges

Access to credit by enterprises



Line of Credit /Loan of Firms across Countries



Sample size: 94 countries

Time period: 2006-2010

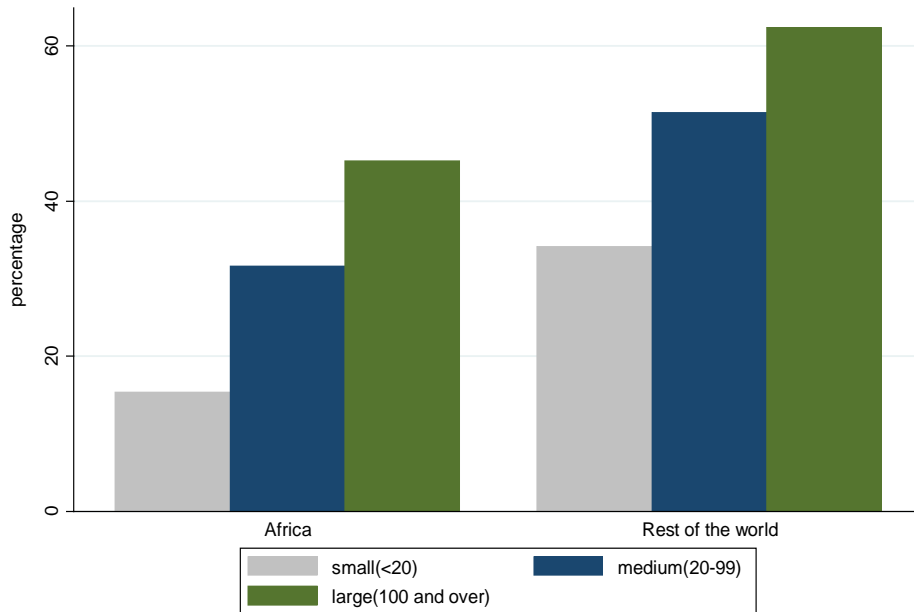
Source: Enterprise Survey 2010

Note: The highest African values are for Mauritius, Malawi, Cape Verde, and Benin

Access to finance – the size gap

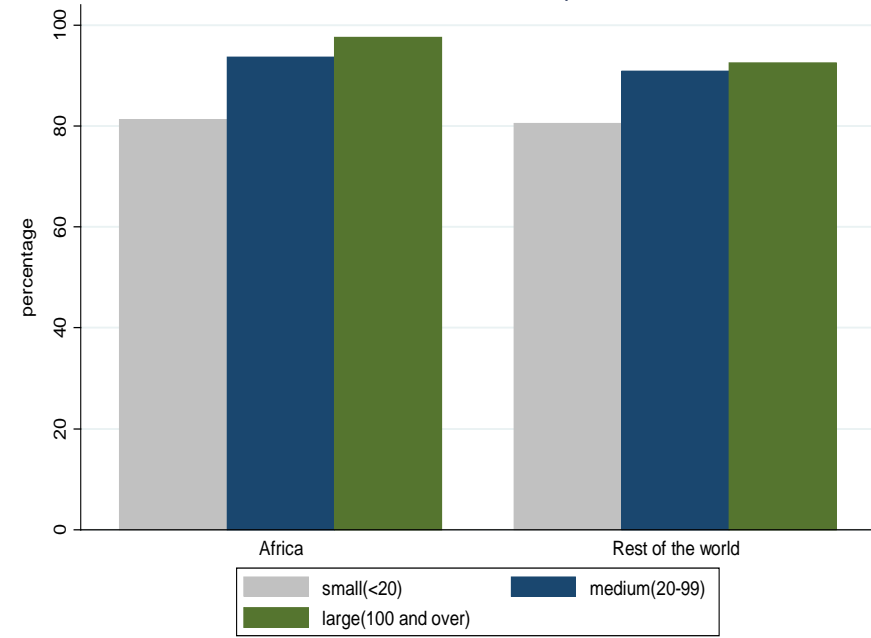


Share of firms with a line of credit



Sample size: 90 countries
Source: Enterprise Survey 2010

Share of firms with deposits



Sample size: 90 countries
Source: Enterprise Survey 2010

Landscaping African finance



- SME finance part of the overall challenging financial sector agenda in Africa
- African financial systems characterized by
 - Small scale
 - Bank-based
 - Short-term
 - Costly
 - Concentrated and non-competitive

Why are SMEs left out?



- **Transaction costs**
 - Fixed cost component of credit provision effectively impedes outreach to “smaller” and costlier clients
 - Inability of financial institutions to exploit scale economies
- **Risk**
 - Related to asymmetric information
 - Adverse selection: High risk borrowers are the ones most likely to look for external finance
 - ✦ Increases in the risk premium raise the risk of the pool of interested borrowers
 - ✦ Lenders will use non-price criteria to screen debtors/projects
 - Moral hazard: The agent (borrower) has incentives that are inconsistent with the principal’s (lender) interests
 - ✦ Agents may divert resources to riskier activities, loot assets, etc.
- **These challenges arise both on the country- and bank-level**

Access to credit: A conceptual framework



- **Access Possibilities Frontier (APF):** constrained optimum; maximum access to credit given “state variables”: macroeconomic environment, contractual and informational framework, technology etc.
- **Define observed access relative to APF:**
 - Self-exclusion/too few investment projects
 - Outcome below APF: lack of competition, regulatory constraints, lack of appropriate lending techniques etc
 - Outcome above APF: excessive, imprudent access
 - APF too low: state variables

Supply or demand-side constraints?



<i>Do you have a loan?</i>			
Region	yes	no	
Africa	22.44	77.56	
Rest of the World	47.59	52.41	

↓

<i>Did you apply for a loan?</i>			
Region	yes	no	
Africa	22.82	77.18	
Rest of the World	40.01	59.99	

Supply or demand-side constraints? (2)



Why did you not apply?	Africa	Rest of the world
no need for a loan - establishment has sufficient capital	40.8	64.44
application procedures for loans or lines of credit are complex	17.96	6.51
interest rates are not favorable	16.74	12.48
collateral requirements are too high	9.55	5.18
size of loan or maturity are insufficient	2.25	1.68
it is necessary to make informal payments to get bank loans	5.69	1.75
did not think it would be approved	6.92	6.42
other	0.1	1.54

Empirical findings



- Lower access to and use of credit in Africa reflected in both lower share of firms with credit and lower share of applications
- Little evidence for self-exclusion
- Important role for supply side constraints:
 - Macroeconomic environment
 - Contractual framework
 - Application procedures

How to close the SME financing gap



- **Competition is key for the financial innovation**
 - New providers
 - Government's role: allow entry, but also force cooperation in infrastructure
- **Focus on the necessary services and look beyond existing institutions**
 - Service provision should be priority
 - Look beyond banks to NBFI
 - Look beyond stock exchanges to private equity
- **Focus on users, looking beyond supply constraints**
 - Supply constraints only part of story
 - SMEs: business environment; turn investment into bankable projects

Competition as key for financial innovation



- **Competition is key for innovation that is necessary for broadening financial systems**
 - Reap potential benefits of technology
 - New lending techniques
- **New players**
 - Foreign banks can bring experience and capacity as well as new lending techniques
 - NBFIs and non-financial corporations can expand overall scale and thus bring in more competition
 - Look beyond organized capital markets to OTC, private equity etc.
- **Level playing field – open infrastructure to all safe and sound players**
 - Might imply an activist government role
 - Relates to credit registries, payment system etc.

Look at demand-side constraints



- **Financial literacy**
 - Financial awareness of products and options
 - Financial capability
- **Accounting and auditing standards**
- **Business development services – turn investment into bankable projects**
- **Don't ignore non-financial constraints**

The role of government



A mix of modernist and activist policies

- **Competition**
 - Enable entry, domestic and foreign
 - Might have to force providers to share infrastructure
- **Move from retail to wholesale role**
- **Looking beyond institution building**
 - Space for activist policy a function of governance, size etc.
 - Partial credit guarantee schemes?
- **How to nurture innovation?**
 - Challenge funds

Conclusions



- In order to understand SMEs' access problem, consider different constraints and resulting policies
- Competition can foster the necessary innovation to expand
- Different providers have important roles to play (foreign and domestic banks, NBFIs, MFIs, equity funds etc.). One size does not fit all
- Government has role to play, both in developing and enabling markets
- Banks and NBFIs have to play their role, adjusting business models etc.
- Demand-side constraints should not be ignored!

Thank you



Comments and suggestions?

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