Financing MSMEs in Emerging Markets

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The Many Faces of Finance

• MSME finance topic is about external finance
• Where can a MSME obtain finance from outside the business? Potential sources:
  ✓ Friends and relatives
  ✓ Informal lenders
  ✓ Trade creditors
  ✓ Equity investors (angels, equity investment institutions, government funds, etc.)
  ✓ Financial leasing companies
  ✓ Debt financiers: banks, non-deposit-taking lenders (NDTL), non-recurrent buyers of debt, mutual finance schemes, etc.
  ✓ Capital market investors via issuance of debt instruments
  ✓ Government support programs via loans, grants, risk sharing, or interest subsidies, etc.
  ✓ Risk financiers (insurers, mutual insurance schemes, government risk compensation, etc.)
  ✓ Crowd-funders
How Does a Good Market Look Like?

• The objective of an economy should be to develop an effective, efficient and inclusive market for MSME finance, with the following main characteristics:
  ✓ The demand side has convenient access to a diversified range of affordable finance timely
  ✓ The supply side can underwrite efficiently and able to structure incentives for the financed, with manageable transaction cost
  ✓ Various finance players are allowed to operate based on commercial principles with clear and relatively low entry requirements, e.g., NDTLs
  ✓ Different forms of finance compete fairly on an equal footing following *inter alia* the market “price for risk” signals
  ✓ The demand side has adequate knowledge in managing financing relationships, with necessary protection and redress mechanisms in place; and financiers and the financed can exit in an orderly manner when needed

Four Main Players in a Market
Key Elements in Market Development

- Each MSME finance sub-market has its own requirements to make the market "tick"
- Using lending industry (credit market) as an example, three layers of different requirements (see graph)
- In emerging markets, reforms in this space have generally not be easy as most of the contents involve government agencies which often do not understand (e.g., Ministry of Justice), may not be committed, or face resource and capacity constraints
- The job of APEC-ABAC in this area should be to work on the 1st and 2nd layers
- What does it mean? See a simplified case

Foundations for a Credit Market

- Financial Infrastructure
- Sector Capacities, Regulation and Supervision
- Lenders, Borrowers, Services Providers

- Good corporate governance; adequate strategies; appropriate credit methodologies, staffing, risk management, incentive structure, etc. suitable for their respective segments, etc.
- Fair entry requirements, sufficient competition, risk-based regulation, practical operating standards and conditions, development of NDTLs, operating infrastructure, etc.
- Legal and institutional arrangements that enable lenders to overcome the difficulties of information, incentive and transaction cost in debt finance operations
Case: What Infrastructure is Needed for AR Finance?

• A simplified case of accounts receivable (AR) lending:
  ✓ Buyer A is a medium-sized enterprise in APEC Economy Charlie, which source from three smaller size suppliers; the usual payment term is three months upon the satisfactory receipt of goods
  ✓ Suppliers I, II and III all need to borrow; otherwise, they will not have funds to start the next cycle of operations
  ✓ They apply for loans from Bank Beta to be secured by their changing receivables due from Buyer A (the account debtor, or "customer")
  ✓ Will Bank Beta lend to these three suppliers (the "client")?
  ✓ Supposed all three are bankable clients, why and why not?
• This is an enabling environment matter, i.e. the 1st and 2nd layer issues
Case: What Infrastructure is Needed for AR Finance?

- Lenders will have to consider:
  - Can ARs be taken as collateral in Economy Charlie?
  - How will lender Beta get information on the "customer"?
  - Will lender Beta be able to perfect its security interest on ARs and establish priority against third parties?
  - Is lender Beta empowered to collect (enforce) directly from customer (account debtor) in case of need?
  - In the event of client bankruptcy, what will be the position of lender Beta vis-a-vis other creditors? In the event of customer bankruptcy, what will be the position of lender Beta?
  - And, .... so on
- These concern secured transactions system, credit reporting system and insolvency framework
- Without answers to most of these questions, do not expect that you will have good MSME finance in your economy

Role of APEC-ABAC

- Annex I reflects the state of play for SME finance and Annex II for micro business finance in selected APEC economies
- Access to finance is among the top business obstacles for the developing APEC economies (Enterprise Surveys, World Bank Group)
- The APEC Financial Infrastructure Development Network (FIDN) has been working on the 1st and 2nd layer reforms, in collaboration with IFC, industry associations (e.g., FCI, Thai Bankers Association, Vietnam Banks Association), private sector supporters, and government agencies (e.g., Philippines DOF, China PBOC), etc.
- Measurable progresses have been made in some economies (e.g., Vietnam, China, Philippines)
Role of APEC-ABAC

• Continuous efforts in MSME finance will be required in the foreseeable future; and, going forward, more advocacies to and pressures on governments will be useful and, also, greater efforts are required in insolvency reforms and the development of a professional debt collection industry
• A good way to think about all these in one term: how could a market be created? how can a market grow? how will a market function better?
• With such a broader market perspective, public sector reforms, industry collective efforts, and private sector solutions can all fit together
• This should be the very essence of "public-private collaboration to develop APEC Financial Markets"

Thank You!
### Annex I: Access to Finance by Firms in Selected APEC Economies

<table>
<thead>
<tr>
<th>Economy</th>
<th>% of firms with a bank loan/line of credit</th>
<th>% of investments financed by banks</th>
<th>% of investments financed by supplier credit</th>
<th>% of investments financed by equity/stock</th>
<th>% of firms identifying access to finance as a major constraint</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>25.3</td>
<td>4.5</td>
<td>1.9</td>
<td>3.2</td>
<td>2.9</td>
</tr>
<tr>
<td>Indonesia</td>
<td>27.4</td>
<td>19.3</td>
<td>5.3</td>
<td>1.4</td>
<td>16.5</td>
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<tr>
<td>Korea</td>
<td>N.A</td>
<td>20.0</td>
<td>0.1</td>
<td>8.1</td>
<td>12.1</td>
</tr>
<tr>
<td>Malaysia</td>
<td>31.0</td>
<td>15.6</td>
<td>5.2</td>
<td>9.5</td>
<td>12.1</td>
</tr>
<tr>
<td>Mexico</td>
<td>32.0</td>
<td>20.0</td>
<td>0.1</td>
<td>8.1</td>
<td>12.1</td>
</tr>
<tr>
<td>Peru</td>
<td>66.8</td>
<td>34.7</td>
<td>10.9</td>
<td>5.4</td>
<td>8.5</td>
</tr>
<tr>
<td>PNG</td>
<td>45.7</td>
<td>26.5</td>
<td>0.0</td>
<td>0.0</td>
<td>3.2</td>
</tr>
<tr>
<td>Philippines</td>
<td>29.9</td>
<td>10.0</td>
<td>2.6</td>
<td>5.7</td>
<td>10.7</td>
</tr>
<tr>
<td>Thailand</td>
<td>15.5</td>
<td>9.9</td>
<td>3.8</td>
<td>0.8</td>
<td>2.4</td>
</tr>
<tr>
<td>Vietnam</td>
<td>41.1</td>
<td>16.4</td>
<td>3.5</td>
<td>8.5</td>
<td>10.9</td>
</tr>
<tr>
<td>East Asia &amp; Pacific</td>
<td>27.9</td>
<td>10.1</td>
<td>3.4</td>
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<td>12.2</td>
</tr>
<tr>
<td>High Income OECD</td>
<td>50.7</td>
<td>20.3</td>
<td>4.2</td>
<td>2.4</td>
<td>11.6</td>
</tr>
</tbody>
</table>

Source: Compiled from Enterprise Surveys data, World Bank Group.
Note: The above does not show % of finance available from non-bank lenders.

### Annex II: Access to Finance by Adults in Selected APEC Economies

<table>
<thead>
<tr>
<th>Economy</th>
<th>Borrowed Any money</th>
<th>Borrowed from a financial institution</th>
<th>Borrowed from family/friends</th>
<th>Borrowed from a private informal lender</th>
<th>Borrowed for a farm or business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>43.2</td>
<td>23.4</td>
<td>16.9</td>
<td>0.8</td>
<td>3.1</td>
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<tr>
<td>China</td>
<td>36.3</td>
<td>9.6</td>
<td>25.1</td>
<td>1.1</td>
<td>7.0</td>
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<tr>
<td>Indonesia</td>
<td>56.6</td>
<td>13.1</td>
<td>41.5</td>
<td>2.9</td>
<td>11.7</td>
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<tr>
<td>Japan</td>
<td>23.1</td>
<td>7.9</td>
<td>6.0</td>
<td>0.3</td>
<td>1.1</td>
</tr>
<tr>
<td>Korea</td>
<td>39.4</td>
<td>18.2</td>
<td>17.1</td>
<td>0.7</td>
<td>4.6</td>
</tr>
<tr>
<td>Malaysia</td>
<td>56.1</td>
<td>19.5</td>
<td>39.0</td>
<td>0.8</td>
<td>6.1</td>
</tr>
<tr>
<td>Mexico</td>
<td>50.8</td>
<td>10.4</td>
<td>26.0</td>
<td>9.9</td>
<td>9.5</td>
</tr>
<tr>
<td>Peru</td>
<td>27.5</td>
<td>11.2</td>
<td>10.4</td>
<td>2.3</td>
<td>6.8</td>
</tr>
<tr>
<td>Philippines</td>
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<td>11.8</td>
<td>48.7</td>
<td>13.5</td>
<td>13.6</td>
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<tr>
<td>Thailand</td>
<td>50.3</td>
<td>15.4</td>
<td>31.1</td>
<td>9.1</td>
<td>12.8</td>
</tr>
<tr>
<td>Vietnam</td>
<td>46.8</td>
<td>18.4</td>
<td>29.9</td>
<td>1.8</td>
<td>7.1</td>
</tr>
<tr>
<td>US</td>
<td>51.4</td>
<td>23.3</td>
<td>19.8</td>
<td>1.4</td>
<td>2.5</td>
</tr>
<tr>
<td>High Income OECD</td>
<td>39.8</td>
<td>18.4</td>
<td>14.9</td>
<td>0.9</td>
<td>2.6</td>
</tr>
</tbody>
</table>

Source: Compiled from Global Findex, World Bank Group.