Contract for Technical Assistance Support for Improving the Investment and Business Environment in the Southern African Development Community Region (SIBE)

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Consultancy Services to document best policies and practices on SMEs financing within and outside the region, develop a knowledge product and build capacity of DFIs on best policies and practices on SMEs financing.

Handbook on Best Policies and Practices for SME Financing in the SADC Region.

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1 Table of Contents

1. Abbreviations

SADC	Southern African Development Community
DFI	Development Finance Institution
SMEs	Small and Medium Enterprises
CRC	Credit Reference Centre
PBC	People's Bank of China
SMEDCO	Small and Medium Enterprises Development Corporation
MSMEs	Micro, Small and Medium Enterprises
MFIs	Microfinance Institutions
VCFs	Value Chain Finance
P2P	Peer to peer
SOEs	State Owned Enterprises
NGOs	Non-Governmental Organisations
CGAP	Consultative Group to Assist the Poorest
USADF	United States African Development Foundation
SADC DFRC	SADC Development Finance Resource Centre
WAEMU	West African Economic and Monetary Union
ATM	Automated Teller Machine
ICT	Information Communication Technology
AfDB	African Development Bank
NFBI	Non-Banking Financial Institutions
IFC	International Finance Corporation
SMEAZ	SME Association of Zimbabwe
DIBs	Development Impact Bonds

2. Introduction

The realisation that financial inclusion is a key enabling element, both in the fight against poverty and in reaching the goal of inclusive economic development, is leading to an increasing focus on financial inclusion policies and initiatives.

"Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs - transactions, payments, savings, credit and insurance - delivered in a responsible and sustainable way"

The World Bank

Access to finance is one of the key components of financial inclusion amongst usage and the quality of the products. Following the Southern Africa Development Community (SADC) study on documenting best policies and practices on (Small and Medium Enterprises) SMEs financing within and outside the region, this handbook is intended to share knowledge of the best practices for providing finance to SMEs. It is mainly targeted at Development Finance Institutions (DFIs) and other financial services providers, policy makers and any other stakeholders interested in ensuring that SMEs in the SADC region are adequately funded. This handbook is therefore informed by the current challenges faced in the provision of finance to SMEs, lessons drawn from the SADC region as well as best practices from outside the region. It is intended to contribute to the effectiveness of SADC DFIs and related financial services providers in providing finance to SMEs.

Access to stable and appropriate funding sources is crucial for the survival and growth of SMEs. However, in regions with bank-dominant systems, most SMEs face poor access to finance. This highlights the need for further policy support for bank loans for SME finance. However, such policy support alone is not sufficient to provide long-term financing to growth-oriented SMEs due to the nature of the banking sector's short-term credit and rigid banking regulations in the region. Moreover, the bank-dominant system makes SMEs more vulnerable to financial shocks because SMEs do not have opportunities to diversify their funding during crisis. To address this issue, the diversification of financing models beyond conventional bank lending can provide an alternative platform for the financing needs of SMEs and expand their financial access. It is important to note that interest rates or cost of funding for SMEs will always be high due to the inherent risk associated with SMEs, there will always be a trade-off between cost of funding and availability of the finance. Therefore, while bank financing will continue to be crucial for the SME sector, more diversified options for SME financing could support long-term investments and reduce their vulnerability to financial shocks. This could include options such as private equity, venture capital, crowdfunding, and other alternative financing sources. By diversifying their funding sources, SMEs can reduce their reliance on bank loans and mitigate the risks associated with a bank-dominant system.

Olomi and Urassa (2008), in the study based in Tanzania, identified three major groups of constraints of access to finance by SMEs. The first group of factors included the capacity (low level of knowledge and skills), under-developed culture of business, non-separation of the business between personal issues and family, credit history of SMEs, and lack of knowledge of available finance services. The second group of factors included the number of competent personnel and lack of experience of SMEs. The third group of factors is related to the regulation of the environment where transactions occur between lenders and borrowers, lack of system identification, and credit reference bureaus. These identified factors will form the gist of the discussions in this Handbook.

3. Understanding the SME Sector, Segmentation and Targeting

The definition of SMEs varies worldwide due to the fact that the size of any enterprise is a relative matter that varies according to the country and its level of economic development. Despite the general agreement on the importance and size of SMEs, there is a wide disparity in their definition. However, the usual definition of SMEs includes that they are registered business projects with fewer than 250 employees each. In the SADC region and beyond the region, in their quest to effectively serve the SME segment, governments and interested stakeholders have attempted to come up with various definitions of SMEs. It is important for DFIs to use a consistent definition of SMEs so that they can develop a strategic plan that is tailored to the needs of their target sector. In this respect it is important that DFIs stick to a definition that is agreed upon by the government and the banking industry. Such definitions already exist in most of the SADC Member States. Other countries have gone further to use this understanding to segment SMEs and then come up with tailored financial services. By dividing the SME market into smaller segments, DFIs and banks can better understand the specific financing needs of each group. This information can then be used to develop financing products that are customised to the needs of specific groups of SMEs.

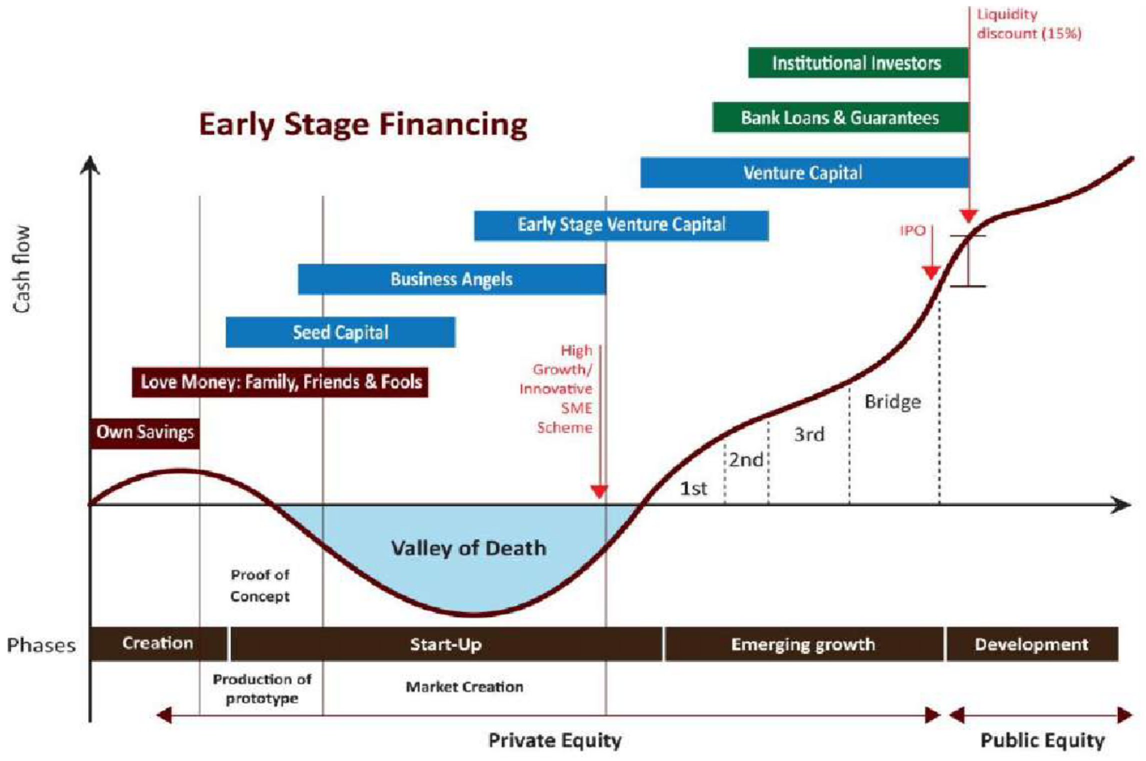
To avoid a "one size fits all", DFIs need to segment SMEs into small categories guided by some commonalities – this way appropriate financial products can be designed for each specific group.

For all SME financing programs, targeting SMEs based on their needs is a beneficial strategy for DFIs and related financial institutions. It can help to increase their efficiency, reduce their risk, and ensure the deployment of suitable financing products to SMEs at different levels of development. By targeting SMEs based on their needs, resources would be allocated more efficiently as it makes it easy to focus on the types of SMEs that are most likely to be successful and to repay their loans. By understanding the specific needs of SMEs, DFIs and banks can better assess the risk of lending to them, thus reducing the risk of loan defaults.

Overall, dividing the SME sector into categories and sub-segments is a beneficial strategy for both the suppliers of credit and SMEs. It can help DFIs to understand the specific risks associated with different sectors and sub-sectors thereby improving their risk management strategies, increasing their innovation, leading to the development of new and innovative products and services that meet those needs and enhance their competitiveness, allowing DFIs to differentiate themselves from other financial services providers and opening avenues for effective collaboration. It can also help SMEs to gain access to the financing and other services they need to grow and succeed.

3.1. The SME Growth and Financing Cycle

In line with segmentation of SMEs according to different categories, the diagram below adapted from the Mauritius strategy, depicts the stages of SME growth and the differing levels and types of funding for each stage of growth.



Armed with the above understanding, DFIs are then best to develop products for the different SMEs depending on their level of growth. Besides allowing DFIs to develop appropriate financial products and services, this understanding will also guide the DFIs as well as other service providers on the supporting capacity enhancement requirements of the SMEs depending on their growth stage.

The following would be suggested capacity enhancements support needs for the SMEs in the various stages of growth:

Creation	Start-Up	Emerging Growth	Development
Main concern of SME is to establish themselves in the market and survive.	At this stage, SMEs have survived the initial start-up phase and are focused on generating enough revenue to cover their costs.	At this stage, SMEs have established themselves in the market and are generating consistent revenue. At this stage, the SMEs may also be experiencing rapid growth and are focused on scaling up their operations.	At this stage, SMEs have become established players in their market and are focused on maintaining their position.
Capacity Building needs: Business Plan Building a customer base Product development/prototype	Capacity building needs include: Developing marketing and sales strategies Building relationships with suppliers and customers.	Capacity building needs include: Building a strong operational and management team. Improving governance structures.	Capacity building needs include: Building a culture of innovation. Advanced business management, Human Resources, supply chain,

		Increasing operational capacity Developing stronger systems and processes.	sales and marketing skills and strategies. Developing a long-term strategy Investor readiness programmes ***(see page 35 for actual content of these programmes)***

3.2. Technical Sectoral Studies

Technical sectoral studies as promoted by DFIs in Mauritius facilitate gaining a deeper understanding of the needs of SMEs and the development of more effective financing approaches and are the most appropriate and least expensive tool for DFIs and other financial institutions to understand the needs of SMEs. By conducting technical sectoral studies, DFIs and other financial institutions would be in a better position to understand the value chain of each subsector and identify the gaps and needs of SMEs. This information can then be used to develop appropriate solutions and/ or financing products and services. By offering specialized financing products and services to SMEs, DFIs and other financial institutions would be able to improve their targeting and segmentation, increase their efficiency and reduce their operational costs resulting in sustainability. In addition, technical sectoral studies do contribute to the capacity building of the DFIs staff as they get a deeper understanding of the various sectors through these studies.

Practical examples of how technical sectoral studies can be used to improve SME lending operations are i) A DFI could conduct a technical sectoral study of the manufacturing sector to identify the key challenges and opportunities facing SMEs in this sector. This will also allow the DFI to understand the funding requirements at the various nodes of the various value chains being considered; understand on which part of the value chains SMEs are active; and appreciating the type of funding that can be structured to best fit the SMEs within the context of the value chain. ii) A DFI could conduct a technical sectoral study of the tourism sector to identify the key drivers of growth in this sector iii) A DFI could conduct a technical sectoral study of the agricultural sector to identify the key risks and challenges facing SMEs in this sector.

The DFI could then use this information to develop loan products that are specifically tailored to the needs of SMEs in these different sectors.

4. Developing a Strategy for Financing SMEs

The study revealed that bigger DFIs, financing SMEs may not be a priority. In such a scenario, the need for a dedicated department to serve SMEs need to be prioritised. Such focus would allow proper strategic planning with clear and specific goals in relation to financing of SMEs. In this respect, the DFI should be able to start by answering the following questions:

I. What is our current state of targeting SMEs and the level of financial services provided to them? (Where are we now?)
II. What are our objectives for the SME sector and where do we aspire to reach in our plan to provide financial services to this sector? (Where do we want to get?)
III. What resources and tools do we need to provide within the bank to achieve these objectives?

Developing a Strategy for SME Financing

Developing a strategy for financing SMEs involves several steps and considerations. Here are some key takeaways:

1. Start with a clear strategy and vision: Financial Institutions should develop a clear vision of product offerings and render them for the targeted customers with a streamlined, robust experience. Financial Institutions that rethink their SME-lending businesses can increase their market share and promote profitable growth.

2. Focus on the real needs of SMEs: To have the most impact, Financial Institutions need to focus on the real needs of SMEs, get the basics right, and transform their credit operations. Banks seeking to serve SMEs at a high level will need to make purposeful strides forward in their capabilities, service model, and SME value proposition.

3. Transform credit processes: Financial Institutions need to transform their credit processes to become more efficient and effective in serving SMEs. They need to devise sustainable combinations of credit and auxiliary products and services, as well as a detailed understanding of customers' needs, so that they become credible for cross-selling.

4. Embrace data and digitization: Financial Institutions can leverage data and remove traditional silos to create new avenues for income, mitigate risks, and truly tap into the SME opportunity. A digital approach to SME banking can help banks ease the development of crowdfunding platforms, provide the infrastructure for payments, and engage SME clients.

5. Support the entire SME ecosystem: Financial Institutions should support the entire SME ecosystem by embracing a necessary cultural change in the SME banking sector, from short-term returns to long-term profitability. They can attract and retain the skills needed and implement relevant governance mechanisms, such as aligning financial rewards with good practices.

6. Reduce the bank financing gap: The extent of the bank financing gap highlights the need to find solutions that can reduce or even prevent the adverse financial situation of SMEs. Banks can explore embedded finance solutions that go beyond traditional financing models to close the SME bank financing gap.

In summary, developing a financial institution strategy for financing SMEs involves starting with a clear strategy and vision, focusing on the real needs of SMEs, transforming credit processes, embracing data and digitization, supporting the entire SME ecosystem, and reducing the bank financing gap.

that are designed to ensure efficiency, reduce costs, and form high-quality assets and this will help the DFI to create a profitable portfolio of SME loans.

4.1. Key success factors for a successful DFI strategy

- **Partnering with other stakeholders**, such as other financial institutions, government agencies, and business associations, to reach more SMEs and provide them with a wider range of financing services.
- **Use of technology to streamline operations and reduce costs**. For example, DFIs can use online lending platforms to make it easier for SMEs to apply for and receive loans.
- **Investing in staff training** on how to understand the needs of SMEs and provide them with the best possible service.
- **Regularly monitoring and evaluating the SME strategy** to ensure that it is adapting to changing operating context, meeting its objectives and having a positive impact on SMEs.
- **Aligning the strategy to the DFI's own financial resources** and risk appetite
- **Supportive regulatory environment** and the availability of other sources of finance for SMEs

5. Demand Side Constraints

5.1. Information Asymmetries/Lack of Access to information

Closely related to the challenge posed by the difficulties in defining SMEs, there is the issue of incomplete and inconsistent data on SMEs. This has been cited by all SADC Member States in the various documents that were reviewed during the study. It is evident that Member States' national statistical bodies are facing challenges in collecting data on the number of SMEs, their size, or their industry. This makes it difficult to track the performance of the SME sector and to identify the needs of SMEs. Several roadblocks thus stand in the way of SME finance. SMEs typically are more "opaque" than large firms because they have less publicly available information. As a result, banks have more difficulties in assessing the creditworthiness of SMEs, which can discourage lending to them. Opaqueness also requires banks to rely more on relationship lending when dealing with SMEs. This means that lending depends more on "soft information" gathered by loan officers through personalized contacts. This has also contributed to challenges in coming up with effective strategies for SME financing.

On the other hand, SMEs also find it difficult to access information on the available finance schemes. In cases where the information may be available, it is often difficult for the SMEs to make the right choice due to low financial literacy on their part. In most cases, the loan application processes are complex and time-consuming for SMEs. This can discourage them from applying for loans. Making information readily available is one of the ways banks can ensure that SMEs are financially included. Lack of understanding and awareness of products is one of the main reasons why most SMEs do not use financial products. According to literature as well as responses from countries within the SADC region, this position is common in all countries. Establishing information platforms that assist SMEs to (i) understand products and services on offer (ii) create a repository or track record of critical information that will be used to improve SMEs credit rating during credit assessment processes can help.

SMEs often have difficulty obtaining loans because they lack a credit history. This is because SMEs typically have less access to traditional sources of finance, such as banks and financial institutions. As a result, they have less opportunity to build a credit history. This lack of credit history makes it more difficult for SMEs to demonstrate their creditworthiness to lenders.

5.2. Capacity Gaps of SMEs

Entrepreneurs often lack financial management and business skills. Improved personal financial capability is a precursor to improved financial management of a small business. It is necessary to improve the quality of start-up business plans and SME investment projects, especially for the development of the riskier segment of the market. In many countries, a major impediment to the development of equity finance for young and small businesses is the lack of "investor-ready" companies. Furthermore, SMEs are generally ill-equipped to deal with investor due diligence requirements.

In all the SADC Member States, there has been a growing recognition that both supply- and demand-side factors contribute to SME access to finance. This has led to a focus on demand-side policies that combine financial and non-financial support, such as mentoring, coaching, and advisory services. In this respect, most of the SADC countries have set up specialised institutions/government departments with a mandate to provide SMEs with the support necessary to establish and grow their businesses.

Non-financial support such as capacity building of SMEs has been shown to be effective in enhancing the financial acumen of business owners and entrepreneurs, which can lead to improved business performance. In addition, non-financial support can help to address the skills gap that some SMEs face. There are a variety of capacity building support programs available, including those that are offered by public financial services providers, private sector organizations, and non-profit organizations. Some programs focus on providing general financial education, while others offer more specialized training and mentoring. Business accelerators and incubators are another way to provide non-financial support to SMEs. These programs typically offer a combination of financial and non-financial support, such as training, mentoring, and access to a network of experienced entrepreneurs.

5.3. SMEs' lack of collateral acceptable by banks

Lack of collateral is one of the biggest challenges that hinder SMEs from accessing finance. SMEs often lack the collateral that banks require to make loans. This is because they typically have less assets than large businesses. In addition, the lack of secure property rights is a major obstacle to SME lending in some of the SADC Member States. As an example, most families have access to land in the rural areas but have no title deeds meaning the land cannot be used as collateral. SADC Member States can address this problem by strengthening the legal framework for property rights, particularly land and by simplifying the process of registering and transferring property.

Some of the strategies used to circumvent the lack of collateral by SMEs in SADC Member States include:

- **Broadening the range of assets that can be used as collateral**: Lenders should be allowed to take possession of a wider range of assets, including movable assets such as equipment and inventory. SMEs in the SADC region have more movable assets than immovable assets. GAPI 's network of micro banks in Mozambique accepts local assets such as livestock (goats, cattle, etc) and Small and Medium Enterprises Development Corporation (SMEDCO) in Zimbabwe accepts lease agreements in addition to moveable assets. Broadening the range of collateral assets therefore makes it easier for SMEs to obtain loans.
- **Immovable Assets Registers** -This can make it easier for lenders to find out if an asset is already subject to a security interest. In Mozambique again, a department within the Central Bank maintains the immoveable assets register for the benefit of all lenders to SMEs. GAPI reported that the immovable assets register is operating well, whilst other countries like Zimbabwe are also trying to operationalise it and in Namibia the issue of establishing the moveable asset register is at consultation stage. In some Member States, the framework governing securing movable property as collateral is outdated, and inconsistent. This means that while banks can take movable property as collateral, there is very little value from securing this property as there are practically no ways to register the collateral, enforce against the collateral. Undertaking collateral reforms to modernize legal and registration infrastructures is key for all Member States. These reforms have measurable positive impacts on the cost of credit, reducing interest rates, extending loan maturities and increasing the amount of secured credit available.
- **Warehouse Receipt Systems** - Mozambique has tried to implement warehouse receipt systems but reports are that the system is not operating efficiently. There have been discussions about this model in Zimbabwe, but it has failed to take off due to lack of supportive legislation. Whatever form of collateral is being used, it is important that there are enforcement procedures in place, and this entails developing legal systems to ensure that there are procedures for lenders to enforce security interests in the event of a default. These procedures should be fair and efficient.
- **Group Lending schemes-** These have been found to be effective within the SADC region and in other parts of Africa and outside the African continent especially for smaller loans, particularly for farmer and/ or women's' groups.

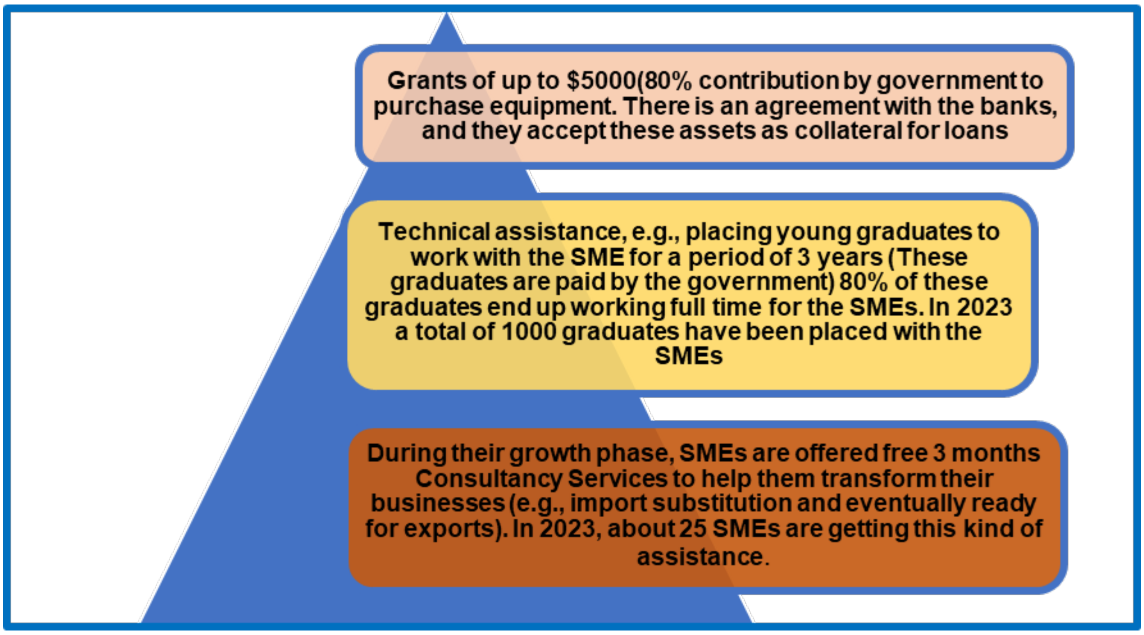
- **Government backed guarantees** set up by various development organizations are a common feature within the SADC region. These would guarantee from between 50-75% of the total SME debt. Despite the availability of such guarantees, this study has noted that banks still demand some form of collateral to cover any of the uncovered exposure for the borrowings. Clearly banks have no confidence in SMEs and have no desire to take any risk on them unless the risk is fully secured.
- **Asset based lending** as promoted by the NB Bank in Malawi and many other financial institutions within and outside the SADC region.
- Supply chain finance and inclusive business models.
- Innovative working capital financing such as factoring and invoice discounting.
- **Cash flow-based lending**. NB Bank in Malawi does advance unsecured loans to some of its clients and SMEDCO lends to women entrepreneurs on an unsecured basis.

5.4. Informality of SMEs

The informal state of SMEs is a major barrier for them to access finance. Banks have expressed more comfort and willingness to consider financing a formal business as opposed to a non-formal one. Non-formal businesses come with a lot of risks and uncertainties while formal entities at least have some form of structure, their being can be investigated, while they are traceable. Member States within the SADC region are, therefore, investing time and resources towards promoting formalization amongst their SMEs. Several institutions across the SADC region are running various programs aimed at assisting SMEs to formalise.

5.4.1. Incentives to encourage formalisation of SMEs

In Mauritius, as a first step, the SME registration unit registers them according to: location, type of business, size, activities, services etc. (In March 2024 information on registered SMEs will be available online) Once this is done, they are then handed over to SME Mauritius whose mandate is to provide various services to SMEs. Then the below incentives follow:



Tanzania aims to use access to digital identity, access to markets, new opportunities and financial services to incentivize informal businesses to formalize and proffers that; "Ideally, formalization should benefit businesses first, and businesses should be educated about the opportunities of formalization in relation to business expansion, access to finance or capital and new market opportunities and *that the formalization of businesses will be achieved by availing digital ID, digitizing money, digitizing payments, deploying user-friendly technologies that allow for data on all the business transactions to be captured, analysed and used to manage business better, and thereby increase productivity.”*

Formalization of businesses comes with the added burden of taxation which includes things like filing tax returns, paying taxes on profits, and withholding taxes on employee wages. However, this is a necessary pain that all businesses must endure. Governments should be lenient towards SMEs as they try to comply with tax regulations, rather than being punitive and harsh. Governments can provide SMEs with tax breaks, simplifying the tax code, and offering help with tax compliance. If SMEs have a bad experience with tax compliance, they are more likely to become tax evaders in the future. It is important for SMEs to have an attitude of compliance, especially if they can see how the taxes they pay are being used.

5.5. Recommendations

Recommendation	Responsible body
There is a need to improve the quality and availability of data on SME finance, which can help policymakers to make better decisions about how to promote SME finance.	Central Banks
Standardize data collection methods: SADC Member States can standardize data collection methods to make it easier to compare data from different sources. This can be done by developing common data collection tools and procedures.	Central Banks
Build national statistical capacity: SADC Member States can build national statistical capacity by providing training and resources to statistical agencies. This will help to ensure that Member States have the resources they need to collect and analyse data on SME finance.	Member States
Focus on missing indicators: SADC Member States can focus on collecting data on missing indicators, such as barriers to access, usage by enterprises, and the role of informal providers. This will help to provide a more comprehensive picture of the SME finance landscape.	Statistical Agencies in Member States working with Central Banks
Ensure that data is open and accessible: SADC Member States can ensure that data on SME finance is open and accessible to the public. This will allow researchers, policymakers, and other stakeholders to use the data to inform their work.	Central Banks/credit bureaus
Developing alternative credit scoring systems that consider factors other than credit history, such as the businesses’ financial statements and its management team.	Central Banks, DFIs and financial institutions in Member States
Educating SMEs about the importance of building a credit history and how to do so.	SME stakeholders (governments, SME bodies, DFIS, financial institutions).

6. Supply Side Constraints

6.1. Capacity building

DFIs advisory services could cover a diverse range of market functions and actors, such as policies, regulations, accounting standards for SMEs; SME lending infrastructure such as credit bureaus and credit information systems, payment systems. However, the challenge is that these activities are not profitable for the DFIs, given the fact that DFIs are expected to be self-sustaining. If DFIs stop advocating for financial inclusion because it is not financially profitable, this could discourage development and private sector investments in markets that are seen as too underdeveloped or risky. In addition, it may present a conflict of interest since DFIs are major players in the SMEs financing value chain. Whilst advocacy work for financial inclusion can help to expand access to finance for SMEs, it may also be perceived as a way to protect and/or benefit the investments of DFIs. On the other hand, if DFIs stop advocating for financial inclusion, it could make it harder for other investors to invest in developing markets.

In this regard it is recommended that DFIs should collaborate with and source funds to finance such advisory services from development partners in the form of grants to complement their efforts of channelling funding to SMEs. NB Bank in Malawi indicated that it is taking this route.

To address the lack of capacity to serve SMEs within the DFIs, there is need for more training to improve staff skills. Sector specific studies and analysis would also help the staff to understand specific value chains. Related to the above, particularly playing a role in supporting emerging sectors, DFIs should ensure that their staff get the necessary training to remain relevant in a fast-paced business environment. There are great opportunities for partnering with development partners who have the necessary expertise. This will enable DFIs to attract relevant finance e.g., Green Climate Fund (GCF) and other funds. In addition, DFIs need to enhance their skills in SME lending to avoid a situation where SMEs shun DFIs and prefer expensive loans offered by commercial banks due to the time it takes to approve loans. This can be achieved by having dedicated SME departments within the DFIs. When DFIs have the necessary inhouse skills they can be effective in offering relevant products and services for the SMEs, such as financial management training: enhancing entrepreneurial and business planning skills of SMEs and strengthening risk management systems of SMEs amongst others.

6.2. Promoting uptake of existing products and services

One of the factors that hinders SME access to finance is their lack of understanding of existing products and services. Capacity building of SMEs in this respect could have positive impact on access. The challenge would be how to finance the capacity building initiatives. Some Member States, for example Namibia has rolled out a government funded capacity building initiative. In the SADC region, there are some specialised institutions which have been set up for this and it is important for DFIs to identify these institutions and collaborate with them. Other DFIs are also collaborating with development partners to ensure that SMEs receive the right information regarding available financing schemes as well as training on the various products and services that may be available and targeted to SMEs.

6.3. Supporting new product development

DFIs are normally set up by their governments to stimulate development, whilst expected to be financially sustainable, a challenge that many DFIs in the SADC region are struggling with. With respect to the funding of SMEs, government funding through the DFIs is normally provided through blended finance instruments such as grants, direct concessional loans and guarantees. In addition to providing funding, DFIs offer a range of other services including wholesale lending to commercial banks and microfinance institutions, (MFIs) advisory services to both financial institutions and businesses. However, as evident from the study, the most popular funding instruments for SMEs is loan finance and partial credit guarantee schemes. A few DFIs in the SADC region do finance SME through equity investments, investing directly in the SMEs or investing in other financial institutions including MFIs. All the DFI investments, i.e., concessional loans, wholesale lending, guarantees, equity investments are normally of a catalytic nature, aimed at ensuring that SMEs are financially included by lowering their risk profile so that they are attractive to commercial lenders.

Supporting the development of suitable new products for financing SMEs requires flexibility and a higher level of risk appetite. DFIs need to be flexible in their approach to market innovations. They need to be willing to try new things and experiment with different solutions. Innovations are inherently risky because market innovations are often untested and unproven There is no guarantee that they will be successful. DFIs need to be willing to take on a higher level of risk when supporting new product innovations. However, the potential rewards of innovations are also high. Market innovations can lead to new financial products and services that are more inclusive, efficient, and resilient. This can have a significant impact on development by increasing access to finance by SMEs, boosting economic growth, and creating jobs. DFIs can mitigate the risks associated with supporting new and innovative financial products for SME lending by:

- Conducting thorough due diligence on potential investments
- Diversifying their investment portfolios
- Partnering with other investors and stakeholders
- Developing exit strategies

6.4. Invest in promoting products that lower the risk profile of SMEs

DFIs face a high risk of borrowers defaulting on loans, which could result in losses.
Blended finance is a strategic approach to financing that combines public and private sector resources to create innovative financial products and services that can help to close the financing gap for SMEs. When DFIs use loans, equity, grants, or guarantees, they do so in such a way as to adjust SMEs' risk profiles to make them more palatable for private investors. This can involve using a mix of tools or structuring investments in a way that reduces the risk for private investors. Blended finance can be a powerful tool for supporting SME growth and development. It can help to mobilize more capital for SMEs and make them more attractive to private investors. By offering loans on concessional terms, in local currency, and paired with other types of capital, such as equity investments, DFIs and development agencies contribute to more access to finance by SMEs.

With blended finance, the provider takes the riskiest parts of a capital stake and thereby de-risking the investment for others who want either lower risk or higher return. This can make SMEs more attractive to private investors and help to mobilize more capital for SME growth.

Five instruments available to DFIs and development agencies to support SME growth through blended finance are loans, equity, guarantees, grants, and technical assistance.

Instrument	Description

Loans	Loans can be used to provide SMEs with the working capital or investment capital. Concessional terms refer to loans that are offered at lower interest rates or with longer repayment periods than traditional commercial loans. This can make them more affordable for SMEs, which often have limited access to capital. Local currency loans can also be helpful for SMEs, as they can reduce the risk of foreign exchange fluctuations.
Equity	Equity can be used to provide SMEs with a longer-term source of capital and to help them grow and expand. Equity investments can also help to attract other investors, such as venture capital firms and private equity funds. For some SMEs, concessional loans may exceed the capacity of their balance sheets. This means that the firm may not be able to afford the monthly repayments on the loan. In these cases, equity investments can be a more appropriate form of financing.
Guarantees	Guarantees can be used to reduce the risk for commercial banks and other private investors, making them more likely to lend to SMEs. First-loss coverage guarantees are a type of guarantee in which the provider agrees to cover the first losses that occur on a loan or investment. This means that the provider is taking on the riskiest part of the investment, which can make it more attractive to private investors. First-loss coverage guarantees can be used to support a wide range of SME financing products, including loans, equity investments, and bonds.
Grants	Grants can be used to provide SMEs with the funding they need to cover start-up costs, invest in new research and development, or expand into new markets.
Technical Assistance	Technical assistance can be used to help SMEs improve their financial and administrative systems, develop business plans, and access markets

The study revealed several examples of how DFIs in the SADC region are using blended finance to support SMEs. When managed efficiently, blended finance can be effective and therefore a powerful tool for mobilizing private investment and helping SMEs to achieve their full potential.

The end goal of blended finance is to increase SMEs' ability to access private capital independently, without having to rely on grants or concessional terms. Local capital providers are essential partners because they have a deep understanding of the social investors and local knowledge of the market, helping to ensure that funds go where they are needed. Local capital providers can play a vital role in blended finance in a number of ways, including:

- Local capital providers have a deep understanding of the local market and can identify SMEs that have the potential to grow and succeed. They can also invest in these SMEs directly or through equity funds.
- Local capital providers can provide technical assistance to SMEs to help them improve their financial and administrative systems, develop business plans, and access markets. This can help to make SMEs more attractive to private investors.
- Local capital providers can partner with DFIs and other development actors to develop and implement blended finance initiatives. This can help to mobilize more resources and expertise to support SMEs.

6.4.1 Value Chain Financing

Value Chain Finance (VCF) refers to "finance that takes place within the value chain and external finance that is made possible by value chain relationships and mechanisms" (Miller and Jones, 2010). Traditionally, VCF has been conducted or facilitated by segments of the value chain that are closely linked, and where contracts and relationships can be commoditized. First, financing can be provided

> *While a lot of focus has been placed on lack of access to finance by SMEs as a major impediment to their growth, more often than not access to markets has proven to be even more critical to resolving the access to finance issues as it normally unlocks a host of other financing options such as supplier credit, order financing, factoring etc. It is thus important for Member States to place equal or greater emphasis on the importance of access markets in addressing access to finance challenges.*

against guaranteed purchase agreements with smallholders. This model involves impact-driven smallholder agriculture lenders, such as Root Capital, Oikocredit, and Triodos, providing short-term trade financing for producer organizations that have contracts with off-takers. In 2011, disbursements from global lenders using this model totalled USD 350 million, with USD 60 million disbursed in Africa. Expanding this model relies on increasing the number and capacity of smallholder-oriented producer organizations that can sign purchase agreements with off-takers and receive financing from investors. Technical assistance providers and donors can support the formation and management of these producer organizations, while local governments can implement policies that support training, management, and access to markets for producer organizations. This model is particularly prominent in exportable cash crops like coffee, cocoa, and cotton in countries like Uganda, Tanzania, and Rwanda.

Alternatively, VCF can be implemented by providing lending to smallholder farmers through the value chains of large multinational commodity buyers. These buyers have powerful long-term incentive relationships with smallholder farmers and insider information to assess their capacity to repay. Some global buyers already provide finance to smallholders engaged in their out-grower schemes, using emerging models such as warehouse receipt systems, in-kind, and direct-to-farmer lending. Warehouse receipt systems could be particularly helpful in Africa, where land is not often used as collateral due to title issues. In this scheme, farmers or farmer organizations deposit their produce in a warehouse, and the warehouse operator issues a receipt indicating the quantity, quality, and type of produce deposited. These receipts can later be used by financial institutions as collateral.

Benefits of implementing VCF for smallholder farmers include:

- Expanded access to finance: VCF can help meet the growing need for agricultural finance and investment, allowing smallholders to access the inputs they need to increase crop yields and income.
- Commercialization of small-scale agriculture: VCF has the potential to advance the commercialization of small-scale agriculture, enabling smallholders to participate in value-added product markets.
- Overall, VCF can be an effective approach to provide financing to smallholder farmers and unlock their potential for increased productivity and income. By leveraging the relationships and resources of large multinational commodity buyers, smallholders can gain access to the finance they need to thrive in the value chains.

Selected VCF Experiences in South Africa South Africa represents possibly the most dynamic retail market in Sub-Saharan Africa. Indigenous and international retailers are innovating to include rural populations and smallholder farmers in their supply chains, as per the following examples:

Bean There is a South African coffee wholesaler and retailer. It provides farmers with a guaranteed purchase agreement at the beginning of the planting season, and then helps them use this agreement to secure a loan from a third party. The loan is used to purchase the inputs necessary to produce the coffee volumes that farmers have promised to deliver by season's end. In addition to improving farmers' financial inclusion, this system yields business advantages to Bean There. Not only is the company able to secure its supply many months in advance, but it also helps to establish an agreed-upon purchase price— providing the business with stability in planning.

Woolworths is one of the largest retail store chains in South Africa. The company has worked to extend finance and technical assistance to smallholder avocado farmers. Because its main avocado supplier, Westfalia, could only provide the needed volume for nine months of the year, it often had to purchase the product internationally. Seeking to minimize transportation costs and increase local production, the company worked with Westfalia to identify other farmers in South Africa who could produce avocados earlier in the year. As a result of these efforts, Woolworths currently provides loans to help a local farmer, which he can use to purchase inputs to produce avocados two weeks prior to Westfalia. The food company is looking to expand further this loan program to farmers owning a total of 150 hectares of land in the region.

The proposed merger between Walmart—an American global company running chains of department stores— with Massmart, a large South African retailer, was met with stiff resistance, sparking a legal effort to block the transaction that was backed by government ministers and trade unions. Possibly in an effort to fend off new attacks and maintain its social license to operate, Massmart (which has since merged with Walmart) is currently stepping up efforts to work with local smallholders through financial inclusion efforts. It recently announced a USD 1.7 million program that will seek to help local smallholders establish links to financial markets in partnership with TechnoServe, an NGO that works with emerging farmers and entrepreneurs.

Source: Good Business Journey Report (2011), Massmart (2011) and Bean There (2012).

6.4.2 IT-based Financial Services in Financial Inclusion

In some developed economies, due to improved financial literacy and higher connectivity, IT-based financial services have been developed. For the SADC region, while this remains an option – it is important that Member States work on the two fundamental drivers of this option viz financial literacy and internet connectivity.

Peer-to-peer lending platforms

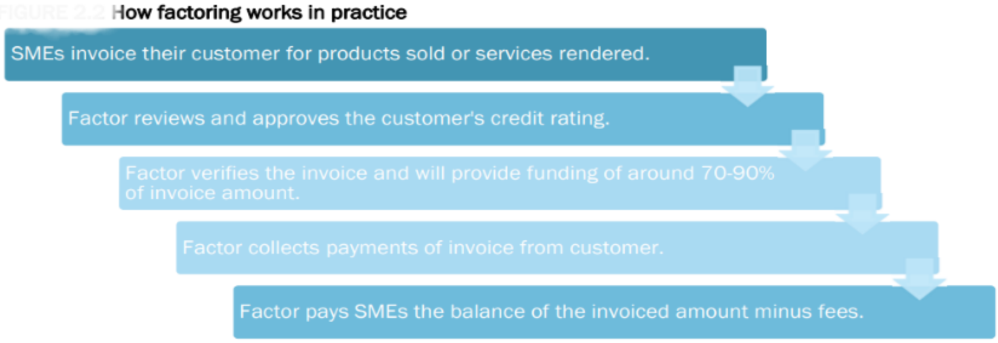
Peer-to-peer (P2P) lending platforms have been a fast-growing phenomenon since 2006 and are an important provider of financial services. According to CreditEase (2013), there are more than 200 P2P platforms nationwide. P2P lending platforms bring lenders and borrowers in rural and urban areas into contact via the internet, with individuals wanting to lend and those wanting to borrow self-matching online. In the transaction procedure, the borrowers pay interest to the lenders via the platforms and the platforms charge transaction fees. Well-known examples of the P2P model are CreditEase, Renrendai, 51Qian, and Tuandai. These platforms target the rural unbanked segments as part of their client portfolio. No exact data on the number of clients and average loan sizes are available, but it is assumed that the number of clients are significant and growing, and a proportion of the loans provided are small or microloans.

6.4.3 Factoring

Factoring has three main features: (i) it exclusively involves the financing of accounts receivable; (ii) the underlying asset is sold to the factor at a discount, rather than collateralized; (iii) it is a bundle of three financial services—a financing component, a credit component, and a collections component.

There are two main categories of factoring, based on the transfer of risk—non-recourse and recourse contracts. In recourse factoring, the factor has a claim against the firm for any account payment deficiency. Under non-recourse factoring, the factor assumes full title to the accounts and bears the default risk without recourse to the firm. Through factoring, it is the factor that assumes the costs implied by collecting information about buyers. In the case of "ordinary factoring," the firm sells its complete portfolio of receivables. In the case of "reverse factoring," the factor purchases accounts receivable only from selected customers of the firm. In this way, the factor increases its risk exposure to a customer, but the cost of acquiring information and assessing credit risk is lower, and typically only high-quality receivables are accepted.

FIGURE 2.2 **How factoring works in practice**



Source: Macías Sánchez, 2011.

Regulations governing factoring.

The legal framework that facilitates international factoring was issued by the International Institute for the Unification of Private Law (UNIDROIT) in May 1988. To date, nine economies have ratified this convention and, in February 2016 the convention was submitted to the U.S. Senate for ratification by the United States. The convention sets forth how a factoring contract is defined as well as the rights and duties of the parties involved, among other provisions, and specifies that factoring should be regulated by the same laws that regulate security interests (to ensure its integration into modern secured transaction systems). The degree of regulation governing factoring varies between economies. However, economies tend to fall into four main categories of regulatory approaches to factors.

These are: (i) economies with complete government supervision, regulation and licensing of all factoring products and services, such as China; (ii) economies that require factors to obtain a full banking license issued by the central bank and compliance of capital ade quacy, such as Austria, France, Italy and Mexico; (iii) economies that require registration by the factor as a financial institution, but do not regulate capital adequacy, such as Bulgaria, Croatia, Germany, Hungary, Malta, Norway, Portugal, Romania, Serbia and Turkey; and (iv) economies with no official regulation or governmental supervision, but in which membership to international factoring associations is highly advanced, such as the Czech Republic, the Russian Federation, the United Kingdom, and the United States.

Online Platforms for Reverse Factoring

Online platforms for conducting reverse factoring transactions are facilitating supply-chain finance to SMEs. After making a sale, SMEs often receive account receivables from their buyers, which are typically paid months after the goods are delivered. Online platforms allow SMEs to shorten the maturity of these payments by making it easier for firms to sell their account receivables to financial institutions in exchange for cash. Large, well-known buyers can post online the accounts payable they receive from their SMEs suppliers. Interested financial institutions then submit offers to buy them at a discount. SMEs accept the most convenient offer and automatically receive payment to their bank account. Using online platforms reduces transaction costs and fosters competition.

Governments have developed successful online platforms. A leading example is a development bank in Mexico, NAFIN (Nacional Financiera), which has operated its own online platform for supply-chain finance since 2001. NAFIN only administers the platform and does not give lending directly, which is provided by private banks. As of 2015, the program encompassed about 12,000 suppliers, over 600 buyers, and about 40 private financing institutions. Due to its success, NAFIN has entered into agreements with other Latin American development banks to develop reverse factoring systems in Central America, Colombia, and Ecuador (de la Torre, Gozzi, and Schmukler 2017). Nowadays, these automated systems are also being offered by fintech (financial technology) companies, as well as new ventures set up by traditional banks, in both developed and developing countries (The Economist 2017).

6.4.4 Invoice Financing

Invoice financing is a type of business financing that allows businesses to borrow money against their accounts receivable to generate cash quickly. It is also known as accounts receivable financing or invoice discounting. Here are some key points about invoice financing:

- Invoice financing allows businesses to use their invoices as collateral to secure a loan or line of credit.
- With invoice financing, a company uses an invoice or invoices as collateral to get a loan from a financing company.
- Invoice financing can help businesses improve cash flow, pay employees, purchase inventory, and ultimately grow faster.
- Invoice financing can be structured as a loan or as a line of credit, sometimes called an accounts receivable line of credit.
- Invoice financing can offer a good alternative to bank loans or credit lines for companies that can’t readily access those more traditional forms of capital.
- Invoice financing can be easier to qualify for than other small-business loans, although borrowing costs can be higher.

Invoice financing benefits lenders because invoices act as collateral for invoice financing, which limits the lender's risk.

6.4.5 Leasing

Lease financing is an asset-based lending mechanism where the leased equipment is the collateral for a loan. This feature makes it an attractive option for SMEs wanting to invest in their innovation capabilities. Leasing offers flexibility, which is an attractive option for SMEs and grants tax-related incentives. To foster alternative SME finance products such as leasing products which are an important source of investment finance, a legislative framework is needed to clarify rights of the parties to a lease, remove contradictions in the existing legislations, create non-judicial repossession mechanisms, and ensure that tax rules are clear and neutral.[1]

6.4.6 Fostering capital markets development - Equity financing

Governments have tried to circumvent banks by developing specific capital markets targeted at SMEs. These markets offer listing and regulatory requirements tailored to SMEs such as lower fees,

[1] *2013- Africa Development Bank – Financial Inclusion in Africa.*

lower profitability requirements, and smaller issuances. The equity financing method refers to the extent to which the company issues a certain portion of shares of its stock and in return receives money. Depending on how the SMEs raise the equity capital, the debtors have to relinquish a certain portion of the business often 25 to 75 % of the business (Covas and Haan, 2006). Gomes et al. (2006) pointed out that equity financing is a method for raising funds for any investments. In this context, equities are issued in the form of common stocks which gives a claim to share in the net incomes after expenses and taxes. Equity holders are paid periodically in form of dividends and can be considered as a long-term security as there is no maturity date.

Despite the initial enthusiasm to promote these markets worldwide, these markets seem to be reaching a small number of firms (Harwood and Konidaris 2015). Asia provides a good example of these difficulties. Since the late 1990s, various countries throughout the region have set up specific capital markets targeted at SMEs. However, these markets have generally only appealed to a small number of SMEs. For example, as of 2014, only 4 firms were listed in SME capital markets in the Philippines, 88 in India, 107 in Malaysia, and 111 in Thailand. In the midst of these unsuccessful experiences, the case of China is worth analysing, given its undergoing efforts to establish these markets.

China: MSME financing through capital markets

Direct financing through equity markets and bond markets for MSMEs has experienced fast growth since the 2000s. The SME Board, the first equity market for SMEs, was launched under the Shenzhen Stock Exchange (SZSE) in May 2004. This board originally acted as a pilot venture market, but now has become a market for growing SMEs to raise funds. In September 2004, another market, ChiNext (Growth Enterprise Board), was established under the SZSE for innovative SMEs

As of end-2013, the SME Board had 701 listed companies with a total market capitalization of CNY3,716 billion, while the ChiNext had 355 listed companies with total market capitalization of CNY1,509 billion (Table 2.9). Manufacturing companies dominate the two boards, followed by IT-related companies. However, the listed companies in the SME Board are geared to traditional industry, while the majority of the listed companies in ChiNext belong to strategic emerging industry. There was no increase in new listed companies in 2013, since the China Securities Regulatory Commission (CSRC) suspended all initial public offerings (IPO) approvals in the SZSE and Shanghai Stock Exchange (SSE) in October 2012.

Setting up SME stock exchanges or junior markets can help to improve the availability of equity investment to SMEs. However, these markets can only be successful if the underlying legal and regulatory frameworks are in place and if there is a sufficient supply of early-stage equity capital available from angel, venture capital, and private equity investors. In the interim, (as is happening in Madagascar, SONAPAR, a DFI takes a minority position in the capital of the SMEs in which it invests to give promoters greater freedom in the operational management of their business. It remains in a position to advise on and control strategic decisions. In Malawi, NB Development Bank finances startups through equity. GAPI in Mozambique takes a different approach. It collaborates with a network of microfinance institutions in which it has shareholding, as opposed to being a shareholder in the SMEs, whilst the (NIPDB) facilitates pitching platforms twice a year to match entrepreneurs with prospective investors.

Whilst equity investment can be a valuable source of financing for SMEs, there are several challenges that can limit the availability of equity investment to SMEs, including:

- Lack of disclosure and governance: Investors need to have access to reliable information about SMEs to make informed investment decisions.
- Lack of minority shareholder protection: Investors need to be confident that their rights as minority shareholders will be protected.
- Weak domestic institutional investor base: In most SADC countries, there is a limited domestic institutional investor base that can invest in SMEs.
- Foreign ownership restrictions: In some countries, there are restrictions on foreign ownership of listed companies.

The underdevelopment of these capital markets could be due to some SMEs' lack of financial literacy, which discourages them from turning to capital markets for funds. Other SMEs might feel that the benefits of listings are offset by the short-termism and volatility of these markets, and the loss of control of their firms. These markets have also had difficulties attracting institutional investors, which are the main participants in capital markets but favour large, liquid companies, whose securities can be disposed of on short notice without affecting their price (OECD 2015)

6.4.7 Partial Credit Guarantee Schemes

All SADC countries have used credit guarantee schemes as a mechanism for lowering the risk profile of SMEs, thus making them a bit attractive for commercial banks. These have enabled SMEs to access finance as they solve the collateral issue problem faced by SMEs. Key features of a well-designed partial credit guarantee scheme include:

- **Eligibility criteria**: The scheme should target SMEs but should not restrict the sectors or types of loans that can be guaranteed. This is because SMEs in different sectors and with different types of loans may have different levels of risk, and the scheme should not discriminate against any sector or type of loan.
- **Approval rules and procedures**: The approval process should be quick and efficient. This is important because it helps to reduce the time and cost of getting a loan, which can be a major barrier for SMEs.
- Coverage ratios: The coverage ratio should be high enough to protect lenders from default risk. A good rule of thumb is to set the coverage ratio at 70-80%.
- **Fees:** The fees charged by the scheme should be risk-based. This means that the fees should be higher for loans that are riskier. The fees should also contribute to the financial sustainability of the scheme.
- **Payment rules and procedures**: The payment rules should be clear and transparent. This is important for both lenders and borrowers, as it will help to avoid any confusion or disputes.
- **Capacity building:** The scheme should support the capacity of lenders to provide SME finance. This can be done through training, technical assistance, and other forms of support.

6.4.8 Supporting Inclusive Business Models

Whilst big businesses are interested in partnering with SMEs, it can be difficult to find SMEs that are qualified, as many SMEs lack the resources and expertise to meet the needs of big businesses. They may also have difficulty complying with the big businesses' procurement and quality standards. DFIs can help by identifying companies interested in inclusive business models and providing them with de-risking capital at concessional rates so that these companies can effectively support the capacity building of SMEs. SMEs benefit immensely from inclusive business relationships with large companies by gaining access to market information, finance, management skills, production expertise, new markets, technologies, business management skills and ideas.

DFIs can play a role in catalysing alternative, innovative, and sustainable business models that promote the inclusion of SMEs by providing de-risking capital that seeks economic, social, and environmental results. DFIs can also facilitate multi-stakeholder platforms to bring together several inclusive business minded companies and set up funds to support them to work collaboratively. DFIs can help to facilitate these platforms by providing the necessary funding and support.

Strategies that DFIs can adopt to finance Inclusive Business Models include:

- Joint financing mechanisms between DFIs, private companies and local banks, e.g., by taking equity in the SMEs.
- Supporting tripartite agreements between SMEs, private companies, and commercial banks through wholesale lending to commercial banks and/or provision of partial credit guarantee schemes.
- Wholesale lending to DFIs (pension funds, etc)
- DFIs lending to microlenders. Partnership with commercial banks, MFIs and other financial service providers, including SOEs and NGOs to reach micro/ remote clients.
- Provision of capacity building funds to the private sector companies to cater for the training of the SMEs.

7. New product Development - Key Success Factors

7.1. Flexibility

DFIs and other development agencies can fill the initial SME financing gap left by risk-averse commercial lenders by incorporating flexibility into their public-sector lending strategies. To help seed enterprises get ready for private investment, DFIs need to work with them early on to improve their organizational and administrative skills and ensuring their preparedness for future private capital integration.

DFIs have an important role to play in financing SMEs in the SADC region, as the private sector is risk-averse and inflexible, with requirements which pilot SMEs do not meet. This is where blended finance from DFIs comes in. Blended finance can provide more flexibility to SMEs and apply more nuance to investment decisions. This flexibility at the initial stages can be invaluable in preparing SMEs for further private-sector investment as they grow.

Below are some specific ways on how SADC DFIs can incorporate flexibility into their public-sector lending strategies to fill the initial SME financing gap:

a) Offer a variety of financial products and services to meet the needs of SMEs at different stages of growth. This could include loans, guarantees, equity investments, and technical assistance.
b) Provide longer repayment terms and lower interest rates than traditional commercial lenders.
c) Accept collateral that is not typically accepted by commercial lenders, such as inventory or accounts receivable.
d) Work with SMEs to develop and implement business plans that will help them to become more profitable and sustainable.
e) Provide mentorship and support to help SMEs overcome the challenges of growth and expansion.
f) DFIs should focus on investing in SMEs that are too risky for commercial lenders but have the potential to make a significant impact on the economy. They should also develop tools and strategies to help these SMEs mitigate their risks and attract private capital in the future.

Here are some specific things that DFIs and other development actors can do to establish a common framework for supporting SMEs:

g) Develop a shared set of criteria for identifying and investing in high-growth SMEs. These criteria should take into account the SME's financial and administrative capacities, its potential for sustainable returns, and its potential to contribute to market development.
h) Work together to develop de-risking instruments and other financial products that meet the needs of early-stage SMEs. This could include guarantees, first-loss capital, and other forms of risk mitigation.
i) Provide technical assistance to SMEs to help them improve their financial and administrative systems, develop business plans, and access markets.
j) Work with commercial lenders to develop partnerships that can help SMEs scale up and transition to private capital.

Expanding attention toward investment facilitation is also critical for the sustainable success of DFIs initiatives. By helping to develop a self-sustaining investment ecosystem, investment facilitation can help to ensure that SMEs in the SADC region have access to capital and support. In addition to providing technical assistance to SMEs to help them develop business plans, improve their financial and administrative systems, and access markets, DFIs can also collaborate with commercial lenders to develop partnerships that can help SMEs scale up and transition to private capital and provide grants to local advisory firms and other intermediaries to help them support SMEs in deal-sourcing and long-term investment facilitation.

7.2. Lowering transaction costs of delivering financial products for SMEs

High transaction costs are a major barrier to SME financing. DFIs and other financial services providers need to ensure that products are delivered in a cost-effective manner, otherwise developing new products and services or improving existing ones may not be effective. Another challenge for DFIs and other financial services providers is the lack of information and poor record keeping systems from SMEs, which makes it difficult to assess their creditworthiness. SMEs require the same level of attention from financial institutions as big businesses, but with lower returns due to the time and costs involved in processing applications for funding. Technology can play a vital role in unlocking access to finance for SMEs by digitizing the lending processes. This also reduces the time it takes to generate reports, as real-time data is available. Additionally, disbursements can be made digitally directly to applicants' e-wallets, eliminating the need for cash disbursements or staff travel for face-to-face meetings.

7.3. Recommendations for greater effectiveness

Start-ups and SMEs have been slow in developing alternative financing markets due to limited awareness and understanding of these instruments. To address this issue, it is not only necessary to **increase knowledge about individual instruments** but also to **support SMEs in developing strategic vision and planning**. It is important to understand how **different instruments can serve different financing needs** at **specific stages of the business life cycle**, the advantages and risks implied, and the complementarities and opportunities for leveraging between some of these sources.

To improve the quality of start-up business plans and SME investment projects, especially for the development of the riskier segment of the market, it is necessary to **address the lack of "investor-ready"** companies. In many countries, SMEs are generally ill-equipped to deal with investor due diligence requirements, which is a major impediment to the development of equity finance for young and small businesses. Furthermore, in some countries, there is an increasing concern about the lack of entrepreneurial skills and capabilities and low quality of investment projects, which is driving more attention to the demand side, such as training and mentoring.

The development of instruments that imply a greater risk for investors than traditional debt finance is enabled by the regulatory framework. However, creating effective regulation that balances financial stability, investor protection, and the opening of new financing channels for SMEs is a challenge for policy makers and regulatory authorities. This is especially true given the rapid evolution in the market due to technological changes and the engineering of products that respond to the appetite for high yields by financiers in a low interest environment. Some investors perceive recent regulatory initiatives, which aim to make the financial sector safer, to be unduly onerous. These investors are also affected by the enduring uncertainty arising from expected regulatory revisions.

To promote the development of alternative financing options for SMEs, it is important to address **information asymmetries** and **increase transparency** in the markets. One way to achieve this is by **establishing information infrastructures** for credit risk assessment, such as credit bureaux, registries, or data warehouses with loan-level granularity. These infrastructures can help reduce the perceived risk by investors when approaching SME finance and enable them to identify investment opportunities. By reducing the perceived risk, investors may also be willing to accept lower financing costs, which are typically higher for SMEs than for large firms.

The following programmes are critical to be constantly run by various SME or Investment bodies in the various Member States.

Investor Readiness Programmes	
Investment Information Dissemination Platform	**Investment Ready Review**
What equity is and the benefits it may bring?	What are the entrepreneur's aspirations?
The limitations of debt funding and the circumstances in which it should be considered	what is the entrepreneur's attitude to ownership and control?
The different types of equity providers in the marketplace and their specific focus	Are their books in order?
How to access the right investor and who are the intermediaries who may provide assistance in finding appropriate investors	Are the owner's personal affairs separate from the business?
Equity investors‟ evaluation process and decision-making criteria	Does the business have an integrated software package?
How to present information which focuses on the investor perspective of the opportunity	How experienced is the entrepreneur and management team?
Determining realistic funding needs for the future	Does the entrepreneur know the market?
What to expect in relation to the equity parties' control and legal safeguards for the future	Has the product been developed to the point of functioning prototype?
Risk and return aspects of equity investment and the determination of "value‟	Is the product/service proprietary or can it be protected?
	Has the product/service been tested in the marketplace?
	How competitive is the product/service?
	Can the entrepreneur provide a reasonable and realistic business plan?
	Can the entrepreneur articulate how the finance will be utilized?
	What is the likely rate of return on an investment?
	Is there the likelihood of an exit strategy?

8. Emerging Opportunities for DFIs

8.1 Niche Market for DFIs

According to the SADC DFRC, “The mandate of DFIs is to cater for unbanked/unbankable economic sectors on account of market failure. DFI activity therefore lies at the heart of financial inclusion policy and plays a key role in economic and social development”; Therefore, SADC recognises that DFIs should focus on investing in areas where there is a market gap, or where commercial investors are not yet willing to invest. DFI funding can also be "catalytic" by helping to attract private investment to new markets or sectors. For example, DFIs might invest in pilot projects to demonstrate the feasibility of a new technology. This could then pave the way for private investors to follow suit. DFIs can use their expertise and resources to help develop and implement new financial products and services that are more inclusive, efficient, and resilient. This calls for a balance between the need for financial returns with the need to promote development.

DFIs should not find themselves in a situation where they are perceived as competition with MFIs and Commercial Banks but should rather find a niche in the so called risky and/or emerging sectors such as health care, agriculture, technology and renewable energies and foster collaboration in the financial services sector. DFIs should play a catalytic role by helping to attract private investment to new markets and sectors that have high potential development impact. This can be done by providing early-stage financing, taking on more risk, or providing other forms of support to commercial investors. By incentivizing commercial investors to invest in projects with high potential development impact, DFIs can play a vital role in achieving their mandate of promoting sustainable development.

DFIs have a mandate to promote development and financial inclusion. However, as the study revealed, DFIs in the SADC region are not investing enough in market infrastructure and FinTechs, even though these are important areas for achieving their goals. This is likely due to a number of factors, such as the perceived risk of these investments and the lack of track records for many FinTechs. DFIs should invest more in market infrastructure and FinTechs because these are important areas for financial inclusion.

DFIs need to be more strategic in their approach to financial inclusion. They need to think about how their interventions can have a systemic impact, and they need to be willing to take on more risk to support new and innovative solutions. This will help to create more inclusive and sustainable financial systems and more sustainable and dynamic markets, which will ultimately present DFIs with new and more diversified investment opportunities and benefit the private investors that they seek to attract to the market.

DFIs could significantly increase their contribution to financial inclusion by:

1. Expanding their focus to consider how their interventions affect the entire financial system.
2. Taking on more risk to test new business models and delivery channels that help bring more funds into the financing of SMEs.
3. Leveraging their technical credibility to facilitate market development.

To be effective, DFIs in the SADC region need to invest resources to understand the local market and the challenges that are preventing SMEs from accessing finance. They should then work with other development actors to design and implement interventions that will make the market more inclusive.

Whilst DFIs in the SADC region have indeed contributed to the efforts of channelling finance to SMEs, they face systemic and non-systemic challenges. Given the foregoing, CGAP argues that to effectively deal with these challenges, DFIs must pursue “a market systems development approach to catalyse systemic change—change that is significant in scale and sustainable”.

8.2 Supporting green economies

Addressing climate change in Africa presents a $3 trillion economic investment opportunity by 2030, and African SMEs are critical to this effort. SMEs' lack of access to financing forces them to behave in ways that are not sustainable and even sustainable SMEs struggle to gain financial support due to their lack of collateral and perceived higher risk and for those who are lucky to access the finance, it comes at very high interest rates. Transitioning to green technologies is very expensive, particularly in underdeveloped markets and the higher upfront costs are prohibitive.

There are opportunities to develop green SMEs in the SADC region through initiatives such as the Green Climate Fund under the United Nations Framework Convention on Climate Change, which aims to support green development in developing countries and looks to raise $100 billion annually for green business development. There is also USADF's Off-Grid Energy Challenge, which works to connect African SMEs with reliable solar energy.

DFIs in the SADC region should lead and be aggressive into tapping into these resources. This might involve transitioning existing businesses and building green businesses and technology from the ground up. While this would require a high upfront capital cost, green technology installation can lead to lower operational costs in the long run. By deploying blended finance instruments. DFIs can support SMEs access to debt markets, allowing SMEs to adapt to climate risks and promote sustainable production practices by adopting green energy.

It is important that policy, legal, and regulatory environments encourage SMEs to pursue long-term economic, social, and environmental results. This is because SMEs play a vital role in society, and their decisions can have a significant impact on the economy, society, and the environment.

Summary of benefits of supporting a green economy:

Long-term economic benefits	**Long-term social benefits**	**Long-term environmental benefits**
- Increased economic growth - Increased employment - Increased innovation - Increased competitiveness	- Improved living standards - Reduced poverty and inequality - Increased access to education and healthcare - Improved working conditions	- Reduced pollution - Reduced greenhouse gas emissions - More sustainable use of resources - Protection of biodiversity

Policy, legal, and regulatory environments can encourage businesses to pursue long-term economic, social, and environmental results in a number of ways, including:

- Providing tax incentives for businesses that invest in sustainable practices.
- Requiring businesses to report on their environmental and social impacts.
- Setting standards for environmental protection and worker safety
- Investing in infrastructure and public services that support sustainable businesses.

By creating an environment that encourages long-term thinking and sustainable practices, SADC Member States can help businesses to create value for all stakeholders. Below are some examples of policy, legal, and regulatory environments that encourage businesses to pursue long-term economic, social, and environmental results:

- The European Union has a number of policies and regulations in place to promote sustainable business practices, such as the Emissions Trading System and the Taxonomy for Sustainable Activities.
- The United States has a number of environmental regulations in place, such as the Clean Air Act and the Clean Water Act.
- Many countries have tax breaks and other incentives for businesses that invest in research and development.
- Some countries have laws that require businesses to meet certain social standards, such as paying a minimum wage and providing paid time off.

Some recommendations for SADC Member States on how to support SMEs in their transition to a green economy are listed below:

- Ensure that DFIs get the necessary training and accreditations to access funds.
- Provide grants and loans to help SMEs cover the costs of switching to green production methods. The Seychelles and Mauritius are already doing this.
- Create tax breaks and other incentives for SMEs that adopt green practices.
- Facilitate certification programs to enable SMEs to comply with requirements.

Promote the use of alternative financing sources, such as crowdfunding, angel investors, and venture capitalists, to help SMEs raise the capital they need to invest in green technologies.

8.3 Supporting Agriculture SMEs

Most of the economies in the SADC region are driven by agriculture, which is a major source of employment and economic growth. Agricultural SMEs play a vital role in bringing food from farms to households. However, most agriculture SMEs in the SADC region, (the majority of whom are individual farmers, particularly women), often operate at a scale that is too small to be commercially investable. This is a good example of the challenge known as the "missing middle." These SMEs are too large for microfinance but too small for commercial bank loans. As a result, agricultural SMEs really struggle to qualify for commercial bank lending in most SADC Member States. With a growing food insecurity in the SADC region and global demand for food, there are so many opportunities for agriculture SMEs. According to UNDP private sector engagement strategy, “The achievement of the SDGs could unlock $12 trillion in market opportunities in these four sectors; food/ agriculture, cities, energy / materials and health and wellbeing.”

Given the foregoing, it is clear that there are opportunities for the DFIs in the SADC region to play a role in catalysing investments in these sectors by supporting SMEs through the deployment of capital into blended finance instruments in order to leverage private sector investments. Businesses, such as supermarkets and large processors, can play a vital role in supporting agricultural SMEs by connecting them to lines of credit and different markets. They could also have a positive impact on employment rates and rural incomes. DFIs, in addition to governments and donors should focus on filling the gaps and providing supply chain services to support the growth of the agricultural sector, including fostering and stimulating investments in the food supply chains. They should also ensure that agri-food SMEs are connecting markets and small-scale farmers. Climate change is adding more risks to agriculture, so it is important to combine finance with technical assistance to help agricultural SMEs manage the changing environment.

Transformational solutions that have the potential to successfully address the SME finance challenge in Africa in a sustainable way need to be holistic. Interventions should be taken at all relevant levels: firms and financial institutions, nationally and globally. Holistic approaches include (but are not limited to) supporting (i) the supply chain projects that build capacity of agri-businesses and small holders through direct support, and linkages to financial institutions and markets; (ii) financial and non-financial institutions that are interested in agribusiness finance to develop products, build necessary skills and develop incentives that better mitigate risks; and (iii) initiatives that work at the business enabling environment level to assist the market place, on the supply and demand sides.

9. Resource Mobilisation

Several DFIs in the SADC region are underfunded, poorly structured and therefore unable to raise funds on the capital markets, making them ineffective in the fulfilment of their mandates. To increase resource flows to DFIs, through the SADC DFRC, it may be worth considering setting up regional facilities such as an SME Fund/ Guarantee facility which could be accessed by all DFIs as well as business development service providers within the SADC region. Resource mobilisation has been identified as an area of potential collaboration amongst the SADC DFIs to increase their effectiveness. Many DFIs in the SADC region are not yet able to independently raise funds on the capital markets. It is recommended that DFIs could come together to set up a regional fund.

If this is not possible, DFIs should consider taking measures that will enable them to attract investors as opposed to solely depending on their governments for funding. Within the Member States, this could be achieved through partnerships with the private sector such as pension funds and other state-owned enterprises (SOEs). The study has shown that within the Member States, partnerships, particularly amongst the private and public sectors and stakeholder engagement are critical success factors in designing SME responsive policies and strategies. Furthermore, when negotiating for credit lines, DFIs need to ensure that the credit lines used to finance SMEs are aligned to the financing needs of the SMEs.

> *Although DFIs are not profit maximisers, their profit generation capacity is arguably a key determinant of their long-term success or failure.*

On the regional level, apart from their relationships with their funders and their membership in the SADC- DFRC, collaboration amongst DFIs within the SADC region is limited as most of the DFIs are inward looking and therefore just fulfilling their national mandates. Below are some sentiments and/ or recommendations from some of the respondents:

- *“To reach more SMEs with robust financing products that contribute to growth and increase resilience, DFIs within the SADC region may work together to set up a joint partnership to develop a structured financial product combining a guarantee fund and mezzanine financing” ANDRIANASOLO LALA Jordy, SONAPAR, Madagascar.*
- *“Most of the DFI’s in SADC have national agenda and therefore inward looking so they do not look outside their own territory for investors, and they also put all their investments in their country “Bernard Masi-CEO of NB Development Bank in Malawi.*

10. Regulatory Barriers

This section of the Handbook emphasizes on the importance of regulators creating a favourable environment for financial institutions, instruments, and markets to operate. By doing so, they can contribute to greater access to finance and promote financial inclusion. The section addresses various aspects related to regulatory and supervisory frameworks, financial infrastructure, and public interventions. Its purpose extends beyond the traditional role of ensuring the stability and efficiency of the overall financial system. Regulators also have the opportunity to contribute to greater access to finance by promoting a favourable legal and regulatory environment. This environment establishes the rules within which all financial institutions, instruments, and markets operate in a given country.

10.1 Importance of SME Information in policy and legislation

The legislative and policy environment establishes the rules for financial institutions, instruments, and markets. To design effective regulatory and policy interventions for SME finance, it is important to have accurate and extensive information on the state of SME finance and the nature of the SME finance problem in each country. This information enables governments to identify cases when SMEs are not being adequately served by the financial sector and helps determine the extent to which the lack of financing to SMEs is caused by supply-side problems or demand-side problems. This information also helps in identifying which kind of intervention might be more appropriate and the impact of these interventions. Moreover, more information is helping traditional financial firms as well as the fintech sector reach out to SMEs. To assist these efforts, governments might want to foster the collection and use of information on the financing needs of SMEs and support alternative financing mechanisms.

10.2 Measures towards effective legislation and policy

Some of the policy measures that can be taken to address the SME finance problem include designing public programs for SME finance which ensure additionality, cost-effectiveness, and user-friendliness, strengthening financial infrastructure, and designing effective regulation that balances financial stability, investors' protection, and the opening of new financing channels. It is also important to create favourable conditions for SMEs to enhance their competitiveness by fostering entrepreneurship, supporting new business models, promoting the internationalization of SMEs, and improving access to financing. To ensure that SMEs and entrepreneurs have access to public support, it is important to establish a formal SME Advisory Council to solicit their input on the policy agenda at the national level. Monitoring and evaluation arrangements for SME and entrepreneurship policies and programs should also be put in place to assess their effectiveness.

The proposal of solutions towards the creation of sound legislation and regulatory frameworks that would support the growth of SMEs in the SADC region **starts** with understanding the current impediments brought about by existing legal and regulatory frameworks within the region. There are a myriad of issues relating to the inadequacies of legal and regulatory frameworks within the region which will be discussed hereunder before proffering of possible solutions. It should be noted that these issues may not be exhaustive but are considered significant and fairly representative of what is obtaining in the region.

The reviewed SME strategy documents and Financial Inclusion strategies highlight the importance of creating an enabling environment to facilitate access to finance for SMEs. This includes a

> *Successful countries have created a legal and regulatory environment that is favourable to SMEs and developing financial institutions and markets that provide them with the credit and other financial services they need to grow.*

supportive financial infrastructure and an enabling regulatory framework. Regulators and supervisors play a key role in creating an enabling environment for SME finance. This includes providing a sound legal and regulatory framework, collecting and analysing data on financial inclusion, and promoting innovation in financial services.

10.3 Current SADC legislative and policy status

The current study undertaken within the SADC region revealed that in a lot of Member States, there is need legislation that supports effective creation, perfection and enforcement of contractual claims which is at the core of financial transactions. Currently the region is fraught with weak legislation to support this cause – which effectively raises the risk of lending particularly to SMEs. Institutions such as collateral registries (for both immovable and movable assets) which are critical in the enhanced ability to enforce claims effectively and speedily through the court system are visibly absent in most of the SADC Member States.

Sharing of borrower information through credit registries or credit bureaus which can reduce non-performance of loans and increase competition, allows borrowers to accumulate "reputation capital" in the form of good loan performance history. The region has very few functional credit bureaus which affects the ability of financial institutions within the region to effectively deal with issues of information asymmetry – raising the risk of lending mainly to SMEs. This has led to a demand for restrictive Know-Your-Customer requirements by banks in a bid to reduce the risk of information asymmetry. Added to this, there are onerous licensing requirements of companies which particularly affects SMEs who struggle to meet these requirements due to the rigour and the costs involved which are normally outside what SMEs can ordinarily afford. Start-ups deal with inconsistent, lengthy or ambiguity in support, regulatory and taxation frameworks within most Member States of the SADC region.

Some of the common regulatory issues that SADC Member States are trying to address include but not limited to:

- Reducing the number of regulatory and compliancy requirements through harmonisation of laws and policies.
- Simplification of processes to encourage formalisation and compliance without burdening the SMEs. In many SADC Member States, start-ups deal with inconsistent, lengthy or ambiguity in support, regulatory and taxation frameworks The legal and regulatory framework should be proportionate to the risks involved in SME finance. This means that regulations should not be so burdensome that they stifle innovation or make it difficult for SMEs to access finance.
- Improving the time, it takes to register a company or lodge returns at the Companies Registry and removing regulatory barriers including KYC and licensing requirements for MSMEs.
- Collection and analysis of data on SME access to finance. This data can be used to identify gaps in the market and to target interventions that will help to improve access to finance for SMEs.

Promoting innovation in financial services. This includes new products and services that can help SMEs to manage their risks, grow their businesses, and access capital, for example strengthening legal frameworks to support some innovations e.g., value chain financing - a product popular in many SADC Member States and revising some legal frameworks. The recent study on access to finance by SMEs within the SADC region also revealed that SMEs face among other legal or regulatory impediments multiple pieces of legislation legal, regulatory and supervisory frameworks with some of the legal framework separately regulating non-banking financial institutions (NBFIs) while there is specific legal and regulatory framework for banking agents. Other issues include the limited availability of legal frameworks for the execution of securities and credit rights, lack of supportive legal framework for the use of movable security and outdated Credit Agreements Collateral Laws, Debtors and creditor's rights.

On the policy front, it was noted that the region is largely served by multiple policies that relate to SME which are sometimes outdated but more often fragmented and ineffective. The policy and legal frameworks in most Member States was noted to be weak in its support not only for SME development but also in supporting innovations like value chain financing and others. The environment does not encourage or support the listing of companies (mainly SMEs) on the local bourses as a way of growth and raising cheaper capital. Reducing the number of regulatory and compliancy requirements through harmonisation of laws and policies is a key intervention that the region has to consider.

In light of the above, this Handbook seek to proffer recommendations to be considered by various SADC Member States in a bid to improve SME financing in the region as considered hereunder:

10.4 Regulatory and supervisory frameworks, financial infrastructure, and public interventions

It should be noted that the financial infrastructure is not exclusively for the payment system, as it involves also other mechanisms and platforms that contribute to a better risk management, such as: (i) information and credit guarantee systems; (ii) electronic register systems and electronic guarantee consultation; and (iii) legal framework for the execution of securities and credit rights, it is important for Member States to ensure that supportive legislation is in place to support these. Every country thus has to ensure that it takes stock of its legislations and policies and ensure that the three issues mentioned above have supportive legislative and policy covering.

The electronic payments services, as part of the financial infrastructure have the advantage of generating digital transaction information, such as the payments history of certain services that can be used by financial institutions to analyse credit risk, design new insurance products, leasing or savings.

10.5 Impact of policies, rules/regulations on Financial Institutions

The rules and regulations set by regulators have a direct impact on how financial institutions operate within a country. The banking system regulatory structure should have a greater implication between concentration of the market and access to finance. It is important to note that when there is a high regulatory regime, then entry barriers may increase. In most cases, the competitiveness of the banking system will not rely on the actual market structure but will rely on the regulatory regime of the country (Black and Philip, 2002). There is no clear relation between regulatory restriction, interference of the government on the process of intermediation and banking system's competitiveness and SMEs' access to finance. However, the efficiency and competitiveness of the banking system may be reduced by regulatory restrictions which may further block the use of information advantages by banks.

10.6 Importance of favourable legal and regulatory environment on Financial Inclusion

Creating a favourable legal and regulatory environment can help promote financial inclusion by ensuring that all individuals and businesses have access to financial services. In the spirit of promoting financial inclusion and in particular, in attempting to address financial inclusion of the regularly excluded rural populations, member countries are encouraged to each develop rural finance strategies which will specifically assist in developing measures that will encourage financial institutions investment in rural areas.

10.7 Role of DFIs in the policy and regulatory discourse

While issues raised above are directed at Member States, DFIs can impact SME growth indirectly by influencing policies and legislation. Having been set up by national governments, DFIs are well placed to influence supportive SME lending policies, legislation, regulations, and infrastructure.

DFIs play a vital role in promoting financial inclusion, not only through funding but they should invest adequate resources in non-funding support. Some of the interventions that DFIs should pursue include the following;

- Leading various multi stakeholder platforms aimed at promoting a better operating environment for SMEs, i.e., connect with and convening market actors. DFIs can bring together a diverse range of stakeholders, including financial institutions, fintech companies, credit bureaus, government agencies, and civil society organizations, to collaborate on promoting best practices for financing SMEs. DFIs are a powerful force in the financial sector. They can use their collective influence to incentivize and drive change among market stakeholders. For example, a DFI could organize a roundtable discussion with government officials, financial institutions, and donors to discuss ways to increase access to finance for women entrepreneurs. This discussion could lead to the development of new policies and programs to support women-owned businesses.
- DFIs can use their influence to advocate for the adoption of best practices in support of SMEs. DFIs have close relationships with government officials and financial sector leaders. This gives them a unique platform to advocate for change and influence policy decisions.
- DFIs can work with governments to advocate for and develop improved policies and regulations and legislation that supports innovative lending products targeted at SMEs and improved SME lending infrastructure.
- DFIs can facilitate the sharing of knowledge and expertise on financial inclusion, including SME financing.
- DFIs have a deep understanding of the financial markets and the challenges and opportunities in their Member States. This technical expertise can be used to design and implement effective SME financing strategies.
- DFIs can also play a complementary role to donors by providing market-based solutions to development challenges. For example, a DFI could invest in a renewable energy business that is developing new technologies to reduce the cost of solar energy. This investment would not only support the development of the renewable energy market, but it would also help to reduce greenhouse gas emissions and improve energy access in developing countries.
- DFIs can take the lead in having written policies and procedures with respect to the environmental impact of projects largely in line with international or national guidelines.

Below are some Best Practices of how regulators can promote SME finance:

- Waive or reduce reserve requirements for loans to SMEs. This would make it cheaper for banks to lend to SMEs.

- Provide guarantees or credit insurance schemes for SME loans. Guarantee schemes are implemented in several Member States, and some are looking into the issue of providing insurance for loans. However, there is need to re-look at the design of some of the guarantee schemes with a view to making them more efficient and effective.
- Create credit registries or collaborate with other databases that make it easier for banks to assess the creditworthiness of SMEs. This can help banks to make more informed lending decisions.

10.8 Recommendations for greater effectiveness

i. The central governments of Member States and financial authorities need to establish documents, policies, and regulations to promote an inclusive financial system to improve financial services to rural people and MSEs.
ii. Member States must ensure that they have accurate and extensive information on the state of SME finance and the nature of the SME finance problem.
iii. The macro environment has to be right for accelerating the development of financial inclusion, any interventions without a desirable macro-economic environment is likely to lead to failure.
iv. More differentiated policies and regulations are needed for different financial institutions. Rural financial institutions have a deeper reach than most banks thus may need more preferential policies to expand their services and to become commercially overcoming viable difficulties in mobilizing savings, and a lack of financial innovation.
v. Policies are needed to expand the sources of refinancing so that non-bank financial institutions can provide financial services to rural and low-income people. It is reasonable to consider the possibility of NBFIs raising funds in the bond market, like other nonfinancial enterprises. More in-depth research is needed to start a pilot program.
vi. Do away with laws that do not allow financial institutions to offer certain products.
vii. Focus on de-risking the SME sector - Governments and SME financing stakeholders need to focus on de-risking the SME sector to attract private funding - private funding is many times bigger than Government/public sector funding.

11 Addressing Infrastructure barriers

Financial infrastructure refers to a system of institutions and organizations that enable the flow of money and credit. Financial infrastructure is essential for SME lending because it reduces information asymmetry and legal uncertainties. It includes accounting and auditing standards, credit reporting systems, collateral, and payment systems. The development of financial infrastructure components is crucial for SMEs to access finance and grow their businesses.

Various studies have shown that despite the various initiatives undertaken by Member States towards improving SME access to relevant and appropriate finance which includes development and implementation of various financial inclusion strategies, the financial infrastructure remains insufficient to fully address the needs of SMEs. While this may have been the case as revealed by a lot of studies, it is also true that there are a lot of success stories that have been noted in various countries within the region. These successes, blended with lessons from other countries around the globe are expected to offer improved solutions for SME financing within the SADC region.

Establishing a sound SME lending infrastructure should be a priority in the financial development agenda of SADC Member States. This is because for financial institutions that are in the business of lending to SMEs, it can lower the costs and risks of availing credit to SMEs, open the way for more modern and efficient lending techniques, and expand the proportion of SMEs that can be served in a viable manner. A sound SME lending information infrastructure should improve transparency and disclosure for SMEs in a cost-effective way, and help SMEs build a credit history. This is critical in helping to address both challenges of information asymmetry and the cost of availing credit to SMEs.

In their various documents, SADC Member States do cite challenges caused by underdeveloped SME Lending infrastructure such as;

- SME Credit guarantee schemes.
- SME debtors central register.
- Credit Reference Bureaux- These systems allow lenders to share information about SME borrowers. This helps lenders to make more informed lending decisions.

DFIs contribute to promoting financial inclusion by supporting the development of financial

Evidence from 42 African countries shows that SMEs are less constrained in countries with both credit bureaus and registries compared to countries with only credit registries.
(Triki and Gajigo, 2012).

infrastructure and addressing the challenges of limited access to finance in developing countries. Their investments and initiatives help improve transparency, reduce information asymmetry, and create opportunities for individuals and businesses to participate in the formal financial system. DFIs support the development of financial infrastructure, including accounting, credit reporting, and payment systems. These systems are essential for the functioning of financial markets and intermediaries. In developing countries, access to finance for households and small and medium-sized enterprises (SMEs) is often limited due to opacity and information asymmetry problems. This can be caused by the absence or underdevelopment of credit information systems and collateral registries.

The lack of information on borrowers' creditworthiness pushes lenders to make certain demands that can make it difficult for low-income households and SMEs to access finance. These actions include:

- **Demanding Collateral**: Lenders may demand collateral that cannot be offered by low-income households or SMEs, such as land, real estate, equipment, or machinery. This is because these borrowers usually do not have many assets, or the legal and property right regime is not adequate in such a way that financial institutions do not accept those assets as collateral.
- **Charging High Interest Rates and Fees**: Lenders may charge high interest rates and fees and ask for excessive documentation requirements. These actions all contribute to increasing the cost of accessing finance for poor households and SMEs.

Development of a sound financial infrastructure is thus a key priority to DFIs within the SADC region.

Technology and Banking in the WAEMU

The West African Economic and Monetary Union (WAEMU) achieved significant improvements in the union's payment and settlement systems. The Real Time Gross Settlement System (RTGS) and the Automated Clearing House were implemented in 2004 and 2006 respectively while the card-based interbank system (GIM-UEMOA) was put in place in 2007. This system, which counts 105 banks, three microfinance institutions and one Electronic Money Issuer as members, has recorded over 1.5 million transactions in 2012. ICTs have played a major role in these achievements. Today, members have centralized operations in one platform and many banks in the Union are moving towards network-based computing, networked ATMs, internet banking, smart card-based products. ICTs have also been used for customer relationship management, customer transaction pattern analysis, credit profiling and risk management. Yet, physical outreach in the union remains low compared to other African regions. At end 2011, the global retail network consisted of 1,560 branches, 1,500 POS and 3,200 ATMs for a total population of approximately 94 million.

The advent of the internet has also revolutionized financial service delivery, empowering organizations with new business models and new ways to offer 24-hour accessibility to their customers[2]. SADC DFIs can also use blended finance to support the development of investment facilitation infrastructure in the region. This infrastructure can help to connect SMEs with investors and make it easier for them to raise capital. DFIs can push for the development of investment facilitation infrastructure, such as online platforms and matchmaking services, to connect SMEs with investors.

11.1. Collateral/Guarantees

Collateral refers to the extent to which assets are committed by borrowers to a lender as security for debt payment (Gitman, 2003). The security assets should be used to recover the principal in case of default. SMEs in particular provide security in form of properties (houses, the businesses, motor vehicles, and anything that could actually bring back the principal) in case of default on loans (Garrett, 2009). Security for loans must actually be capable of being sold under the normal conditions of the market, at a fair market value and also with reasonable promptness. However, in most banks, in order to finance SMEs and to accept loan proposals, the collateral must be 100 % or more, equal to the amount of credit extension or finance product (Mullei and Bokea, 2000). Moral hazard issues can be reduced by collateral requirements by increasing and adding a potential cost to borrowers when those are not making their best effort. Sometimes the borrowers extract the funds provided by the lenders for their own personal and private use. Therefore, the collateral requirements when in place can reduce negative consequences that can rise due to an improper utilization of the funds by SMEs. It is evident that most SMEs are denied and discriminated by the lenders in providing financing. This is because of high risk and for not having adequate resources to provide as collateral (Kihimbo et al. 2012)

[2] *2013- Africa Development Bank – Financial Inclusion in Africa.*

The Indonesian government has implemented several programs to promote financial inclusion targeting MSMEs. The most notable program is the people's business credit program (KUR) that addresses the issue of insufficient collateral for bank loans by MSMEs. Under the program, the Ministry of Finance provides insurance for 70% of loans issued by banks to MSMEs while the risk of the remaining 30% is borne by the banks. Six national banks and 26 regional banks have joined the KUR program to issue loans to MSMEs. The interest rate on KUR loans is 14% for retail business and 24% for microenterprises, which are affordable compared with loans from informal financial sources. To control the risk and the potential liability of the government, Rp5 million was set as the ceiling a microenterprise could borrow. In 2012, the government raised the ceiling to Rp20 million and cut interest rates to 13% for retail businesses and 22% for microenterprises. Despite the success, there are concerns and risks associated with the KUR program………it is a common practice that banks demand additional collateral from applicants for the 30% of the loan that is not insured by the government. There is also evidence of sectoral bias, with the majority of loans granted to enterprises in the trade services sector (Machmud and Huda 2011).

11.2. Movable Collateral

These movable assets (such as machinery, and accounts receivables) account for most of a firm's assets, particularly for SMEs. However, due to weak legal and regulatory environments, banks are often reluctant to accept these assets as collateral, especially in developing countries. In this context, banks prefer immovable assets, which are more difficult to hide and are less likely to be subject to ownership disputes, as collateral. In this context, several countries have pursued reforms of their secured transactions systems, that is, the legal and institutional structures that govern how agents can create security interests over movable assets (Alvarez de la Campa 2013). Reforms aimed at fostering the use of movable assets tend to expand finance to SMEs. Improving movable collateral laws increases borrowing by firms that rely more on movable assets (Campello and Larraín 2016). In addition, after collateral registries are introduced as part of the initiatives to foster the use of movable collateral, firms receive more financing at lower costs (Love, Martínez Pería, and Singh, 2016).

11.2 Collateral Registries

Collateral registries are publicly available databases that contain information about interests in or ownership of assets. They play a crucial role in supporting a comprehensive and integrated secured transactions regime. Here's why a well-functioning collateral registry is important:

i. **Facilitating Awareness**: Collateral registries help create awareness about the existence of security rights in movable assets. By providing a centralized platform for recording and accessing information, they ensure that interested parties are aware of the assets that have been pledged as collateral.
ii. **Establishing Priority**: When multiple parties claim an interest in the same asset, the time of registration becomes crucial in determining priority. A collateral registry allows for the recording of the time of registration, which helps establish the priority of security rights. This ensures fairness and predictability in the enforcement of these rights.
iii. **Reducing Risk**: Collateral registries contribute to the reduction of risks faced by lenders. By providing information about the assets pledged as collateral, lenders can make more informed decisions about extending credit. This reduces the potential losses lenders may face from non-payment.
iv. **Increasing Access to Credit**: A well-functioning collateral registry increases the availability and reduces the cost of credit. It allows businesses, particularly small and medium

enterprises (SMEs), to leverage their assets as collateral for loans. This, in turn, increases their access to finance and promotes economic development.

To ensure the effectiveness of a secured transactions regime, it is essential to have a robust and well-functioning collateral registry. This includes having a sound legal and regulatory framework, as well as a centralized, notice-based, and online accessible registry. By providing transparency, predictability, and efficiency, collateral registries contribute to the growth and development of economies. The implementation of legal frameworks that enable the registration of movable property in collateral registries and that ensure the security and efficiency of transactions can help to boost lending.

Studies have shown that banks tend to increase lending after reforms to collateral laws, which is particularly important in emerging economies where information asymmetries are common. This is because collateral can mitigate asymmetric information in lending markets.

An example of a well-functioning collateral registry: Australia
The Personal Property Securities Register in Australia is an example of a well-functioning collateral registry. Under the oversight of the Australian Financial Security Authority —with more than one hundred full-time employees-the registry records security rights on personal property, fiduciary transfer of titles, financial leases, assignment of receivables, retention of title sales and judgment claims. Following its launch on January 30, 2012, the registry implemented a two-year transitional period, during which secured parties were provided temporary perfection of security rights. In 2014, the number of new registrations reached 2,364,310. Searches soared from 5,886,945 in 2012 to 7,315,379 in 2014, underscoring rising confidence in the new collateral registry and regime.

Registrations can be made against individual and organizational grantors, and no physical presence is required. A standard registration form is provided with free text for some collateral classes. No additional documentation is required to be uploaded to the system. A flat fee, which varies based on the registration duration, is charged. Any interested party can search online using the debtor's identifier, a serial number or a registration number, among other criteria. The registry then produces an "exact match" search. If someone is unable to perform an online search, the contact center of the collateral registry provides technical support, performing the search on behalf of the user and sending them the results via email. Despite its high volume of records, the collateral registry has yet to receive anv comblaints.

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Good practices when setting up a collateral registry include:

a. Using notice-based registration, meaning no documentation is required to be submitted.
b. Allowing online access to data, which has numerous positive effects such as saving time, costs and increasing rural financial lending for distant or smaller financial institutions.

Recent examples showcase the impact of improving the collateral framework in African countries as well. Ghana has made significant advances in reforming the movable collateral registry legal framework and upgrading the registry system. As a result, as of December 2012, over 45,000 loans have been registered since March 2010 and the total financing secured with movable property accounts for USD 6 billion. More than 9,000 SMEs and around 30,000 micro enterprises and individual entrepreneurs have received loans, with women entrepreneurs accounting for a large number of beneficiaries

IFC "Secured Transactions and Collateral Registries." Brochure (revised, forthcoming).

11.3 Credit Registry

Development of credit information systems is a key component in the improvement of SME access to funding. These can be in the form of public credit registries run by the country’s central bank or private credit bureaus. These support banking supervision while promoting access to finance by reducing risks or perception of risks for lenders. The credit registries are a repository of performance of individuals and companies in their banking and other business relationships such as with utility companies, telecommunication companies and other non-bank financial institutions. Lenders thus make use of the information collected in these platforms to assess risks of the companies or related individuals and monitor their performance over the duration of the borrowing. Assessing credit worthiness constitutes the greater cost of loan assessment and as such a good credit information system reduces the cost of borrowing for SMEs. Furthermore, with a good credit information system, opportunities for non-collateralized lending are higher where sufficient information about a borrower's credit repayment history is used to offset or reduce the need for physical collateral – which improves access to finance for participating enterprises.

The enhancement of credit information services is crucial for financial inclusion. The Credit Reference Center (CRC), established by the PBC in 2006, provides limited credit information services to individuals and enterprises. Credit information included in this system is provided to financial and other institutions for references in proving financial services. Apart from the CRC, there are many privately owned credit information service providers that supply limited credit information about local residents. In January 2013, the State Council released the China Credit Reporting Industry Regulation, but more effort is needed to effectively share credit information and make financial inclusion in the PRC more efficient.

12 Monitoring and Evaluation of SME Financing Interventions

The study revealed that there is a systematic weakness in collecting indicators to measure the development impact of various SME financing interventions in the SADC region. As a result, it has been difficult to assess whether SADC Member States' DFIs are achieving their objectives in terms of financing SMEs. DFIs should also include key development impact measures in their lending criteria and have in place a proper system to identify environmental and social risks associated with their financing activities. On the other hand, African DFIs have not clearly defined development criteria incorporated in their investment processes.

12.1. Recommendations on M&E

- Development of clear and concise monitoring and evaluation frameworks that outline the specific indicators that will be used to track progress. This will help to ensure that the data collected is relevant and useful for assessing the impact of the interventions. The monitoring and evaluation frameworks should be developed in consultation with stakeholders to ensure that they are relevant and useful.
- Collecting of disaggregated (by gender, income, and other relevant factors to identify any disparities in the impact of the interventions) data on a regular basis for progress tracking and problem identification. This will help to identify any areas where the interventions are not working as intended and make necessary adjustments.
- Analysing the data and use it to adjust the strategies as needed. This will help to ensure that the interventions are effective and are meeting the needs of the target population.

Communicating the results of the monitoring and evaluation to stakeholders so that they can be aware of the progress and therefore make informed decisions. This will help to ensure that the interventions are supported and sustained. The results of the monitoring and evaluation should be communicated in a timely and accessible manner to stakeholders.

It is important to ensure that DFIs are using their resources effectively and efficiently. By collecting better data and conducting regular assessments of their performance, DFIs can improve their accountability and transparency. This would also help to identify areas where DFIs can improve their performance and ensure that they are making a positive impact in the development of SMEs.
Below are some points on how DFIs can improve their effectiveness:

- Review SADC Member States DFIs' mandates concerning the financing of SMEs to assess the continued relevance of their strategic focus, their terms of engagement with commercial financial institutions, and the sustainability of their efficiency objectives.
- Perform a comprehensive assessment of the development effectiveness of African DFIs to measure public policy performance in in SME financing.
- DFIs should focus on investments that will have a measurable impact on development goals, such as poverty reduction, job creation, and economic growth.
- DFIs should partner with commercial banks and other financial services providers, governments, and other stakeholders to achieve their development objectives.
- Build capacity: DFIs should invest in capacity-building efforts to help their partners as well as SMEs develop the skills and expertise, they need to be successful.
- DFIs should collect data and report on their performance to ensure that they are accountable to their stakeholders.

DFIs should lead from the centre, connecting with and collaborating with all relevant stakeholders in the monitoring of financial inclusion interventions, including making finance available to SMEs and monitoring cross cutting issues like gender and greening of SMEs.

13. Strengthening the Financial Inclusion of SMEs

The SADC Financial Inclusion Strategy emphasises the growth of payments and digital financial services, orienting credit markets towards SMEs and smallholder farmers, and standardising key measurement data.

Past studies have shown that financial inclusion increases the number of business start-ups and improves the profitability of existing ones and that easy access to credit positively affects consumption levels, employment status and income, and some aspects of mental health and outlook (Karlan and Zinman, 2009). It is further argued that providing individuals with reliable access to savings instruments increases saving, female empowerment, productive investment, and consumption (Dupas and Robinson, 2013).

Due to the prevalence of mobile phones in many regions in Africa, mobile financial services are often more accessible and affordable than banking services offered by traditional bank branches. These features of mobile financial services offer new opportunities for expanding financial inclusion in a cost-effective manner. In Africa, 33% of the saving population have savings at a formal institution while 67% saves via informal institutions such as mobile money services signifying the prevalence of financial inclusion through informal institutions and approaches. Mobile money is an important tool for poverty reduction because it offers a means of addressing the impasse that exists between banks and poor households. Many banks do not find it economically attractive to make banking infrastructure and financial services available in poor communities due to high transaction costs relative to small transaction value sizes which make it unprofitable for banks to service this population. Similarly, poor people can be reluctant to access formal financial services due to the inconvenience and high cost involved in accessing and maintain these services (Demirguc-Kunt and Klapper, 2013) relative to the more local and informal alternatives of mobile money services.

Appreciating the constraints and/or challenges faced by SMEs in accessing finance, proposed solutions to most of the issues to improve the financial inclusion environment in SADC in particular have been discussed elsewhere in this Handbook. However, key issues that require serious attention to improve effectiveness of National Financial Inclusion strategies of various Member States include but are not limited to:

Key FI Challenges of SMEs

Among all firms, the financing constraint is more acute among the micro and small firms and also among the informal businesses. Similarly, women-owned enterprises often face higher barriers to access the right type of finance that is necessary for growth.[6]

Key challenges for SMEs finance in Africa include poor customer knowledge which prevents financial intermediaries from formulating an appropriate strategy to target SMEs, lack of financial and management skills and financial literacy across firms, translating into poor financial accounting, record keeping or inappropriate business plans. Lack of collateral is also often cited as a challenge for banks, while poor financial infrastructure in some African countries (*e.g.*, Nonexistent mobile collateral registries or credit bureaus) accentuates the problems of insufficient collateral.

Per interviews of 29 leading banks across six emerging markets around the world, poor business cases were cited as a critical factor for credit declines. Financial institutions perceive poor customer information availability as a critical barrier to lending (McKinsey & Company, 2012).

Improvements in the **credit information systems**, **collateral registries to reduce the information asymmetries**, and **capacity building and business development services** at the firm level need to be addressed to accelerate financial inclusion on the continent.

- Developing and enforcing a financial inclusion policy
- Improving regulations for better financial inclusion
  - i. improve regulations on the digital payments system, consumer credit, electronic money and protection of savings,
  - ii. provide technical support to the Central Banks to develop legal texts related to financial inclusion and to monitor compliance with the texts,
  - iii. develop a legal framework regulating non-banking financial institutions (NBFIs).

- The development of a specific legal and regulatory framework for banking agents or correspondents aims to allow the distribution of alternative financial services, in order to:

  i. improve liquidity management for electronic money distribution agents; and;
  ii. ensure reliable access to funds for clients and viable business models for agents.
- Reinforce the mandate of key institutions in charge of financial inclusion [it is also necessary to strengthen the institutional capacity of organizations overseeing FI strategies, namely in technical, financial and human terms, to enable the various challenges when implementing the financial inclusion policy to be addressed]
- Improve access to and ensure the reliability of information on individuals and their properties (title deeds, securities and collateral registry etc.)

East Africa. Diamond Trust Bank (DTB), one of East Africa's leading banks with a network of 70 branches in Kenya, Uganda, Tanzania and Burundi, has made a strategic choice to systematically target the SME sector which currently represents over 70 percent of its loan portfolio. To ensure the sustainability of its operations, expand offerings and deepen regional collaboration, DTB is making additional efforts to develop a strong SME banking network across East Africa, with technical support from IFC. One of the enhancements to better serve the SME market include the usage of a web-based cash management service, an online banking platform for SMEs and mobile payment solutions. Results are encouraging—DTB's SME loan portfolio has grown by 42 percent to date, representing an additional 1,468 outstanding loans, valued at USD 130.58 million for the group.

Source: IFC (2010, 2011b).

14. Women, Youth, Gender, and Social Inclusion

Women and youth-owned enterprises often face higher barriers to access the right type of finance that is necessary for growth. Women are less likely to use formal financial services mainly because they have lower incomes, are less educated, and more likely to operate in the informal sector. The microfinance sector has made significant progress in serving women, but there is a growing awareness that women entrepreneurs require more than just micro-loans to meet their growth and start-up needs. This presents an opportunity for designing targeted customer management strategies in the microfinance sector. However, due to the limited collateral they can offer and the lack of information regarding their solvency, most small and medium-sized enterprises (SMEs) are unable to meet the conditions for formal financial institutions' financing, and they have a high risk of default. Therefore, women entrepreneurs face significant challenges in accessing finance, which is a major constraint to the growth of female-owned enterprises. To overcome this issue, women entrepreneurs can raise the necessary capital for their business by learning to ask for exactly what they need and by getting more female investors to support one another.

> *Despite the immense strides made by the microfinance sector to serve women, there is an increasing awareness that the growth and start-up needs of women entrepreneurs go beyond micro-loans.*

SADC Member States have come up with various strategies aimed at improving women access to finance such as;

- Establishment women SME desks in bank branches.
- Establishment of women dedicated financial institutions.
- Prioritisation of women owned businesses in various schemes.
- Designing women friendly training programs
- Property rights are important for women entrepreneurs because they can use their property as collateral to get loans from financial institutions. This is especially important in developing countries, where immovable assets (property and buildings) represent only 22% of companies' capital stock. Small and micro businesses that own their property do not have to pay rent, which can save them money and help them to grow their businesses. In the case of agriculture, women invest more in land that they own. SMEDCO in Zimbabwe does accept immovable rural properties if it is backed by a lease agreement.

Addressing the SME Barriers – IFC Support to Financial Institutions
Nigeria. Access Bank PLC Nigeria is a leading African bank that decided to become an early mover into the women SME space in Nigeria and is part of a coordinated program (Enterprise Development Center, Fate Foundation and IFC) focused on improving financing for women-owned SMEs. Access Bank offers customized credit lines to women entrepreneurs and tailored training courses in financial literacy, business management skills, and trade finance in order to become the bank of choice for Nigerian women entrepreneurs. By the end of 2010, USD 35.5 million loans had been disbursed over a 4-year period with a non-performing loan rate of 0.5 percent, and close to 700 women had been trained by the program.

Source: IFC (2010, 2011b).

15. Response to Crisis

The COVID-19 pandemic had a devastating impact on SMEs around the world, including SADC Member States. The study revealed that there is some evidence of adaptive management strategies by Member States particularly after the global financial crisis and the Covid 19 pandemic. However, meaningful, long-lasting interventions seem to have been carried out by those DFIs which are self-sustainable and not dependent on funding from their governments. Other interventions were of a short-term nature to keep enterprises afloat and therefore not really aimed at building future resilience of enterprises.

It is important to note that governments often adopted several measures simultaneously. Whilst these measures may have helped to mitigate the impact of the pandemic on SMEs, a lot of SMEs in the SADC region closed during the pandemic. In some countries it is understood that government supported schemes benefited big companies as opposed to SMEs. SME Association of Zimbabwe (SMEAZ) in Zimbabwe indicated that none of their members received the support although they heard about the announcement of the various schemes. This highlights the risk that government support may have failed to reach the intended beneficiaries in some countries.

SADC Member States responded to the COVID-19 pandemic by providing a range of support measures to SMEs. These measures were designed to address the liquidity to businesses that were facing short-term cash flow shortages due to reduction in business volumes. Support measures were open to SMEs in different economic sectors, although some countries had priority sectors. A key feature of the policy responses was the use of a variety of instruments which included the following.

- Various studies were carried out to understand the impact of the pandemic on SMEs to come up with responses to assist SMEs.
- Direct loans to SMEs.
- Grants
- Concessionary loans
- Extended loan repayments, and longer moratoriums.
- Guarantees to banks that lend to SMEs. (In Namibia the transactions grew five times during the pandemic)
- Creation of credit funds that lend to SMEs, e.g., the SME Fund in the Seychelles.
- Tax breaks to investors in SME lending funds.

In an ODI webinar that examined how DFIs could tackle liquidity issues faced by investees after the Covid 19 Pandemic, it was concluded that; “There is plenty of opportunity for DFIs to find their own niche in healthcare using innovative financing mechanisms. While debt will remain important, grants, guarantees, technical assistance, and equity can all be used to tackle healthcare challenges. Some challenges will require more concessional capital, while others will require capital that is more patient. To be transformative in healthcare, DFIs need to break from their project finance mindset and investigate ways to complement private investment, donor capital, and domestic governments. DFIs can act as a catalyst for market development by investing via pooled investment vehicles, volume guarantees, first loss guarantees, and Development Impact Bonds (DIBs), although the popularity of these types of investments among DFIs is limited. By using innovative financing mechanisms, DFIs can play a more transformative role in the healthcare sector. They can help to address specific challenges, such as the lack of access to healthcare in rural areas or the high cost of healthcare. They can also help to attract private investment into the healthcare sector. To seize the opportunity to make a meaningful contribution to the COVID-19 crisis recovery, DFIs must broaden their investment space in healthcare across markets and across instruments.

Investing in Health Care

Small and medium-sized enterprises (SMEs) can invest profitably in the healthcare sector by following a multifaceted approach to understand the underlying drivers. Here are some ways SMEs can invest in the healthcare sector:

i. Identify the healthcare industry: The healthcare sector is made up of many different industries, including pharmaceuticals, devices, health insurers, and hospitals, and each has different dynamics. SMEs should identify the industry that aligns with their business goals and expertise.
ii. Follow prevalent trends: When deciding on a healthcare company in which to invest, SMEs should keep prevalent trends in mind. Positive trends include the aging population and the baby boomers, people living longer, and advances in medical technology.
iii. Do heavy research: SMEs should do heavy research on the industry, as well as outline clearly what medical services or products they will be offering and why they or their staff are qualified to run a healthcare business safely.
iv. Explore financing options: Financing is an engine of growth for the private health sector. Private healthcare businesses can use financing to expand and invest in quality improvements. SMEs can explore financing options such as loans, grants, and venture capital.
v. Partner with the government: Governments around the world have made supporting SMEs a priority throughout the COVID-19 pandemic through programs such as direct financial assistance, public guarantees on loans, and tax relief. SMEs can partner with the government to provide long-term solutions to the challenges they face, including pressure to decarbonize, international competition, and digital disruption.

In summary, SMEs can invest profitably in the healthcare sector by identifying the healthcare industry, following prevalent trends, doing heavy research, exploring financing options, and partnering with the government.

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APPENDICES - RESOURCES FOR DFIs ON SME FINANCING

1. FINANCIAL MECHANISMS AND PRODUCTS

Table 1: Financing for SMEs - A Case of UK Government Support to SMEs

Programme	Terms	Output
Loans		
Funding for Intervention Scheme	Cheaper borrowing for banks and building societies	More and cheaper loans and mortgages (does not only target SMEs)
National Loan Guarantee Scheme	Government guarantees on unsecured borrowing by banks.	Cheaper business finance by reducing the cost of bank loans under the scheme by up to 1 percentage point.
Community Development Finance	Loans to a specific disadvantaged geographic area or disadvantaged groups	Varies but can include loans to start-up companies, individuals and established enterprises from within that community who are unable to access finance from traditional sources.
Enterprise Finance Guarantee	Loan guarantee to SMEs	Facilitates additional lending to viable SMEs lacking the security or proven track record for a commercial loan.
Business Finance Partnership	Increase supply of capital through nonbank channels	First tranche of BFP funds will lend to midsized businesses, helping to diversify the channels of finance available to them
Business Finance Partnership: Small Business Tranche	Increase supply of capital through nonbank channels for small businesses.	Increase non-traditional finance such as peer-to-peer platforms, supply chain finance and mezzanine finance for businesses with a turnover below £75m.
Start-up Loans	Loans to young people (18-30) to start a small company	Open up finance to those who would not normally be able to access finance due to a lack of track record or assets.
Investment / Equity Finance		
Seed and Enterprise Investment Schemes	Range of tax reliefs	Help small, early-stage companies and small higher risk companies to raise equity finance through encouraging individual investors to purchase new shares in qualifying companies.
Venture Capital Trust Scheme	Range of tax reliefs	Help small higher risk companies raise equity finance indirectly through the acquisition of shares in a VCT.
Business Angel Co-Investment Fund	Co-investment fund	Support business angel investments into high growth potential early-stage SMEs.
Enterprise Capital Fund Programme	Public-private venture capital funds	Address a market weakness in the provision of equity finance to SMEs by using Government funding alongside private sector investment to provide equity finance to early-stage companies.
UK Innovation Investment Fund	Venture capital fund of funds	Invest in technology-based businesses in strategically important sectors to the UK including digital technologies, life sciences, clean technology and advanced manufacturing.

Table 2: Credit Guarantee Schemes - Advantages and Challenges[3]

Advantages	Risks/challenges
• Overcome bank's risk aversion to lend to SMEs caused by information asymmetry. • Overcome failure of collateral based lending, especially where contract enforcement is weak. • Effective in leveraging large sums of additional lending. • Potential cost reduction for lending to SMEs • Improve the loan appraisal capabilities of the banks and systems of monitoring. Overcome the risk of innovating new business models, products, outreach mechanisms. • Achieve financial and economic additionality and transformation of sector	• Demand side weaknesses make for high rates of NPLs without and with the scheme. • Potential low demand for a CGS. Lack of liquidity or better returns from other asset classes prevent additional SME lending. • Risk of low additionality (the SME lending would have happened anyway). • Potential abuse of the PCG scheme by the banks and SMEs (moral hazard risk that excessively risky loans are placed under the CGS). • Cost of guarantee premiums makes for untenably high cost of borrowing. • Unwillingness of the banks or borrowers to pay for the guarantee making the scheme underused. • Failure of the scheme to change behaviour & business models results in failure to deliver wider, systemic impacts.

Table 3: Credit Guarantee Schemes - What Works?

Design Feature	Overview of Issues	Best Practice
Target groups	• Targeting the scheme (e.g. on specific sectors, geographies) can help maximise the additionality effect. • However, too specific targeting can increase the bureaucratic costs (e.g. through verification).	Moderate targeting
Government Institution vs Separate Entity	• Where schemes are initially implemented through a public institution, they should eventually be transferred to a stand-alone entity. • There are examples of purely private-sector initiatives, such as Italy's network of mutual guarantee schemes, "Confidi".	Establish a legally separate entity
Funding / Costs / Profits	• If fees are too high, lenders might be reluctant to use the fund, and it can result in the exclusion of good customers. • While fees should cover operating costs, the fund itself should be able to cover cost of claims. • Most schemes receive lump-sum payments to set up the fund but additional funding options include a levy on participating banks, continued subsidies through soft loans and direct budgetary appropriations.	Operate on a profit-making basis to cover operating costs with reserves in place Keep fees proportionate
PFI, staff and management capacity (TA vs no TA)	• The selection of PFIs is key to success or failure of a fund. It is necessary to have experienced local staff and representatives of borrowers and lenders in the scheme's management. • Evidence shows that TA to support small scale lending for banks can have an impact on the long-term sustainability of the scheme. • Training and advice for borrowers can also impact the demand for loans and increase attractiveness to lenders through provision of guidance on preparation of loan applications, financial statements etc.[36]	Capacity of implementing organisations key to success of fund. TA in credit analysis and product design can ensure sustainability.

[3] *SME Financing – How To Topic Guide, Hamilton Kerry & Beck Thorsten, April 2016*

Size of Bank / Centralisation vs Decentralisation	Both large and small banks can deepen services to SMEs through the use of guarantee funds Small banks often have an advantage in understanding niche segments while large banks are better suited to developing innovative approaches in areas such as credit scoring. Commitment to the SME segment is more important. Decentralisation can also show positive results working through a branch network of participating banks (e.g. Japan), but this does result in a costlier solution.	Capacity to reach out to SMEs and commitment more important than size of banks
Selective vs portfolio approach	Individual loan-level guarantees involve the guarantee agency in the screening stage to review eligibility and risk profiles. In this approach, lenders will usually first approve the loans and then seek a guarantee approval on the borrower's behalf. The "portfolio" model allows lenders, to assign guarantees to higher risk loans or targeted borrowers and inform the guarantors after the loans are approved or the loan defaults. While the loan-level approach might allow for more careful screening and risk management, it is also costlier for the credit guarantee fund.	Selective approach at pilot stage followed by hybrid scheme allowing guarantees to be extended to a portfolio of loans up to a limit, after which loans would be screened.
Type of lending	At a minimum, funds should be available for extension of guarantees for working capital, funds for investment and leasing. Definition of maximum loan sizes and limits on exposure to any single borrower and lender should be established.	Define purpose, products, loan size and limits
Collateral vs no collateral	Guarantees can help close the financing gap by substituting collateral provided with credit protection provided by an external guarantor. Guarantees and collateral are often used together on the same loan. This is not a problem if no overlap exists between the share of the loan covered by the collateral and the one covered by the guarantee. Partial collateralisation can also reduce the borrower's incentive to default. However, guarantees clearly do not meet their objectives in broadening credit supply if they are used as a backup protection on a collateralised loan.	Caps on the level of collateral can be used to ensure additionality criteria is upheld.
Sharing of risk / Screening and Monitoring .	Under a first loss guarantee (also known as a joint and several guarantee), the fund is required to pay an agreed percentage of the outstanding loan at the moment of the default. The remaining is covered by the lender, which can also retain the proceeds from the realisation of any collateral provided by the defaulting borrower. A final loss scheme will consider any recovered monies, which are shared in a pre-agreed ratio between the financier and the guarantor. Clear division of responsibility between guarantor and lender should be established with screening and monitoring functions the responsibility of the lender.	Risk sharing mechanism and responsibilities for screening and monitoring should be well-defined with partner institutions.
Coverage rates	Appropriately set coverage rates ensure an equitable distribution of risk among all participating parties (guarantor, lender and borrower). Too low a coverage ratio might reduce the value of the guarantee and dampen take-up, while too high a coverage ratio could incentivise the lenders to take excessive risk.	Coverage ratio defined to take into account take-up and risk

Defaults and Claims	Trigger conditions for default should be clearly defined and claims handled in a timely fashion. A vigorous post-claim loss recovery procedure should be established.	Clear definition and claim recovery process
Regulation and supervision	The scheme should be subject to prudential standards and supervision, including capital adequacy requirements, loan portfolio evaluations and provisions, mandatory accounting standards and establishment of a debtors reporting system. The best supervising body will be dependent on the country involved.	Scheme should be subject to legal and regulatory supervision
Sustainability and Longevity	Schemes should aim at self-sufficiency and stability by building up reserves with plans in place to ensure progression to a sustainable stand-alone entity. Although may be appropriate to limit length of guarantees for individual firms (e.g. start-ups) there is no reason why the scheme itself should be limited in its lifetime once operating sustainably. Partial reinsurance of the scheme with a counter-guarantor could be considered.	Sustainability achievable through build-up of reserves from appropriately priced guarantees.

Table 4: Credit/Equity Lines to Banks - Advantages and Risks[4]

Advantages	Risks/Unintended Consequences

[4] *SME Financing – How To Topic Guide, Hamilton Kerry & Beck Thorsten, April 2016*

• Private sector FIs are better than development or government institutions at targeting and reaching the healthiest and most creditworthy SMEs. • FIs are better at assessing and analysing risk. • FIs are commercially and not politically driven. • Market based investment decision making minimises market distorting effects. • Cost – development partners do not manage funds directly resulting in cost efficiencies. In the cases of large funds economies of scale can be achieved since management and administration can be leveraged across a larger pool of funds. • Additionality – Instrument targets risky funding that would not be otherwise done in the market. • Transformation – strengthening of FIs can have positive impacts on the broader financial system. • Demonstration – successful examples of funding SMEs can encourage others to enter the field thereby increasing the level of funding and keeping prices competitive. • Sustainability – particularly where the FI has realigned its strategy to focus on the SME segment, sustainability is likely beyond the term of funding.	• Crowding out of private sector investment can occur when DFIs are providing cheaper finance than can be raised elsewhere (i.e. by local investors); this can be mitigated by adopting market rates. • Lack of additionality: (i) in cases where investment is made in countries where the banking system is already liquid. (ii) Increases the incentive for local banks to earn money by lending money provided by others. (iii) DFIs are lending to the 'best' FIs instead of taking the risks that others are unwilling to take. (iv) when investors continue to fund 'successful' FIs rather than exiting once they have achieved the demonstration effect. • Focus generally is on strengthening FIs rather than increasing their ability to serve a specific segment and therefore funds may not always reach intended recipients. • May reduce competition in market, acting as a disincentive for others to expand business to SMEs. • When investing in large DFI facilities that subsequently invest in banks, development partners can sacrifice control over the funds' direction and impacts

Table 5: Credit/Equity Lines to FIs - What works?[5]

Design Feature	Overview of Issues	Best Practice
Reaching target groups	▪ Funding may not reach target segments as it is supporting general funding capacity of the FI. ▪ Long term strategic change of FIs may not be achieved by funding alone. ▪ Where funding is limited, FIs may have little incentive to expand product offering away from most profitable segments.	Incentives for targeting SME sector supported by TA
Partner Financial Institutions	▪ Strategy and commitment to SME sector more important than size. There is evidence that smaller financial institutions have an advantage in reaching out to SMEs nearby, whereas larger financial institutions might be better placed to use new and innovative lending techniques. Capacity of institutions to work with SME sector (particularly in ▪ specialist areas such as agriculture) is important.	Size not important. Identify PFIs committed to SME segment
Type of Investment	▪ Credit or Equity? Funding should be provided according to the binding constraint and the extent to which it provides leverage. ▪ Loans are usually made in foreign 'hard' currency which may favour on-lending to larger companies who have a greater demand for this.	Consider key constraints of PFI and potential for leverage
Country focus	▪ To ensure additionality and ensure funds are not market distorting, investments should focus on markets that are underdeveloped and poorly served. ▪ Ensure markets are not already liquid	Target poorly served illiquid markets

[5] *SME Financing – How To Topic Guide, Hamilton Kerry & Beck Thorsten, April 2016*

TA	▪ Complementary TA can make a big difference in ensuring sustainability beyond the lifetime of the programme. ▪ Supporting TA to encourage uptake by SMEs can also be valuable. ▪ Effective TA can include: - helping management develop an SME strategy by defining objectives, client segments, products, marketing and distribution channels and staff; - assisting in the reduction of operating costs by encouraging implementation of SME banking best practice; - improving credit risk management and supporting improvements in lending practices and loan portfolio risk management systems; and - providing sector specific support in target areas where technical knowledge is required (e.g. agriculture).	TA adapted to specific needs of institution and sector
Cost and Exit Strategy	▪ Development partners need to weigh up the cost of intervention through larger funds and balance this with loss of control over ▪ activities. Investors should also have a strategy for exiting investments once they have achieved the demonstration effect and private investors are ready to supply substitute funds	Value for money should be considered. Exit strategy put in place
M&E	▪ In order to ensure greater accountability and focus on target segments, development partners need to be able to measure the impact of funding. ▪ PFIs should be tasked with showing results in return for the funding they receive. This may involve improving MIS systems and TA.	M&E requirements built into design of programme
	▯	

Table 6: The Advantages of Leasing Finance[6]

For SMEs	For Providers
▪ Allows SMEs to access/purchase productive assets they could otherwise not afford. ▪ No/low collateral required beyond leased asset. ▪ Cost is competitive with traditional credit, due to benefits of collateral and low processing and transaction costs. ▪ Provides access to medium term finance which is particularly difficult for SMEs to access. ▪ Islamic compliance: leasing is seen as an interest free product and considered the same as a rental. ▯ "Ijarah" is a kind of leasing relevant within the MENA region.	▯ The lessor maintains legal ownership of the asset and can exert greater control over the investment. ▯ The lessor can monitor assets more easily. Lessors can actively apply specialised knowledge, providing the opportunity to extend product lines. ▯ Increases customer base and provides additional marketing channels for financial services. ▯ Improved credit scoring and processing systems that can be applied across finance providers
For Market Development	**For the Broader Economy**
▯ Contributes to the development of overall domestic financing market. ▯ Increases financial sector competition, having the effect of reducing the general cost of finance. ▯ Can play a critical role in bringing in small businesses into the formal financial system - as informal businesses have access to lease financing, they start to build a history of financial transactions addressing information failure and providing an incentive to formalise.	▯ Leasing finance can have knock on effects on equipment manufacturers and encourage infrastructure improvements. ▯ Leasing can support the global climate change and environmental and sustainability agenda - Lack of financing for energy efficiency equipment is identified as a major barrier to the development of this industry.

Table 7: Leasing - What works?

Design Feature	Overview of Issues	Best Practice
Target groups	▯ Leasing is particularly relevant in the most vulnerable countries, including fragile and conflict-affected markets, which usually have weak business environments and in which small entrepreneurs do not have a significant asset base and credit history. ▯ Leasing can be most useful for agriculture and other equipment focused sectors such as sustainable energy financing.	Most impact in underserved environments with small agricultural or equipment focused SMEs with little borrowing capacity
Legal and regulatory framework	▯ The appropriate legal and regulatory system is a vital pre-condition for success and sequencing is crucial when considering broader programmes in this sector. The establishment or upgrading of collateral registries can be critical in this context	Critical to establish such framework first
TA	▯ TA can play a key role in ensuring the sustainability of programmes. Often banks are offering leasing alongside other more traditional products that bank officers will lean towards as they know them better. NBFI providers may need support in developing a sustainable funding strategy that allows them to compete with larger bank providers. (Evidence from the IFC from a review of their Leasing Advisory Services Programs suggests that there needs to be flexibility in the TA provided focusing on the unique requirements of the target market).	To be most effective TA should be adapted dependent on sector needs and FI capacity.

[6] *SME Financing – How To Topic Guide, Hamilton Kerry & Beck Thorsten, April 2016*

Funding	▪ Funding (in particular longer-term funding) can be a core constraint for banks and NBFIs in expanding operations in this sector. Loans, equity finance or provision of guarantees can help overcome this constraint	Determine which funding constraint is binding
Support to Banks or Leasing Companies	▪ Private leasing providers are generally the first players to enter new leasing markets, particularly in the most frontier markets. These companies may initially have an advantage in pricing, and they play a strong development role, but their advantage can be eroded quickly as banks enter the market. ▪ Private providers often need to develop a unique selling point to survive – this could be in the form of specialist knowledge of a particular technical or geographic sector. ▪ Banks often need support in the processes and credit management techniques required in what is often a new product area for them.	Both types of providers can play a significant role but often need differing support to succeed.
Partner Financial Institutions	▪ Choice of PFIs is critical. Knowledge of the SME sector and commitment to its development is a key determinant of success. ▪ Development of leasing associations should be considered to support the industry. ▪ As leasing providers develop, there may be the opportunity for providers to securitise portfolios of lease receivables, which can assist in deepening the securities market (if present) and create new investment products.	Competition can help lower financing rates and expand financing volumes and programmes should encourage this
Infrastructure	▪ Should be a sufficient presence from equipment suppliers and an ability for them to supply and service/maintain the assets.	Assess market linkages and ability of equipment suppliers to support the development of leasing
Demand-side	▪ Awareness raising amongst SMEs should be considered as well as TA to support their 'readiness' for financing.	Marketing and TA to support target SMEs
Type of financing	▪ Financial support to leasing providers should be given dependent on need and be structured in such a way to avoid market distortion (can include loans, guarantees or equity) in leasing providers. ▪ It is also important to develop a clear exit strategy[7]	Define purpose, products, loan size and limits

Table 8: Equity Finance - What Works?[8]

Design Feature	Overview	Best Practice
Fund structure / Attracting Investment	Combining public and private funding provides opportunities to leverage investment. For example, CDC reported that during 2004-2008 it committed $ 7.1 billion to funds that attracted three times the amount from commercial investors. In their 2008 Report, the AsDB reported an even higher mobilisation factor, of over $8 for every $1 invested.	Blending private and public funding to leverage further private investment
Fund Size	SME focused private equity funds, with average investments below $2 million, have generally produced relatively low financial returns[56]. This outcome has been a reflection of: ▪ high transaction costs, ▪ comparatively small overall size of the funds with resulting difficulties to attract good managers, and ▪ absence of exit prospects in markets without liquid stock markets.	Investments over $2m to ensure economies of scale in operation

[7] *IFC review of best practice in this area can be found at:* [*http://www.ifc.org/wps/wcm/connect/5f99ac004aaaadb68137d39e0dc67fc6/Leasing.pdf?MOD=AJPERES*](http://www.ifc.org/wps/wcm/connect/5f99ac004aaaadb68137d39e0dc67fc6/Leasing.pdf?MOD=AJPERES)
[8] *SME Financing – How To Topic Guide, Hamilton Kerry & Beck Thorsten, April 2016*

TA	▪ Supply side: Equity fund management requires highly skilled staff which is often lacking in developing countries. ▪ Demand side: SMEs may not have the skill sets required to access equity investment or even the knowledge of them. ▪ Developing a pipeline of investment ready SMEs ensures sustainability of deal flow. ▪ TA can increase chances of success of investments targeting operational improvements.	TA to support both demand and supply side stakeholders
Type of equity product	Start-up and early-stage companies may benefit more from working with VC funds and angel investors while private equity and general equity funds may be more appropriate for SMEs in their early growth stage.	Dependent on stage of development of SME
Timing / Exit Strategy	▪ Equity investment often requires long-term commitment by donors which can be against conventional practices. ▪ Impacts may not be seen in the short term and this needs to be recognised in any M&E strategy. ▪ There will be many failures and a few high return successes.	Development partners need to commit to longer term financing and
	▪ Clear but patient and flexible exit strategies can be helped by encouraging the crowding-in of private sector investment.	have clear exit strategy
Monitoring and Evaluation	▪ M&E needs to be incorporated into conditions of investment. By ▪ careful transaction structuring and intensive monitoring after investment, the private equity fund managers can avoid many of the problems that deter banks and other financiers from investing[9].	Evidence can incentivise further investment.
Demonstration effect	▪ Successful initiatives have a good potential to attract other investors. E.g. Norfund acting as a first mover in Angola's first private equity fund; and DEG's[10] role as co-founder of the Kyrgyz Investment and Credit Bank when no other local banks offered long-term finance.[11]	Be alert to first mover opportunities to catalyse investment
Sustainability and impact	▪ Equity investing has the potential to influence investees' social, environmental, and governance policies and has an advantage over debt products in this respect. ▪ Evidence that funds need not trade-off financial for social returns. ▪ Evidence suggests bridging the equity gap can make a significant contribution to economic development.	Incorporate social, environmental and governance standards into investment models / Impact investment

Table 9: Blended Finance - What works?[12]

Design Feature	Overview of Issues	Best Practice
Additionality	▪ There is a risk that blended funding can crowd out market-based funding or prevent the emergence of market-based funding sources.	▪ Funding should be used to catalyse investments that would not otherwise happen and to accelerate development impact in key sectors.
Sustainability	▪ Commercial sustainability should be aimed for within a specified timeframe (dependent on nature of project).	▪ Establish an exit strategy ▪ Encourage crowding in of market-based lenders (consider systemic and project risks that can lead to negative demonstration effects).

[9] *Lerner, 2004*

[10] *Subsidiary of KfW, the German government-owned development bank.*

[11] *Bortes, Sinha and Grettve (2011). How do DFIs measure the development returns to investment in private enterprises? A review of the literature. Nathan Associates London Ltd.*

[12] *SME Financing – How To Topic Guide, Hamilton Kerry & Beck Thorsten, April 2016*

Objectives	▪ Development objectives should be balanced with financial incentives. ▪ Relationships with funders and investors that possess similar development goals and complementary investment goals can be useful.	▪ Avoid crowding out private sector finance. ▪ Social environmental and development objectives should be matched with commercial aims.
Design	▪ Transparency should be a priority while protecting commercial confidentiality. ▪ Consistency is critical: mainstream and standardise approaches to programme implementation focusing on scalable investment structures and workable products.	▪ Recognise diverse private sector incentives and needs. ▪ Define clear mandates and strategies for engaging private sector investors

Table 12: Trade and Supply Chain Finance - A summary of products

Product	What is it?	How does it work?
Merchant and e-commerce finance	Small businesses selling their goods on platforms such as Amazon, eBay or Alibaba are now offered working capital lines and loans by those platforms[81].	Payment processors and e-commerce platforms can be better placed than traditional lenders to assess the risk of advancing money as they can view a significant portion of daily transactions. The collection process is also simplified as payments flow through their systems and processers can take repayments directly from revenue received.
E-invoice management portals	Evidence shows that if invoices are sent out quickly, it greatly increases the likelihood of getting paid, regardless of the credit terms.	Invoice management portals (e.g. Tradeshift). can help automise receivables management and streamline the end-to-end process. The timing of the payment, however, still remains at the buyer's discretion.
Invoice Finance	Online receivable finance companies now allow small businesses to monetise outstanding receivables quickly and easily. Compared to traditional off-line factoring, online invoice finance is flexible tool and quick.	Accounting software can be integrated within the invoice finance platform allowing SMEs to apply for loans based on the value of receivables. As the application is processed mostly automatically, payment can be received almost instantly. A transaction history is built up over time making future applications even more straightforward.
Supply Chain Finance (SCF)	Unlike invoice finance, which usually does not rely on the cooperation of buyer, SCF is typically initiated by the buyer. Traditional SCF involves a high degree of cooperation between the supplier and the buyer. Formal programmes allow suppliers the ability to opt for early payment of invoices at a discount.	Traditional SCF programmes involve complex legal frameworks and are only efficient to operate at larger scale. A FinTech solution offers efficiency at lower scale, making working capital accessible to the entire supply chain by linking to an online portal. SMEs benefit from cheaper cost of working capital relying on the greater creditworthiness of their customer.

12.1 Summary Table[13]

Credit Guarantee Schemes	Growth oriented but collateral constrained SMEs who have struggled to access formal finance	▪ Partner FIs committed to SMEs. ▪ Appropriate pricing to ensure sustainability beyond donor support. ▪ Informed loan officers and development of products relevant to SME segment (supported by TA). ▪ Establishment of separate legal entity after pilot stage. ▪ Strong management team	▪ Effectiveness maximised when partnered with a SME focused financial institution which is committed to growing the segment. ▪ Example: Jordan Loan Guarantee Corporation providing guarantees of up to 85% to banks since 1994	▪ There must be demand for guarantees. Over-supply of donor funding is an issue in some countries affecting utilisation and impact. ▪ Self-sufficiency can be achieved ensuring impact is sustained. ▪ Has been shown to increase the levels of lending to SMEs where used, although sustainability of impact is a bit more questionable after support is removed.	▪ Risk of low additionality where markets are already liquid. ▪ Low take up due to ill-informed loan officers. ▪ Moral hazard, i.e., excessively risky loans put through the scheme. ▪ Failure to change business models effecting sustainability of initiative post funding. ▪ Can be market distorting as loans given to previously 'unbankable' SMEs.
Credit/Equity lines to banks/FIs for SMEs	Growth oriented SMEs in underserved or illiquid financial environments	▪ Choose appropriate FI partners. ▪ Ensure incentives in place to channel funds to SME. portfolio ▪ Ensure additionality criteria upheld.	▪ Particularly effective when combined with TA. ▪ Example: Türk Ekonomi Bankası (TEB) who with IFC support increased SME clients from 20,000 to 700,000 from 2005 to 2011. (RTI International 2011)	▪ Sustainability most prevalent in cases where banks are committed to SME segment and have the internal capacity to adopt appropriate process and risk management techniques. ▪ Measurement of impact currently weak and M&E should be included in instrument design.	▪ Banks do not always channel funds to SME portfolios. ▪ Can crowd out domestic investment. ▪ May reduce competition in the market. ▪ FIs become reliant on external funding.
Leasing	▪ Small SMEs who are collateral constrained. ▪ Agricultural SMEs. ▪ Muslim borrowers as considered to be 'interest-free'. ▪ Sustainable energy or other capital-intensive sectors	▪ Effective laws and regulations governing leasing transactions, clear accounting standards, an appropriate tax regime. ▪ Choice of partner institutions critical. ▪ Product must be tailored to the specific segment.	▪ Can be particularly effective in agricultural sector and in fragile/post-conflict states. ▪ When combined with TA impact is more sustainable. ▪ Example: Central and South Eastern European transition economies (Haiss and Kichler 2009)	▪ Can reach sections of SME segment that would not be eligible for formal lending especially when tailored to specific need. ▪ Can bring small businesses into the formal financial system. ▪ Can increase competition. ▪ Can offer long-term benefits for those reached if structured and sequenced appropriately.	▪ Direct subsidisation of leasing companies can be harmful to the development of the leasing industry distorting the market and reducing competition. ▪ Assistance to banks can squeeze out smaller private leasing companies.
Equity Funds to SMEs	Early stage and high-risk SMEs who need funding for growth.	▪ Well informed and efficient fund managers with good local knowledge	▪ Support effective when type of equity product tailored to stage of development of company.	▪ Unlike lending have the potential to influence social and environment behaviours.	▪ Crowding out of private sector investment. ▪ If equity investments are made without supporting

[13] *SME Financing – How To Topic Guide, Hamilton Kerry & Beck Thorsten, April 2016*

	More tailored for medium-sized firms	▪ Often needs long term commitment by development partners. ▪ Clear exit strategy needed supported by development of equity market.	▪ When TA, incubators or accelerators to provide necessary support to SMEs making them 'investment ready'.	▪ Can influence governance structures of firms. ▪ Demonstration effect leverages private investment leading to long-term growth.	development of equity market as a whole, may result in inability to access other investment when donor funding is removed.
Financial Government Benefits to SMEs	▪ Dependent on specific instrument but can be particularly effective when targeting small or newly formed technology or capital focused SMEs.	▪ Benefits of the incentive must outweigh the administrative costs of applying for them. ▪ Incentives must be significantly large to encourage changes in investment decisions. ▪ As most benefits are applied for after the event, the system should provide confidence on delivery.	▪ Well-targeted incentives that directly reduce the cost of capital to SMEs, (such as investment tax credits for R&D) and encourage investment. Bloom et al (2002) using data from 9 OECD countries covering the years 1979 to 1997 found significant impact of fiscal R&D incentives.	▪ Impact and sustainability dependent on the nature of instrument although evidence suggests that well targeted and designed fiscal measures can stimulate research and development leading to firm growth and sustainability.	▪ Tax holiday can be prone to abuse incentivising SMEs to dissolve before end date. ▪ Similarly, VAT thresholds provide an incentive for staying small. ▪ Benefits can act as a subsidy to sections of the market causing distortion.
Grants and Loans / Blended Finance	▪ Broad range of SMEs. Can be particularly for SMEs seeking to innovate but lacking the resources to do so.	▪ Blended Finance – strong partnerships with clear mandates. ▪ Balance of commercial and development objectives ▪ Challenge Funds – transparent, competitive, well-managed process the focuses on projects with potential for commercially sustainability.	▪ Blended Finance-Demonstration effect crowds in private sector investment in areas where access to finance most required (e.g., clean energy financing). ▪ Challenge funds. Challenge is well focused on key issue and innovation results in transformational change. e.g., M-PESA mobile money transfer.	▪ Combined effect of commercial finance with donor support including TA can provide a holistic approach to investment leveraging private sector investment and ensuring sustainability. ▪ Grants such as challenge fund have the potential to trigger systemic change through innovation	▪ Blended finance can be considered as a subsidy to a company impeding competition. ▪ Can be market distorting, crowding out private investment. ▪ Can support projects that wouldn't be commercially viable on their own. ▪ Misallocation of resources.
Innovative and Technology based Solutions (FinTech) – including P2P & crowdfunding	SMEs who are unable to access traditional forms of finance due to lack of collateral or track record	▪ New platform's ability to attract investment. ▪ Awareness amongst SME community and willingness to access alternative financing mechanisms. ▪ New products relevant to SME financing needs.	▪ Development partner support currently limited to helping the development of the sector and direct funding of individual platforms, e.g. EIB planned investment in Funding Circle. ▪ Almost no evidence to success at present (beyond indications of growth) and, therefore, best practice is limited.	▪ Market driven. ▪ Early indications show that platforms have been effective. ▪ Can be effective way of leveraging private sector investment. ▪ Can provide competition in the market and addresses specific market. failures (such as information asymmetry). ▪ Removes geographic barriers to investment.	▪ Broader impacts not yet known. ▪ Not widely regulated at present. ▪ Technological infrastructure may not exist in many developing countries to allow fair access.

12.2 Other Resources

New-Approaches-SME-full-report.pdf (oecd.org)
Agricultural value chain finance (fao.org)
AFI_GN36_sme_AW_digital.pdf (afi-global.org)

2. GREEN FINANCING

Green-credit-schemes-for-MSMEs_260722.pdf (afi-global.org)
AFI_SMEF_IGF-MSMEs_AW_digital_0.pdf (afi-global.org)
Roadmap for Inclusive Green Finance Implementation - Alliance for Financial Inclusion (afi-global.org)
Measuring Inclusive Green Finance - Alliance for Financial Inclusion (afi-global.org)
Leveraging Digital Financial Services to Advance Inclusive Green Finance Policies - Alliance for Financial Inclusion (afi-global.org)
Towards an Inclusive Green Future: An Analysis of the Intersection Between Inclusive Green Finance and Gender Inclusive Finance - Alliance for Financial Inclusion (afi-global.org)
Greening the Financial Sector Through Provision Policies: The Role of Central Banks - Alliance for Financial Inclusion (afi-global.org)
Green Bonds, Sustainable Finance and Climate Change – Point of View - IMF F&D | DECEMBER 2019
PowerPoint Presentation (unep.org)

3. FINANCIAL INCLUSION

Developing and Operationalizing a National Financial Inclusion Strategy: Toolkit (worldbank.org)
National Financial Inclusion Strategies: Current State of Practice (2022) - Alliance for Financial Inclusion (afi-global.org)
Financial Inclusion in Africa (afdb.org)

4. INCLUSIVE BUSINESS

Private Sector Division, UNDP: "Brokering Inclusive Business Models" (2010)
Inclusive Markets Development Handbook (2010)
And the following supporting tools:
Private Sector Division, UNDP: "Assessing Markets" (2010)
Private Sector Division, UNDP: "Guide to Partnership Building" (2010)

5. POLICIES AND FINANCIAL INFRASTRUCTURE

G20_Policy_Guide_Digitisation_and_Informality.pdf (gpfi.org)
AFI_NFIS_PM_AW2_digital.pdf (afi-global.org)
improving-access-to-finance-for-SMEs.pdf (doingbusiness.org)
SME_case_study_report.pdf (gpfi.org)