Workshop on small and medium enterprises’ access to finance and the role of development banks in Asia and the Pacific and Latin America

United Nations Conference Center, Bangkok, Thailand
27-28 September 2017

Concept note

I. Background

Small and medium-size enterprises (SMEs) constitute the largest number of companies in any country and play a fundamental role in the creation of employment, the development of skills, and the diffusion of technological knowledge. Past studies have also shown that financial access helps generate new firms, which are generally vibrant and creative.¹ However, in comparison to larger firms, SMEs often have difficulties to access financing from the formal financial system because financial institutions, particularly commercial banks, often view providing loans to them as too risky or involving high transaction costs. Because of the significant role of SMEs in supporting inclusive growth, employment and innovation, enhancing their access to finance is highlighted in Sustainable Development Goals 8 and 9 of the 2030 Agenda for Sustainable Development.

Besides commercial banks, microfinance institutions (MFI), which include not-for-profit organizations and NGOs, self-help groups, inclusive businesses and social enterprises, provide a wide range of financial services to the poor and to micro, small and start-up enterprises. Pioneered by the Grameen Bank in Bangladesh, MFI have employed innovative solutions such as a shared liability model and collateral-free lending, which resulted in very low default rates. In recent years, however, some microfinance markets have become saturated, with borrowers becoming over-indebted by taking on too much credit from multiple MFIs and other informal sources of credit.² This highlights the importance of establishing effective regulations for MFIs.³

In some countries, commercial banks have attempted to expand their loans to SMEs by creating special units to lend directly to them or by outsourcing operations to MFIs. A successful example of the latter is the partnerships of ICICI Bank of India with several MFIs. In these partnerships, loans are negotiated and disbursed to clients by MFI staff on behalf of ICICI Bank, and the MFIs are paid a flat fee or a percentage

³ Beyond the need for regulation, there is a question about the appropriateness of MFIs to encourage investment and growth. Recent research suggests that two key features of MFI loans – shared liability and repayment requirements without grace periods may discourage risky investment. See World Bank. 2014. Global Financial Development Report 2014: Financial Inclusion, p. 111-3.
of the loan interest for originating and maintaining the accounts, and for recovering the loans. ICICI supports the development of capacities of MFIs through training and mentoring.4

To further expand lending to SMEs by private financial institutions, countries’ lending infrastructure, which includes credit bureaus, credit guarantees agencies and collateral registries need to be improved. In particular, it is important to make available more and better information about SMEs credit risks. A useful model from the Asia Pacific region is the Credit Risk Database (CRD) of Japan. This database is managed by the CRD Association, the members of which include credit guarantee corporations and financial institutions.5 In addition to databases of SMEs, it would also be useful to set up centralized databases of MFIs to reduce information costs for banks looking for viable MFIs as business partners.6 In the case of Latin America, some development banks have opted to develop a relational banking approach to lending, as opposed to arms’ length banking, which can improve the capacity of financial institutions to assess and monitor credit risk and evaluate the re-payment capacity of SMEs.

National development banks can play a significant role in promoting and expanding financial inclusion of SMEs through innovative products to help overcome market failures as well as create new markets from which commercial financial institutions can also benefit. A recent example is the Korean Development Bank, which has launched a number of initiatives in 2013 and 2014 to support SMEs that develop new technologies or that support the creative economy. Such initiatives include a growth accelerating programme to provide venture companies and start-ups not only with funding but also with networking opportunities and mentoring support.7 In the case of Latin America, the Brazilian National Bank (BNDES) and Nacional Financiera in Mexico (NAFINSA) have created important instruments for financial inclusion such as the “Tarjeta BNDES” and the productive chains program which has become, without doubt, the most important second-tier credit program in Mexico. National development banks can also promote financial inclusion through innovation in financial processes and by strengthening their connectivity with the rest of the financial system, including commercial banks.

In addition to commercial banks, MFIs and national development banks, new companies that provide financial services by making use of software of modern technology, known as fintechs, have enormous potential for meeting the financial needs of SMEs. The Asia-Pacific region has led global investments in fintechs in 2016, over passing North America for the first time.8 Within the region, China has had a leading role. In 2016 Ant Financial, the financial services affiliate of e-commerce giant Alibaba Group that operates China’s online-payments platform Alipay, received 40 of the total investment in fintechs in the region.9

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6 Subhanij, T. 2016. Op. Cit. Because deposit-taking MFIs are regulated by national supervisory authorities, the proposed database would apply to unregulated, non-deposit-taking MFIs.


9 Ibid.
With 400 million annual active users, Ant Financial uses big data analytics to calculate credit scores and provide working capital loans to merchants.\textsuperscript{10} However, the advancement of fintech as an innovative solution for SME financing requires proper regulation, as is clear from recent cases of fraud involving peer-to-peer (P2P) lending platforms.\textsuperscript{11} A major challenge to regulators is how to strike the right balance between facilitating innovation and preserving financial stability.\textsuperscript{12} Another challenge is how to ingrate fintech with commercial and development banks.

II. Objective

The objective of this workshop is to discuss challenges and tools to enhance access to finance by SMEs in Asia and the Pacific and Latin America. The importance of enhancing access of SMEs to financial services was emphasized in the Fourth High-level Dialogue on Financing for Development in Asia and the Pacific organized by ESCAP in April 2017. In addition, the promotion of financial inclusion is one of the areas for deepening regional cooperation in the regional road map for implementing the 2030 Agenda for Sustainable Development in Asia and the Pacific adopted by ESCAP member States in May 2017.

The workshop will focus both on market-based approaches and on the role of national development banks, and it will discuss ways to improve countries’ lending infrastructure and financial regulation, as well as opportunities and challenges arising from the rapid expansion of fintechs. Recommendations emanating from the workshop will provide guidance to countries in Asia and the Pacific and Latin America on strategies to enhance SMEs financing while ensuring financial stability and fiscal sustainability. The workshop is expected to identify needs and areas for furthering regional cooperation in both Asia and the Pacific and in Latin America to support developing countries implement effective policies and reforms to enhance the financial inclusion of SMEs.

III. Organization and Participation

The workshop is organized by the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) in partnership with the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), the Council on International Financial Cooperation (CIFC) of the Republic of Korea, Asian Development Bank Institute (ADBI), the Alliance for Financial Inclusion (AFI), and Asia Foundation (AF). It will bring together government officials, practitioners from the private sector and from national and regional development banks, and experts from both Asia and the Pacific and Latin America. It will include both short presentations and panel discussions to discuss the state of the art and best practices in both Asia and the Pacific and Latin America on SME financing. The main conclusions of the workshop will be reflected in an outcome document aimed at disseminating the lessons learned in other fora, including the inaugural meeting of the Committee on Macroeconomic Policy, Poverty Reduction and Financing for Development in November 2017.

\textsuperscript{11} https://www.ft.com/content/41e706f4-d631-11e6-944b-e7eb37a6aa8e.
\textsuperscript{12} http://www.allenovery.com/SiteCollectionDocuments/Innovate_or_stagnate.pdf