

# Using evidence to improve access to finance for SMEs



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# The role of SMEs



- ✓ Key source of job creation and social mobility
- ✓ Hire and train low-skilled workers
- ✓ Market aggregators
- ✓ Multiplier effect
- ✓ Crucial to the development of strong, dynamic economies



# Constraints to SME growth

Access to finance

Human capital and skills

Access to markets

Regulatory constraints

Lack of infrastructure



# But.. What works?



- Billions of dollars spent annually to promote entrepreneurship
- Yet, **little evidence on most effective ways to address those barriers.**

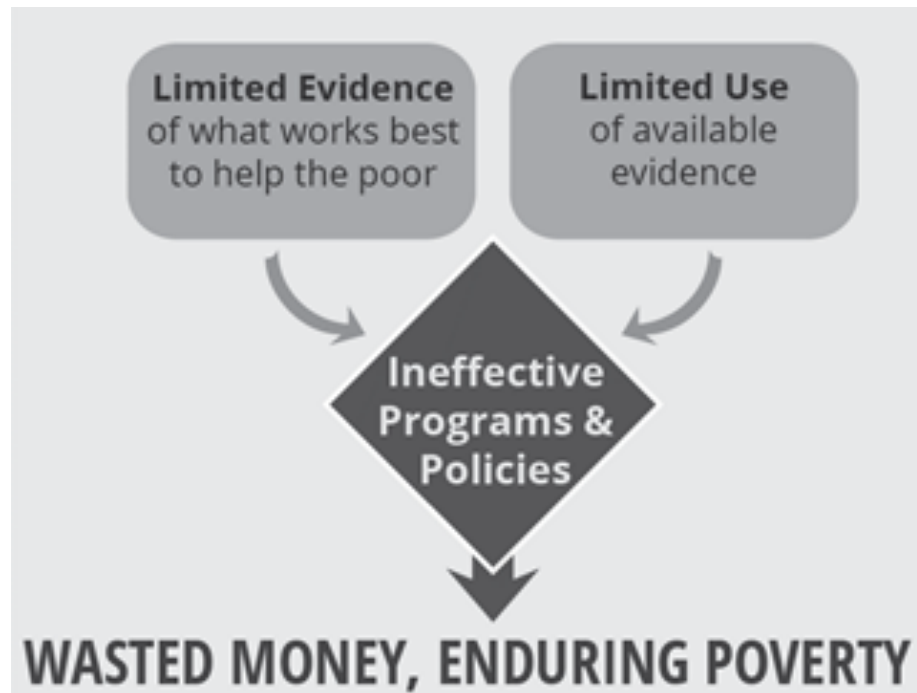
There is need for **innovation, experimentation and learning in the SME development space.**



# Innovations for Poverty Action

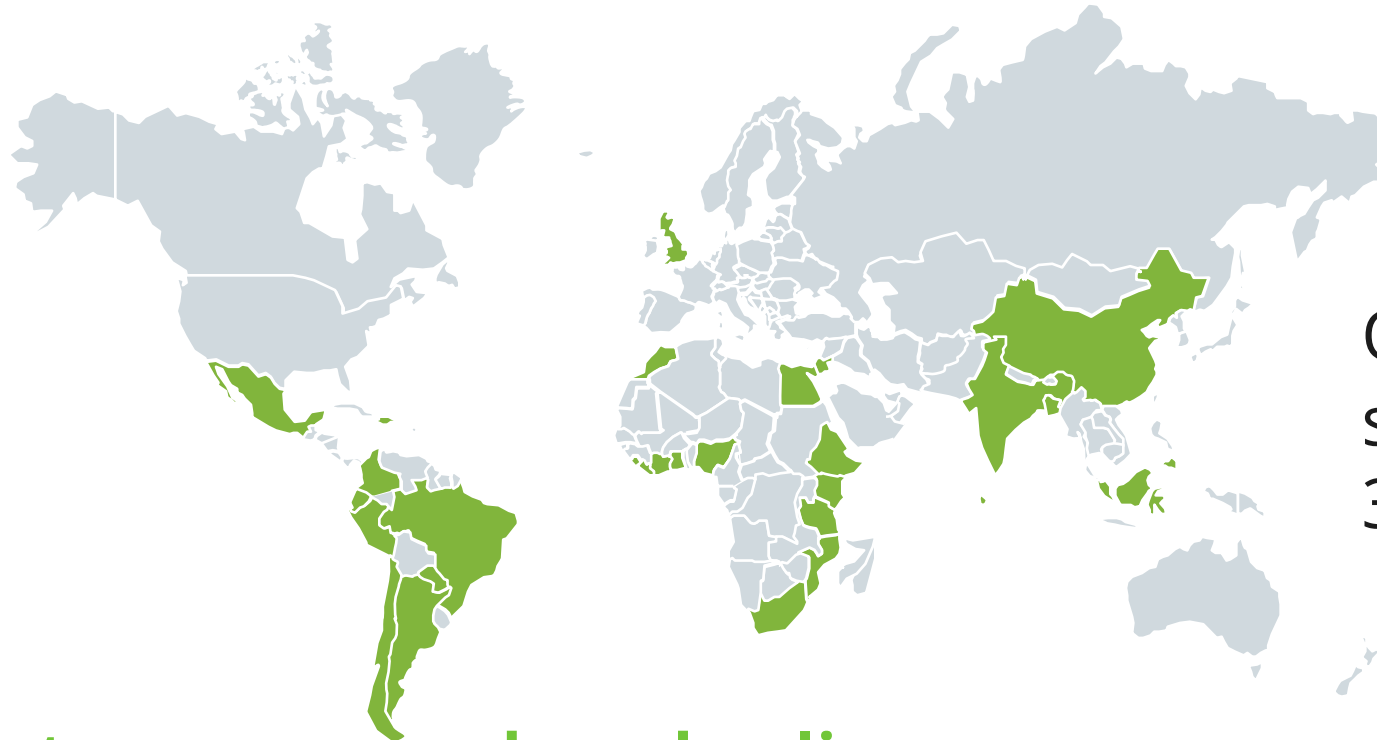
*Discovering and promoting effective solutions to global poverty problems*

## The Problem



# The SME program at IPA

Discovering and promoting effective solutions to barriers that restrict SME growth in developing countries



Over 100 studies across 33 countries

Bridge the gap between research and policy

Build the body of evidence

Promote evidence based decision making



# SME Program Research Agenda

## Human capital and skills

Business training

Mentoring

Consulting services

Business plan competitions

## Access to finance

Innovative financial products

Better screening mechanisms

Alternative collateral models

Matching grants

## Access to markets and information

Export support

Matching platforms

Value chain development

Government procurement



# Access to finance

- Approximately 45-55% of MSME's are unserved or underserved
- Value of credit gap >2 trillion USD
- SME's are very dependent on external financing
- Bank's are reluctant to lend to SME's because its expensive and risky





# SME's face constraints along the entire lending cycle



**Featured study I:**  
Computer  
generated credit  
scores in Colombia

**Featured study II:**  
Flexible collateral in  
Colombia

**Featured study III:**  
Financial literacy  
training in the DR

**Featured study IV:**  
Relationship  
banking in India



# SME's face constraints along the entire lending cycle



- Limited historical information
- Incomplete financial records
- No credit bureaus





# Improving client screening

Featured study: The impact of computer generated credit scores on lending in Colombia

# Using computer generated credit scores for client screening

- Reduce processing time and costs
- Increase incentives of credit committee
- But do you lose valuable “soft information”?



Can a computer generated credit score **reduce the bank's cost** and **improve the quality** of the bank's loan review process



# Studying the impact of computer generated credit scores

- Partnered with Bancamia, a bank in Colombia
- Randomly assigned availability of score across loan applications in 8 branches
- Experimental design:
  - **Group A: Credit score given to committee prior to decision**
  - **Group B: Credit score given to committee after decision**
  - **Group C: Control Group, no credit score**



# Computer generated scores improve efficiency of loan process

- Fraction of **non decisions drops by more than 40 percent** with a credit score
- Committee spent **more time on harder to evaluate applications**
- Effect mainly seen through the **incentive channel**
- **Information technology can play a role in decentralized decision making**



# SME's face constraints along the entire lending cycle



- SME'S don't have the type of collateral required by banks



# Using movable assets as collateral

- New secured transaction reform in Colombia in association with IFC and Colombian government
- Ability to use movable collateral such as vehicles, machinery, accounts receivable etc.
- Reform includes
  - Unified online registry
  - Increased enforcement in the case of default

What is the impact of the reform on lender's and on SME business outcomes?





# SME's face constraints along the entire lending cycle



- Many business owners unprepared to make business decisions





# Improving financial management of SMEs

Featured study: Keeping it simple – Financial literacy and rules of thumb for micro-entrepreneurs

# Training micro-entrepreneurs in financial literacy

Strong association between improved understanding of financial concepts and outcomes

Evidence on success of training programs is mixed



Can training programs improve financial practices and outcomes?

How can financial training be taught more effectively



# Studying the impact of “rules of thumb” training

- Partnered with a microfinance institution (ADOPEM) in the Dominican Republic
- Randomly assigned training opportunity across **1,200** clients
- Experimental design:
  - **Group A: Traditional accounting training**
  - **Group B: Rules-of-thumb training**
  - **Group C: Control Group, no training**



# “Rules of thumb” training more effective than traditional training



- “Rules of thumb” trainees were 6 to 12 percentage points more likely to separate business and personal cash
- More effect on less sophisticated clients
- Better revenue particularly in bad weeks

**Financial training programs can work. One size does not fit all when it comes to training**



# SME's face constraints along the entire lending cycle



- Higher default rates compared to larger borrowers



A woman with dark hair, wearing a patterned shirt, is looking at a tablet computer. In the background, there is a television showing a colorful scene, and a white washing machine with a poster on it that says "CHALLENGER".

# Improving repayment rates

Featured study: The personal side of relationship banking

# Using relationship banking to reduce default rates

- ✓ Creates more personal responsibility for client
- ✓ Gathers more “soft information” on the client



I got **big success** with just one **Smart** move.

Get SME Loan up to Rs. 10 crore

Can a **personal relationship** between the lender and borrower lead to **lower default rates without increasing lending cost?**





# Studying the impact of relationship banking

- Partnered with a ICICI Bank in India
- Randomly assigned increased interaction across **1319** loans
- Experimental design:

**Group A: Personal touch treatment**

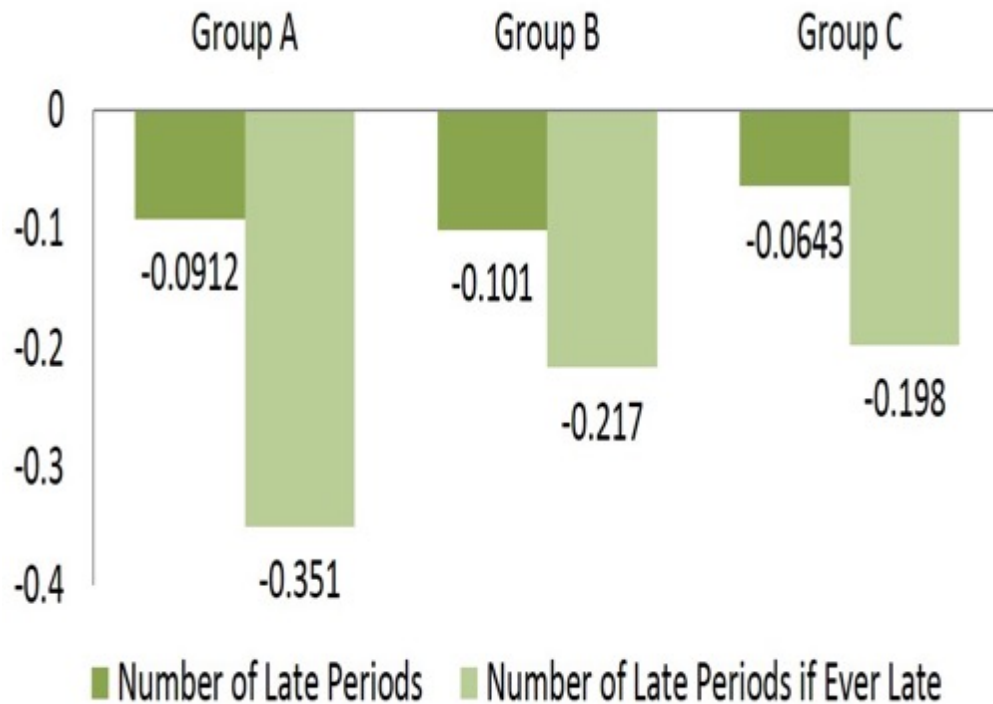
**Group B: Medium touch treatment**

**Group C: Reminder treatment**

**Group D: Control Group**



# Personal interaction improves loan repayment



- Groups A and B had .1 fewer late payments compared to D.
- Reduction in the number of multiple delinquencies
- Improved customer satisfaction
- Additional cost compensated by reduced late payments
- No difference between high and medium touch groups.

**Personalized attention is sufficient**



# Conclusion

- Small tweaks can have material impact
- But, many questions still remain
- Rigorous evidence can point us to the most effective ways to help SME's improve their access to finance
- Strong research partnerships are key to ask the right questions and make sure results are implemented



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MATA AMAFUMBE

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LITRE-1000-

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YOGHURT

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1 LITRE-500-

THANK YOU

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