Improving Access to SME Finance

Evidence Dialogue on SME Development in Kenya

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PLUMBER
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Performance of Emerging Market Firms Matters

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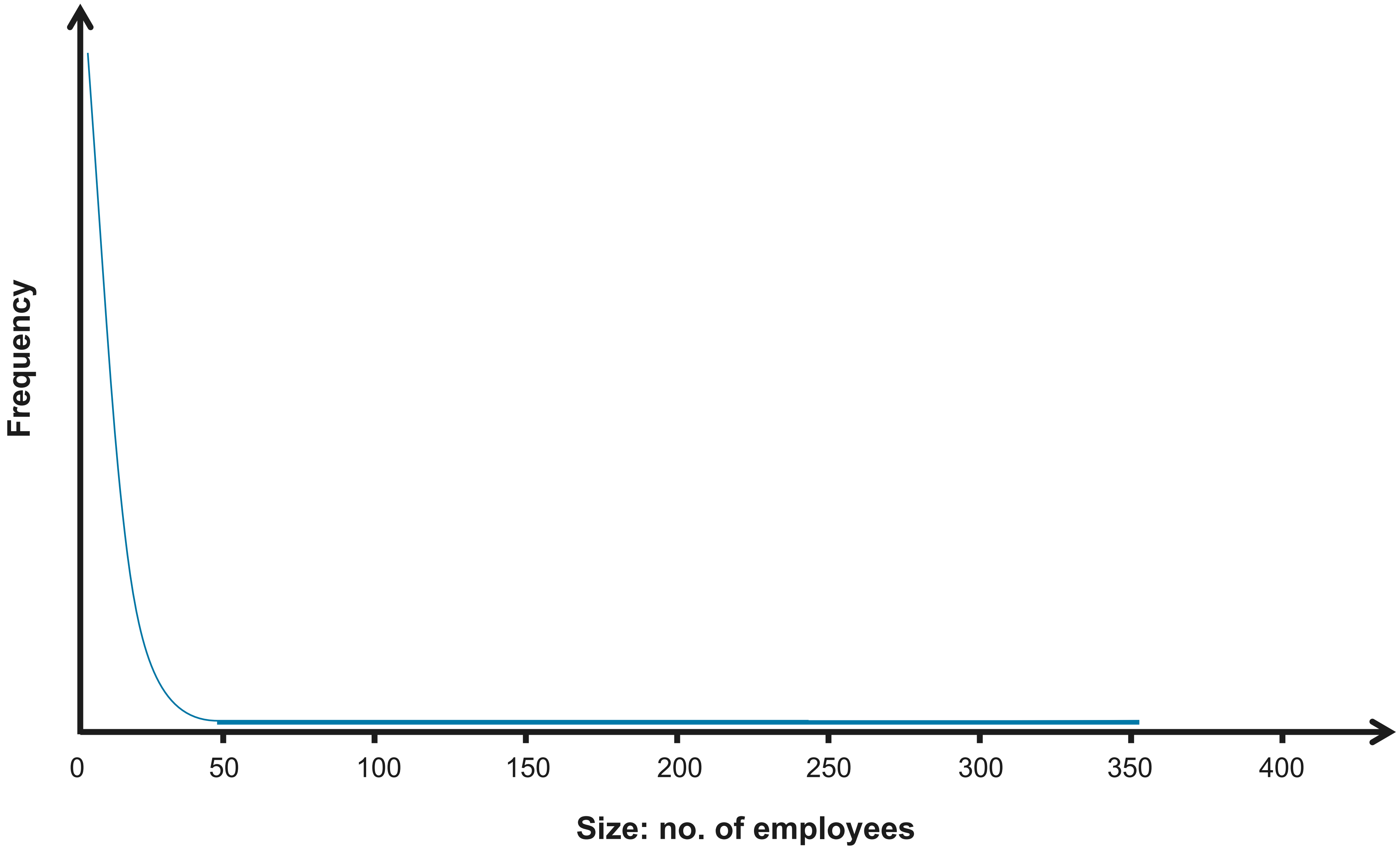
<u>Question:</u> How to help small firms grow?

Empirical Puzzle



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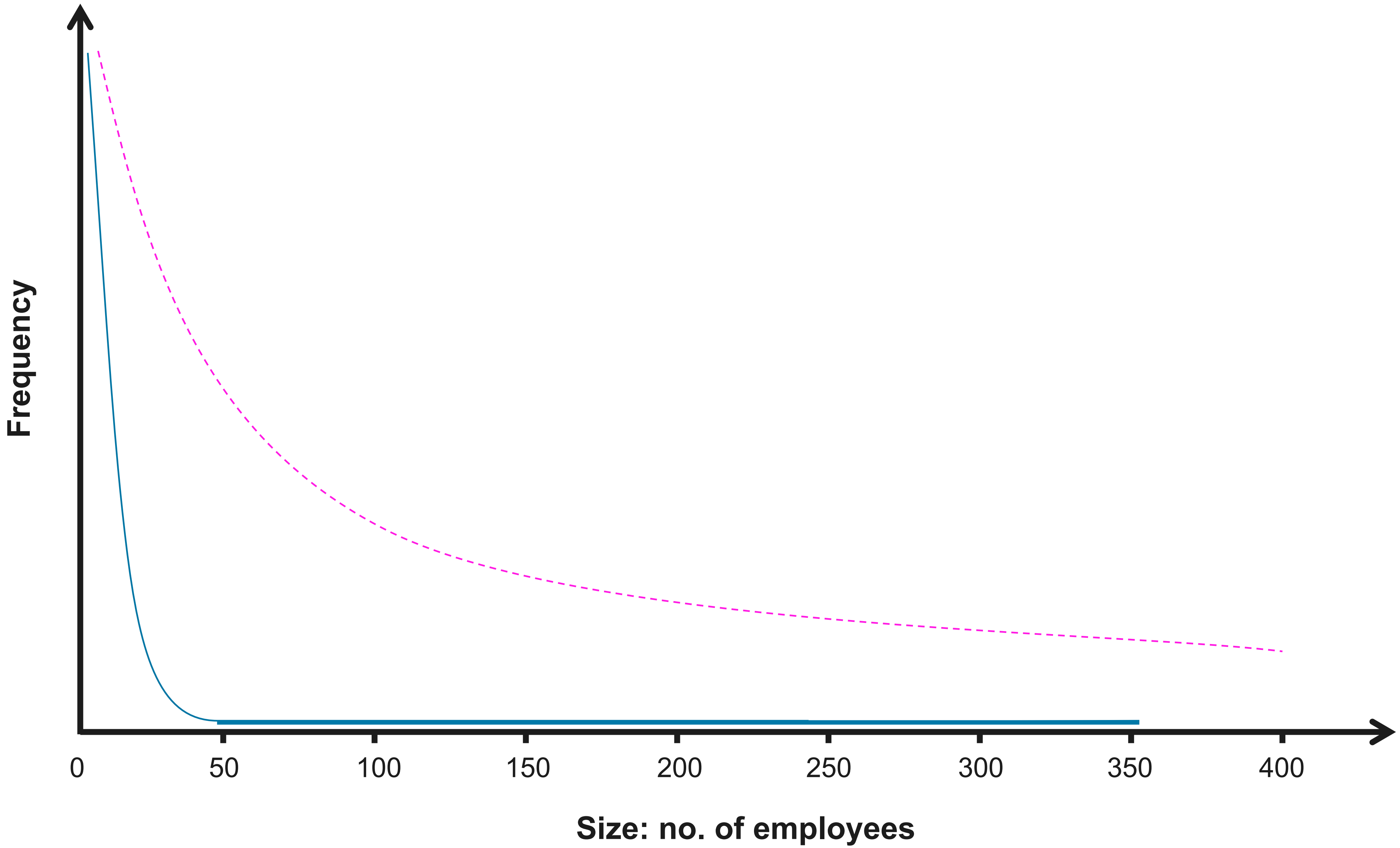

Possible Solutions?

Institutions (e.g. property rights)

Formalization (e.g. registration)

Managerial Capital (e.g. business skills)

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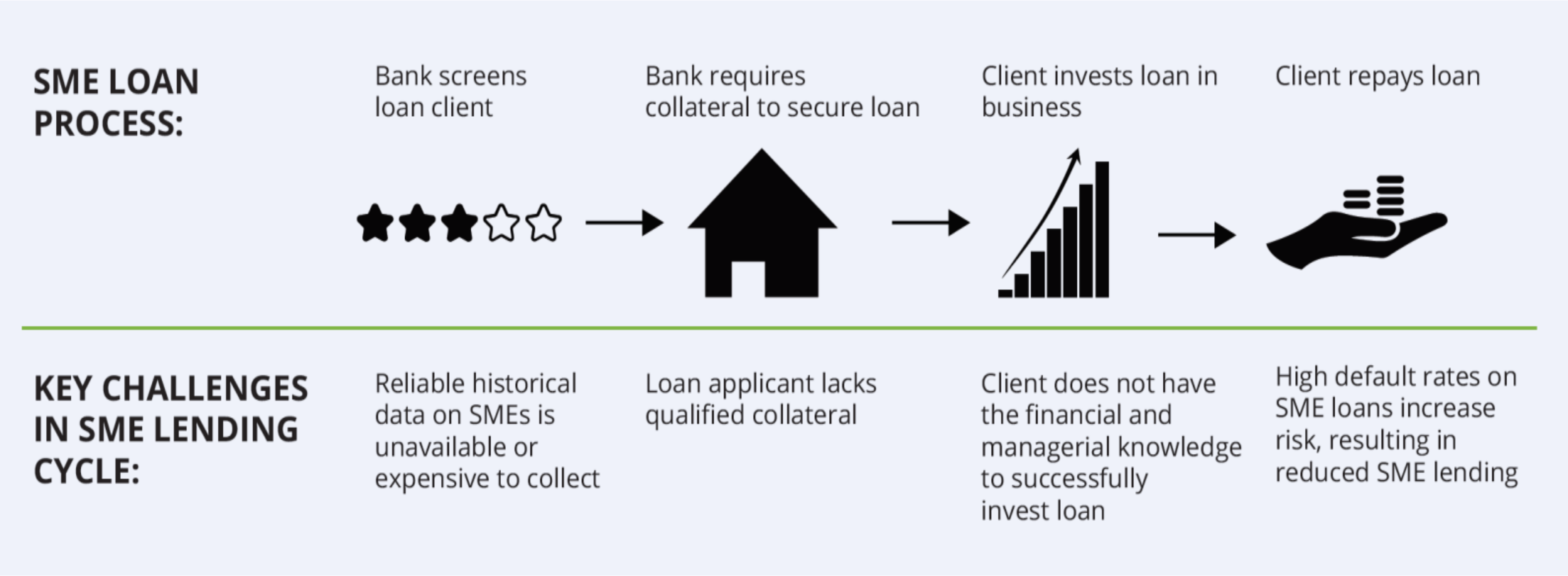
Access to Finance Challenge

- Globally, 55-68% of SMEs underserved by financial institutions (IFC):
  - SME credit gap of US$0.24 trillion in Sub-Saharan-Africa; US $18 billion in Kenya.
  - MSME gap of US $0.33 trillion and US$19 billion, respectively.
- Impact evaluations of grants to small firms show severe credit constraints (e.g. McKenzie and Woodruff, 2008):
  - Estimated returns to capital 3-5 times higher than market interest rates

Why Credit Constrained?



Source: IPA SME Brief, 2015

Solutions?

What has been tried:

- Cash Grants
- Microcredit

Promising new/under-researched avenues:

- Credit Guarantee Schemes
- Collateral Registries
- Trade Finance
- Psychometrics
- Digital Credit
- Alternative Credit Scoring

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Cash Grants

Strong effects for male-owned enterprises, but not for female-owned enterprises in both short- and long-run.

- de Mel, McKenzie, and Woodruff, 2008 and 2012

Why?

- Sector selection
- Women are less entrepreneurial (?!)
- Spousal capture
- → Worth exploring household rather than enterprise-level outcomes (Bernhardt et al, 2019)

Microcredit: Theory of Change

Need	Input	Output	Outcome	Impact	LT Impact

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Need	Input	Output	Outcome	Impact	LT Impact
Small firms are credit constrained	Microcredit	Business Investment (start/improve business)	Increased sales/profits	Improved HH income	Improved HH welfare (e.g. health, education, satisfaction)

Microcredit: Audacious to Humble

- Magic bullet against poverty
- Lifts millions out of poverty
- Raises income and consumption of the poor
- Helps poor cope with poverty
- Not about income or consumption, but rather about freedom and empowerment

JPAL Policy Bulletin (2015) Summary

Outcome	Bosnia & Herzegovina	Ethiopia	India	Mexico	Mongolia	Morocco	Philippines
Business ownership	↑	-	-	-	↑	-	-
Revenue	-	-	-	↑	-	↑	-
Inventory/assets	↑	No data	↑	No data	↑	↑	-
Investment/costs	-	-	↑	↑	No data	↑	↓
Profit	-	-	-	-	-	↑	-
Household income	-	-	-	↓	-	-	-
Household spending/ consumption	-	↓	-	↑	↑	-	-
Social well-being	-	-	-	-	-	-	↓

Contract Structure

- MFI loans require repayment to begin immediately
- Contract structure not conducive for investment
- Possible explanation why money is spent elsewhere
- **Rigol, Field, and Pande (2013) experimentally allow for a longer term loan with a 2-month initial grace period**

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- **Rigol, Field, and Pande (2013) experimentally allow for a longer term loan with a 2-month initial grace period**
- They find:
  - Business investment goes up
  - Profitability and variance also go up (borrowers are making risky investments)

Dynamic Incentives

Dynamic incentives allow lenders to reward good borrowers while punishing defaulters.

But without a national ID system, dynamic incentives cannot be used:

- Loan defaulters can avoid sanctions by using different identities
- Easier when multiple lenders operate in same area
- Lenders respond by limiting the supply of credit

Biometrics for Borrowing

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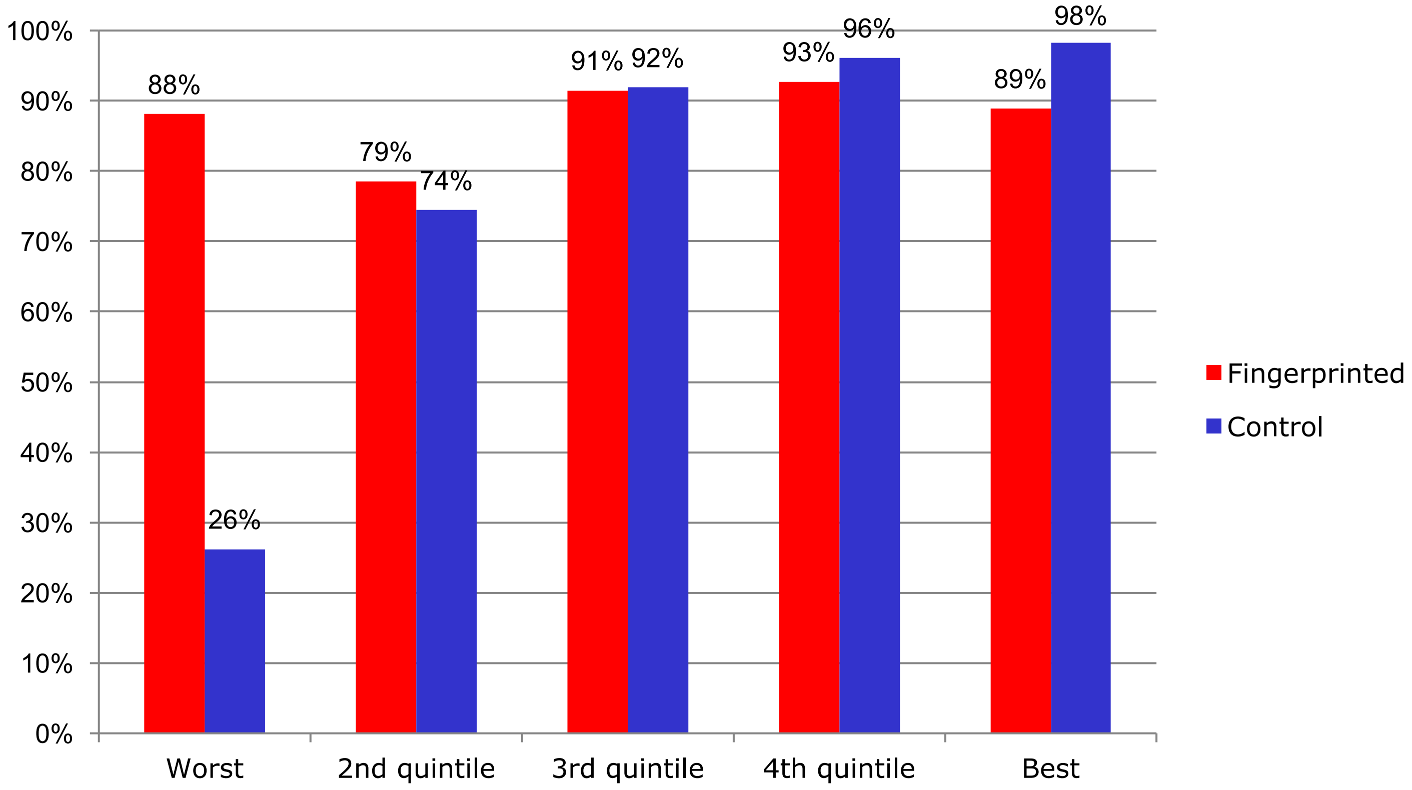

Credit Guarantee Schemes

- Governments pledge to repay loan amount in case of SME default.
- This reduces the lender's expected credit losses, acting as a form of insurance against default.
- CGSs can help improve information available on SME borrowers in coordination with credit registries and bureaus.
- Can help build the credit origination and risk management capacity of participating lenders.
- Important countercyclical role, providing support to small businesses during a downward economic cycle.

Collateral Registries and Trade Finance

Movable Collateral Registries:

- Easier to pledge and collect collateral → improved access to finance
- Relatively new tool and rigorous research is lacking

Trade Finance:

- Suppliers act as financial intermediaries
- More research needed on impacts (e.g. Jaza Duka in Kenya)

Digital Credit and Alternative Scoring

- Digital savings, credit, payments, and education platforms are widespread (e.g. M-Pesa, Arifu)
- Large number of studies are ongoing to study impact of digital credit on firms and HH outcomes
- Alternative Scoring:
  - Psychometrics
  - Using mobile call records to generate scores
  - Using digital education platform engagement to predict credit worthiness

Conclusion

- Access to finance for firms is an important avenue for alleviating credit constraints and improving SME growth.
- Recent advances and innovations have made products and services widely available.
- Research is fast catching up to industry in terms of identifying key impacts of various new credit tools and products.

Thank you

INNOVATIONS FOR POVERTY ACTION

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