Role of the private sector in resource mobilization and SME financing

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1. Introduction

- Inclusive finance: provide access to financial services to large category of individuals and firms
  - Financial access tends to reduce inequality and poverty
  - Non-inclusive financial systems: small firms and poor individuals that do not have access to finance.
- Access to finance by small and medium enterprises (SMEs) constitutes an important policy concern
  - Critical for sustainable growth and development
- Resource mobilization and credit allocation functions have important implications for economic growth and development (Levine, 1997; 2005).

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2. SME Financing

- SMEs consistently report having severe obstacles in their access to finance in comparison to larger firms.
- SME financing in PICs relies on domestic financial systems.
- SME obstacles in Fiji (Naidu and Chand, 2011):
  - Inability to obtain external financing
  - Losses due to sabotage and crime
  - Payroll, rent and utilities
  - High interest rates on loans
  - Government tax and customs duty

2. SME Financing

- Survey of a group of MSEs in Fiji show that obtaining finance is constrained by banks' interest rates, fees and charges, and collateral requirements (Sharma and Gounder, 2012a)
- MSEs in Fiji with little or no "acceptable" collateral and little or no contribution to make towards the loan, have considerable difficulty in obtaining finance from the formal financial sector (Sharma and Gounder, 2012b).

2. Private Sector Resource Mobilization

- In PICs, financial systems are dominated by the banking system. Banks (as opposed to non-banks) provide around 92% of all credit to the private sector in Fiji.
- Banking activities are still highly traditional, confined mainly to deposit lending activities; investment banking and venture capital are virtually non-existent (Sharma and Gounder, 2012a).
- Bond markets are in general mainly composed of sovereign issues.

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2. Private Sector Resource Mobilization

- What is mobilizing?
  - ‘Mobilizing’ suggests that the private sector resources are available but that it is somehow *not being channelled* for development due to specific *obstacles* or a *lack of incentives* (Vaes and Huyse, 2015).
- Commercial banks constitute the major source of external finance for MSEs.
- Banks/lenders are expected to operate within the confines of
  - Regulatory framework (safe, sound and stable operations)
  - Accomplish business goals (shareholder wealth maximization)

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2. Private Sector Resource Mobilization

- Why is it difficult to mobilize private sector financing for SMEs?
  - Likely to be informal: risks in lending to these enterprises
  - Lack of reliable and complete financials
  - lack collateral

- Access to finance does not increase as financial systems grow larger.

- Thus the need for **policy interventions** aimed at increasing SME financing.

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3. Improving SME access to finance

- Statutory organisation to support the creation and development of SMEs
  - Governance systems and processes
  - SME advisory services

- Special lending criteria for the SME sector
  - Products designed for SMEs to fund setting up new business or assistance with existing business
  - Few banks control the dominant forms of funding and lending (Sharma & Brimble, 2011)
  - Traditionally, banks in PICs have had little interest in SMEs
  - High cost associated with the labour intensive process of collecting soft information of SMEs

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3. Improving SME access to finance

- State owned development banks/cooperative banks
  - Market substituting role
  - Special focus on operators of small and medium business enterprises
  - Use of public funds to trigger additional private involvement

- SME Credit Guarantee Scheme
  - Government guarantee to pay a fixed proportion of the principal outstanding on defaulted SME loans

3. Improving SME access to finance

- Basic regulatory foundations for property rights
  - Collateral to secure credit
  - Strengthening the SME securitization market

- Financial regulatory system for an enabling environment
  - Strong debt resolution mechanisms
  - Ability of financial institutions to readily obtain credit information on potential borrowers is a key factor limiting the supply of credit