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ABOUT THE WORKING GROUP
The Small and Medium Enterprise Finance (SMEF) Working Group was formally launched at the September 2013 AFI Global Policy Forum in Kuala Lumpur, Malaysia. The vision of the SMEF WG is to contribute to the development of MSMEs in developing and emerging countries through financial services. The SMEF WG promotes the development and implementation of policy frameworks that improve access to financial services for SMEs within national contexts. The SMEF WG has two key objectives: (1) to create a shared understanding of how different aspects of financial services contribute to the development of sustainable SMES in developing and emerging countries; and (2) to identify policy frameworks and interventions that enable and enhance the socio-economic role of SMES, with a specific but not exclusive focus on financial sector policy.

The Alliance for Financial Inclusion’s (AFI) working groups are supported by AFI’s funding partners.

ABOUT THIS GUIDELINE NOTE
This Guideline Note outlines a range of options and good practices to facilitate access to finance for small- and medium-sized enterprises (SMEs). It is intended to serve as a first point of reference for regulators preparing to plan, assess and implement policy and legal measures to support access to finance for SMEs. The Guideline Note synthesizes the work of several international and national agencies on SME finance, and highlights innovations with potential to transform this space. This, combined with discussions with experts (G20/B20 working groups, World SME Forum, SME Finance Forum), has informed the policy guidelines for SME finance in this Note, which national regulators can use as they put policy measures and regulations in place. Many governments have been stepping up efforts to foster a diversified environment for SME finance. Some of their experiences will be summarized in this Note as examples.

ACKNOWLEDGMENTS
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1 This Guideline Note draws heavily on existing research, most notably: (1) IFC SME Finance Policy Guide, 2011; (2) G20/B20 working group reports, various years; (3) World SME Forum reports, various years; and (4) OECD, Financing SMEs and Entrepreneurs, various years.
BACKGROUND

Market failures, regulatory constraints, supervisory weaknesses, financial infrastructure deficiencies and the capacity and behavior of financial institutions and SMEs, all vary by country and context. For national authorities, diagnostic assessments that consider both demand and supply issues are therefore a necessary first step in the selection and sequencing of tools presented in this Guideline Note.²

Similarly, the capacity of governments to implement reforms, of regulators to effectively introduce and supervise new or reformed regulations, of business advisory services to support entrepreneurs and of the financial sector to respond to a more enabling environment, will also vary.

Sharing experiences on SME finance reforms, both successes and failures, is an important way for us all to learn and this Guideline Note is an effort to do just that. The intent is for the Guideline Note to serve as an initial reference for AFI members developing policy and regulation for SME access to finance, and to open dialogue among AFI members. It is hoped that their reactions to the lessons and experiences in this Guideline Note will prompt broader discussions on the issues we all face, enrich our work and ensure more sustainable solutions to SME access to finance across the globe.

INTRODUCTION

THE ROLE OF SMEs

Small and medium enterprises (SMEs) are the backbone of virtually every economy in the world. SMEs represent more than 95 percent of registered firms worldwide, account for more than 50 percent of jobs and contribute more than 35 percent of Gross Domestic Product (GDP) in many emerging markets. The contribution to GDP increases as economies develop, with SMEs in the developed world accounting for well over 50 percent. SMEs generate most of the new jobs in an economy, diversify a country’s economic base, promote innovation, deliver goods and services to those living at the bottom of the social pyramid and can be a powerful force for integrating women and youth in the economic mainstream and strengthening economic resilience.

However, for SMEs to generate economy-wide benefits, appropriate decisions about financial allocation are critical and require allowing:

» productive SMEs to expand and become large firms;
» distressed but productive SMEs to restructure; and
» unproductive SMEs to exit so their resources can be reallocated to growing firms.

Accordingly, consecutive G20 Presidencies (Turkey 2015, China, 2106, Germany 2017, Argentina 2018 and Japan 2019) have placed considerable emphasis on the importance of SME development and worked to highlight SME-related issues in the global economy. Other governments and key international institutions have also been focusing more heavily on the issue of SME support, particularly financial.

ACCESS TO FINANCE FOR SMEs

One of the biggest constraints to SME development is the lack of financial resources to start, sustain and grow a business. Between 55 and 68 percent of formal SMEs in emerging markets are either unserved or underserved by financial institutions.³ The total credit gap for formal SME enterprises is between USD 0.9 and $1.1 trillion, while the total credit gap for formal and informal enterprises is estimated between $2.1 and $2.6 trillion (see Figure 1). According to Investment Climate Surveys, in over 70 percent of countries, SMEs cite access to finance as the single biggest obstacle to doing business (followed by access to electricity, the informal economy, tax rates and political instability).⁴

² Diagnostic assessments may vary from country to country depending on the specific circumstances and objectives of the country. Factors to be considered include, among others, financial capacity, financial infrastructure, regulatory framework and laws related to SME finance.
⁴ Ibid, pp. 3-4.
SMEs require a mixture of debt and equity to grow. They also need different types of financing, which are likely to change and evolve as they grow. For instance, most SMEs commence operations with their own funds, typically money from friends, family or founders. However, the financial needs of most growing businesses quickly surpass the financial limits of this group. Locked out of bank financing, SMEs must secure alternative sources of financing—equity support, trade finance or even small amounts of bank (or other financial institution) finance—to avoid stagnating or shutting down completely. At this point, SMEs enter what is known as the “Valley of Death” (see Figure 1).

Figure 1 illustrates the typical life cycle of an SME and the types of funding used by SMEs around the world (taken from Enterprise Survey data for both investment and working capital). Reliance on “own funds” (or internal funds) is significantly higher in developing countries and which, in the absence of alternative funding sources, stunts SME growth and overall economic development.

SME FINANCE DATA

The availability and collection of relevant data is critical to properly assess SME financing needs, to create a value chain ecosystem that supports economies of scale for public authorities and financial suppliers, and to rationalize business advisory services to respond to the needs of SMEs.

Appropriate data on SMEs enables them to be differentiated and segmented and for suitable interventions to be identified for specific groups. Accurate and comprehensive data also informs the selection, prioritization, sequencing, benchmarking and monitoring of elements of SME finance policies. Therefore, governments should invest in regular collection and dissemination of reliable financial inclusion data.
As pointed out in AFI Guideline Note No. 16: SME Financial Inclusion Indicators, evidence-based policymaking based on comprehensive, reliable, objective and timely data, is key to ensuring SMEs have effective access to finance and desired development outcomes are achieved. When comprehensive and accurate data is available and gaps in SME access to finance can be assessed, a benchmark for designing effective policies can be developed and goals and targets can be better monitored. Such data also provides policymakers and other stakeholders with a consistent framework for cross-country comparisons, which in turn facilitate peer learning among AFI members.

Since there is no single, internationally accepted set of indicators for SME access to finance, work already conducted by international organizations, particularly the G20 Global Partnership for Financial Inclusion (GPFI) and the Organization for Economic Co-operation and Development (OECD), can serve as a reference point for regulators to collect data that supports policymaking and monitoring. This work has informed the development of AFI’s SME Finance Base Set, which can also serve as a reference.\(^5\) Data collection requires cooperation and collaboration among various agencies and stakeholders, including central banks and financial supervisory authorities, financial institutions and SME representatives.\(^6\)

**GUIDELINES ON DATA COLLECTION**

The following measures are recommended to improve the data landscape for SME finance:\(^5\)

- Harmonize the definitions of the concepts to be measured: a) ensure comparability across countries and over time; b) devise development strategies; and c) adapt or design informed policies. This is especially important for data and measurement on access to finance for SMEs and women-owned SMEs.
- Standardize data collection and indicator computation. The use of international concepts, classifications and methods promotes transparent, consistent and efficient statistical systems.
- Build or improve national statistical capacity to improve data availability and quality, and focus on missing indicators, including (among others) barriers to access, usage and quality for SMEs and the role of informal providers.
- Build consistent and reliable data sources for access to finance for agricultural SMEs.
- Ensure open data access.
- Rationalize and enhance the coordination of business advisory services to link entrepreneurs to markets and finance.

The key principles and dimensions of the AFI SME Finance Base Set can be a useful starting point for members embarking on such a data collection effort. The principles include: (a) completeness; (b) usefulness; (c) consistency; and (d) flexibility, and the dimensions include: (a) access indicators; (b) usage indicators; and (c) quality indicators.\(^8\)

In addition, the GPFI Data and Target Setting Subgroup has identified the following initial steps in data collection from the perspective of emerging and developing economies:\(^9\)

**i) Addressing gaps in statistical capacity.** This involves the way in which financial inclusion statistics are measured, collected and disseminated:

- a. Demand-side databases are seldom publicly available because of confidentiality, transparency or private property.
- b. Data and measurement on SME access to finance are less developed than that for households.
- c. Data on informal providers and informal businesses is difficult to gather.
- d. Supply-side data on usage is often weakened by a lack of financial identity, making it difficult to properly develop country-level aggregates from individual users.
- e. Lack of harmonized definitions, standardized data collection and indicator construction (especially for SMEs), active versus dormant accounts and demand-side data, all make it a challenge to compare indicators.

**ii) Addressing gaps related to financial inclusion dimensions.** These gaps relate to indicators on input, output and impact, including:

- a. Access and usage indicators that measure entry into the formal financial system; and
- b. Next generation output indicators, such as quality of services, financial literacy and absence of barriers to access. These need to be developed in a consistent way.

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5. See: AFI, September 2015, “Guideline Note No.16: SME Financial Inclusion Indicators Base Set”.
8. For additional explanation of the principles and key dimensions, see AFI, September 2015, “Guideline Note No.16: SME Financial Inclusion Indicators Base Set,” pp. 2-3.
In addition, given the increasing importance of FinTech in SME access to finance (see Volume 2 of this Guideline Note), data should be expanded to include relevant digital access and usage indicators.

As AFI has recognized, collecting data from the informal sector on SME access to finance presents challenges. Although informal financial services are important in the SME finance landscape, the difficulty in consistently measuring the prevalence and use of such services, the lack of regulatory oversight over informal providers and, therefore, the lack of reliable data, convinced AFI’s SME Finance (SMEF) Working Group to focus exclusively on regulated service providers.10 The definition of SMEs varies from country to country, so the SME Finance Base Set relies on each country’s definition, preferably one set out by law or a particular set of regulations. This therefore restricts the definition of SMEs to formal SMEs that have been registered by a recognized authority or agency. The SME Finance Base Set addresses the access, usage and quality of financial services for regulated financial service providers only.

The type of data that would be required includes the following, based on the OECD SME Finance Indicators. Table 2 provides more detail on the basic/core indicators.

In terms of actual data to be collected, it is important to consider both supply- and demand-side indicators. The OECD Scoreboard presents national data mainly on the supply side of finance sourced from either central banks or surveys of finance suppliers. The Scoreboard also includes some demand-side data collected by surveys from both private and public institutions. However, the Scoreboard recognizes that demand-side data needs improvement. Ideally, quantitative demand-side data collected by SME surveys would complement OECD methodology and strengthen the interpretative power of its framework. Whereas a plethora of qualitative SME surveys (i.e. opinion surveys) exist, quantitative demand-side surveys are rare. Furthermore, comparability of national surveys is limited, as survey methodologies differ from country to country.

One example of an effective demand-side survey is the 2010 International Eurostat Business Survey on SME Access to Finance. This survey provides an illustrative case of a coordinated effort by several statistical offices to collect harmonized statistics on access to finance, ensuring cross-country comparability. The survey results allow comparative and specific analysis of EU member states, and in 2011, Eurostat and several countries (including Denmark, Finland, Ireland, Luxembourg and Spain) issued reports on the survey findings.

Another example is a demand-side survey developed in Canada. Annex 2 presents a simplified quantitative demand-side survey on Small Business Credit Conditions conducted by Industry Canada in 2010. This constitutes good practice for demand-side surveys, yielding high-quality data while limiting costs for administrators and the burden on respondents.

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### TABLE 1: SME FINANCE INDICATORS

<table>
<thead>
<tr>
<th>CORE INDICATORS</th>
<th>WHAT THEY SHOW</th>
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<tbody>
<tr>
<td>1 Share of SME loans in business loans</td>
<td>SME’s access to finance compared to larger firms</td>
</tr>
<tr>
<td>2 SME short-term loans in SME loans</td>
<td>Debt structure of SMEs. % used for operations and % used for expansion</td>
</tr>
<tr>
<td>3 SME loan guarantees</td>
<td>Extent of public support for SME finance</td>
</tr>
<tr>
<td>4 SME guaranteed loans</td>
<td>Extent of public support for SME finance</td>
</tr>
<tr>
<td>5 SME direct government loans</td>
<td>Extent of public support for SME finance</td>
</tr>
<tr>
<td>6 SME loans authorised/SME loans requested, or SME loans used/SME loans authorised</td>
<td>Tightness of credit conditions and willingness of banks to lend. Proxy for above indicator, however a decrease indicates credit conditions are loosening</td>
</tr>
<tr>
<td>7 SME non-performing loans/SME loans</td>
<td>When compared to the ratio of non-performing loans (NPLs) for all business loans it indicates if SMEs are less creditworthy than larger firms</td>
</tr>
<tr>
<td>8 SME interest rates</td>
<td>Tightness of credit conditions and risk premium charged to SMEs</td>
</tr>
<tr>
<td>9 Interest rate spreads between large and small enterprises</td>
<td>Tightness of credit conditions; indicates how closely interest rates are correlated with firm size</td>
</tr>
<tr>
<td>10 Percent of SMEs required to provide collateral on their last bank loan</td>
<td>Tightness of credit conditions</td>
</tr>
<tr>
<td>11 Venture capital and growth capital</td>
<td>Ability to access external equity for start-up, early development and expansion stages</td>
</tr>
<tr>
<td>12 Payment delays</td>
<td>Indicator of cash flow problems; difficulty in paying and being paid</td>
</tr>
<tr>
<td>13 Bankruptcies</td>
<td>Rough indicator of ability to survive during a crisis</td>
</tr>
</tbody>
</table>
### TABLE 2: CORE INDICATORS OF SME ACCESS TO FINANCE

<table>
<thead>
<tr>
<th>Core Indicator</th>
<th>Unit</th>
<th>What It Shows</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Allocation and Structure of Bank Credit to SMEs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outstanding business loans, SMEs</td>
<td>Volumes in national currency</td>
<td>SME demand for and access to bank credit. A stock indicator measuring the value of an asset at a given time, which reflects both new lending, bank loans that have accumulated over time and loan repayments.</td>
</tr>
<tr>
<td>Outstanding business loans, total</td>
<td>Volumes in national currency</td>
<td></td>
</tr>
<tr>
<td>Share of SME outstanding loans</td>
<td>% of total outstanding loans</td>
<td></td>
</tr>
<tr>
<td>New business lending, total</td>
<td>Volumes in national currency</td>
<td>SME demand for and access to bank credit. It is a flow indicator measured over one year that tends to respond faster to short-term developments and is therefore more volatile than stocks.</td>
</tr>
<tr>
<td>New business lending, SMEs</td>
<td>Volumes in national currency</td>
<td></td>
</tr>
<tr>
<td>Share of new SME lending</td>
<td>% of total new loans</td>
<td></td>
</tr>
<tr>
<td>Short-term loans, SMEs</td>
<td>Volumes in national currency</td>
<td>The structure of SME debt, i.e. the share of outstanding credit with an initial maturity of less than one year and more than one year, respectively. This could be considered a proxy to gauge the purpose of SME bank loans, i.e. for operational and investment needs.</td>
</tr>
<tr>
<td>Long-term loans, SMEs</td>
<td>Volumes in national currency</td>
<td></td>
</tr>
<tr>
<td><strong>Extent of Public Support for SME Finance</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government loan guarantees, SMEs</td>
<td>Volumes in national currency</td>
<td>Illustrate the extent and uptake of government programs and instruments supporting SME access to finance.</td>
</tr>
<tr>
<td>Government-guaranteed loans, SMEs</td>
<td>Volumes in national currency</td>
<td></td>
</tr>
<tr>
<td>Direct government loans, SMEs</td>
<td>Volumes in national currency</td>
<td></td>
</tr>
<tr>
<td><strong>Credit Costs and Conditions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rates, SMEs</td>
<td>%</td>
<td>The cost of SME loans and how it compares to large firms.</td>
</tr>
<tr>
<td>Interest rates, large firms</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>Interest rate spread</td>
<td>Percentage points</td>
<td>Proxies the conditions SMEs face when applying for bank credit.</td>
</tr>
<tr>
<td>Collateral, SMEs</td>
<td>% of SMEs needing collateral</td>
<td></td>
</tr>
<tr>
<td>Percentage of SME loan applications</td>
<td>SME loan applications/total</td>
<td>The (unmet) demand for and use of credit by SMEs, and willingness of banks to lend.</td>
</tr>
<tr>
<td>Rejection rate</td>
<td>1 (SME loans authorized/</td>
<td></td>
</tr>
<tr>
<td></td>
<td>requested), in %</td>
<td></td>
</tr>
<tr>
<td>Utilization rate</td>
<td>SME loans used/authorized, in</td>
<td></td>
</tr>
<tr>
<td></td>
<td>%</td>
<td></td>
</tr>
<tr>
<td><strong>Non-Bank Sources of Finance (Alternative Finance)</strong></td>
<td></td>
<td>Uptake and ability to access non-bank finance instruments, including external equity for start-up, early development and expansion stages, as well as asset-based finance, such as leasing, hire purchases, factoring and invoice discounting.</td>
</tr>
<tr>
<td>Venture and growth capital investments</td>
<td>Volumes in national currency</td>
<td></td>
</tr>
<tr>
<td>Leasing and hire purchases</td>
<td>Volumes in national currency</td>
<td></td>
</tr>
<tr>
<td>Factoring and invoice discounting</td>
<td>Volumes in national currency</td>
<td></td>
</tr>
<tr>
<td><strong>Digital Finance (Alternative Finance)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>P2P lending, SMEs</td>
<td>Volumes in national currency</td>
<td>The extent of FinTech-enabled SME finance.</td>
</tr>
<tr>
<td>P2P lending as share of total loans, SMEs</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>Challenger banks’ lending, SMEs</td>
<td>Volumes in national currency</td>
<td></td>
</tr>
<tr>
<td>Challenger banks’ lending as share of total bank lending, SMEs</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td><strong>Financial Health</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-performing loans, total</td>
<td>% of total business loans</td>
<td>The incidence of late or non-payments for SME loans compared to the overall corporate sector. Proxies the (relative) riskiness of lending to SMEs.</td>
</tr>
<tr>
<td>Non-performing loans, SMEs</td>
<td>% of total SME loans</td>
<td></td>
</tr>
<tr>
<td>Payment delays, B2B</td>
<td>Number of days</td>
<td>The occurrence of payment delays in the B2B sector, i.e. the difficulty in paying and being paid, to capture the extent of cash flow problems.</td>
</tr>
<tr>
<td>Bankruptcies, SMEs</td>
<td>Number and year-on-year growth rate in %</td>
<td>A proxy for the overall business environment in which SMEs operate and the ability of small firms to survive economic downturns and credit crunches.</td>
</tr>
</tbody>
</table>

Source: Core indicators based on OECD Financing SMEs and Entrepreneurs 2017, except for access to digital finance.
LEGAL AND REGULATORY FRAMEWORKS FOR SME FINANCE

THE ROLE OF REGULATORS

OBJECTIVES

Regulators and supervisors play a key role in the design and implementation of an enabling environment for SME finance, which includes providing the legal and regulatory framework in support of SME access to finance, interventions promoting SME finance and the collection and analysis of data on access to finance. All formal financial intermediaries are regulated in some measure by government regulatory bodies, typically the central bank and the securities exchange commission (SEC). In rare cases, regulatory authority and responsibilities may reside with other government agencies, usually a special group of intermediaries (as in the case of SBICs in the US, discussed later).

Central banks usually regulate deposit-taking and lending intermediaries, primarily banks. Their core regulatory functions are to protect the financial system and prevent crises. SECs typically regulate non-bank financial intermediaries, such as stock exchanges, investment advisors, securities brokers and public companies listed on exchanges. The core function of SECs is to protect investors, including individuals, businesses and endowed organizations. There are some financial intermediaries that are not clearly classified as banks or securities-related businesses, and may be regulated by either the central bank or SEC, depending on the country. Some intermediaries in some countries are regulated by both. Insurance companies are an example of financial intermediaries that may be regulated by either or both.

POLICY GUIDELINES

To design and implement a legal and regulatory framework that enables and facilitates SME finance, regulators can take the following steps:11

a) Make a case for regulatory intervention

> Define the regulatory philosophy and establish policy objectives;
> Establish an open and transparent regulatory decision-making process; and
> Assess market failure to identify problems to be addressed and determine whether government action is justified.

b) Design and implement appropriate policy measures

> Identify measures that address the problem as identified, including non-regulatory measures;
> Assess the benefits and costs of each alternative policy proposal through a structured regulatory impact assessment; and
> Design and implement the chosen regulatory solution while taking account of issues surrounding clarity, consistency, proportionality and accountability.

c) Design effective enforcement strategies

> This will ensure regulatory measures are successful; and
> Enforcement measures should be fair, transparent and well integrated in the overall regulatory decision-making process.

d) Conduct ex-post evaluation

> This will determine whether the regulation remains relevant in its current form or if its goals could be better achieved in another way.12

One of the challenges emerging and developing economies face is that human and financial resources and the capacity of regulatory and supervisory bodies can be weak. This is exacerbated by a high degree of informality among SMEs, which makes it difficult to plan appropriately and address their needs. Adding responsibilities with limited resources (e.g. monitoring SME finance) or expanding coverage (e.g. covering microfinance institutions and non-bank financial institutions) may create a capacity challenge that makes reforms less effective. Consequently, regulators could consider starting with a basic institutional framework that is more compliance- or rules-based, and gradually shifting to a more sophisticated regulatory framework as markets and regulatory and supervisory capacity develop over time.

EXAMPLE OF GOOD PRACTICE

BALANCING FINANCIAL ACCESS AND AML/CFT REGULATION IN SOUTH AFRICA

South Africa’s Financial Intelligence Centre Act (FICA) and its regulations determine the AML/CFT obligations of financial institutions. It requires financial institutions to keep a record of a client’s identity and any documents obtained in verifying that identity. Two requirements of the FICA regulations were subsequently identified as potential obstacles for customers in the low-income market: (i) a national identity document to verify personal details, and (ii) documentary proof of residential address when opening a bank account. Around one-third of adult South Africans, many of whom live in informal housing, could not provide documentary proof of residential address.

11 For more details see: IFC, 2011, “SME Finance Policy Guide”.
In 2002, an exemption was issued eliminating the need to obtain and verify address details, and relaxing recordkeeping requirements for accounts and services subject to balance and transaction limits. Further refinements in 2004 supported a basic bank account (“Mzansi”) and related payment services. To date, over six million of these accounts have been opened. Subsequently in 2006, the South African Reserve Bank allowed banks to open mobile phone-operated bank accounts (within certain transaction and balance limits) without having to undertake face-to-face customer due diligence and with even lower transaction limits.


PRUDENTIAL REGULATION AND LENDING GUIDELINES FOR SME FINANCE

MACROPRUDENTIAL REGULATIONS
The 2008-09 global financial crisis magnified challenges for SME finance and presented policymakers with a choice between promoting business growth and safeguarding financial stability. International standard-setting bodies, under the leadership of the G-20, set up a comprehensive reform agenda for improving the regulatory framework governing the activities of banks and other financial institutions. Recommendations by the Basel Committee on Banking Supervision (BCBS) under Basel III stand out for their potential impact on SME finance.13

Basel III has become the benchmark and global framework for the regulation of bank capital, liquidity and leverage, and aims to address the financial regulation deficiencies that led to the global financial crisis. Specifically, the provisions of Basel III have meant a significant increase in the amount and quality of capital requirements, and new liquidity ratio requirements have skewed banks toward less risky assets, such as sovereign bonds. As Basel III provisions are implemented, the cost of capital for banks is expected to increase the cost of borrowing for bank clients, especially SMEs.

WHY DOES BASEL III AFFECT LENDING TO SMEs?
While financial stability brings substantial benefits to SMEs, they are typically the first to feel the impact of a financial crisis, as there is a perception that they are risky borrowers and are generally rated/scored below that of large corporations. Although SMEs did not cause the financial crisis, the subsequent credit crunch has severely limited their access to credit. With Basel III, banks will need to hold extra cash in reserve as they will not be able to lend out as much money as pre-crisis levels. Banks may also demand additional security to comply with the reduced risk allowance. This means banks may require personal guarantees for SME loans or even move away from lending to SMEs.

HOW DOES BASEL III AFFECT LENDING TO SMEs?
When Basel III is implemented, banks will face two choices: credit pricing or credit rationing. Banks could either set a higher price for firms to obtain credit due to the reduced credit supply, or simply ration the amount of money they loan. SMEs would be disproportionately affected if banks opt to ration, as they would no longer be able to obtain credit even if they can pay the price.14 Small businesses also have less bargaining power, so they are likely to face higher credit costs.

To partially address the impact of the additional Basel III regulatory requirements and ensure loans to SMEs are not significantly affected, a supporting factor for SME loans is included in the Basel III Capital Requirements Regulation (CRR). Defined as 0.7619, it is applied to the capital requirements of SME exposures in banks’ balance sheets. SME exposures that fulfill the eligibility criteria can multiply their risk-weighted assets by the supporting factor, effectively reducing their capital requirements. As such, the relative cost of capital for SME exposures is lowered and provides an incentive for banks to continue lending to them.

MICROPRUDENTIAL REGULATIONS FOR SME FINANCE
Notwithstanding Basel III and specific SME laws or legislation, financial regulators may issue guidelines to directly or indirectly encourage banks and financial institutions to lend to SMEs. The two most common prudential regulations are implemented through lower risk weights for SME loans and lower liquidity requirements. Other types of regulation used to spur lending to SMEs include improving credit processes and imposing a quota/lending requirement for financial institutions to dedicate a certain percentage of their total lending to SMEs.

POLICY GUIDELINES
While these regulatory reforms have significant stability benefits for both advanced economies and emerging markets and developing economies (EMDEs), Basel III recommendations have been calibrated primarily for advanced economies. The adoption of these reforms is optional for the vast majority of EMDEs and the degree of implementation has varied across countries.15 Because the Basel III recommendations were initially designed with large, internationally active banks in mind, they may not meet the stability needs of EMDEs, which grapple with different sources of fragility and may find the proposed tools and policies less effective.

13 For a description of Basel III provisions, see Financial Stability Board: http://www.fsb.org/
14 See the Association of Chartered Certified Accountants (ACCA), July 2011, “Framing the debate: Basel III and SMEs”.
Nevertheless, many countries are adopting and adapting Basel II/III to different extents depending on the status and sophistication of their financial sector. A key challenge for EMDEs that implement Basel III is achieving key economic and financial goals, including developing local financial and capital markets and improving access to finance for SMEs and the stability of domestic financial systems.

Regulators in developing countries do not merely adopt Basel II/III because these standards provide an optimal technical solution to financial stability risks in their jurisdictions. Regulatory decisions are also driven by concerns about reputation and competition (see Box 2).

EMDE regulators generally have several factors to consider when determining the extent to which they should implement Basel III provisions:16

- Identify incentives and distinguish between prudential, reputational and competitive motives, while also considering the impact on SME access to finance. In deciding whether, to what extent and how to implement Basel III, regulators need to establish not only what is optimal from a technical perspective, but also the importance of reputational and competitive concerns in their jurisdiction, as the incentives of different stakeholders—incumbent politicians, regulators and the banking sector—may not align. Incumbent politicians keen on promoting the country as a financial services hub, for example, may discount the costs that an off-the-shelf Basel adoption entails for the regulatory authority, banking sector and SME finance. Meanwhile, internationally oriented domestic banks may push the government to embrace Basel III not out of prudential concerns, but because they expect to reap reputational and competitive benefits, including vis-à-vis smaller domestic rivals.

- Tailor Basel standards to national circumstances. Regulatory agencies outside the Basel Committee on Banking Supervision are not bound by its rules and are not subject to peer review procedures. Regulators on the financial periphery can use this freedom to adapt global standards to meet domestic regulatory needs, as some are already doing.

- IFRS 9. IFRS 9 is an accounting standard for financial assets issued by the International Accounting Standards Board (IASB). It replaced IAS 39, Financial Instruments - Recognition and Measurement, from January 2018. It is meant to respond to criticisms that IAS 39 is a) too complex; b) inconsistent with how entities manage their businesses and risks; and c) defers recognition of credit losses on loans and receivables until too late in the credit cycle. The development of IFRS 9 became imperative after the global financial crisis, and major markets, including the UK, Hong Kong, Singapore and China, have all adopted IFRS 9.17 IFRS 9 will change the way banks book provisions on financial assets, such as loans and bonds. It requires banks to make appropriate provisions in anticipation of future potential losses, rather than the prevailing practice of providing only when losses are incurred. This implies that banks will recognize provisions from the day a loan is extended, including undrawn commitments. In short, with the adoption of IFRS 9, banks may have to increase provisioning, which could affect their earnings. In trying to deal with potentially higher provisioning, banks may restructure or reprice loans, making them more expensive for borrowers with riskier credit profiles.

AFL members should assess their own situation and decide how to incorporate the provisions of Basel III. A recent comparative analysis of 11 low and middle-income countries (LMICs) shows that the adoption of Basel II/III varies.18 These case studies underscore the importance of stakeholder interests in the financial system, especially bankers, regulators and politicians. Of these 11 countries, Ethiopia lies at one end of the spectrum as it has chosen not to adopt Basel II or III. The relative isolation of Ethiopia’s banking sector and lack of multinational banks gives domestic banks few competitive incentives to adopt the Basel framework. Thus, in the absence of strong technical, competitive or reputational incentives, Ethiopia currently has no domestic champions for Basel II/III adoption.19

On the other hand, Pakistan has adopted Basel II and III to a significant degree. In the 1990s and early 2000s, the adoption of Basel II was driven first by a policy of promoting financial services, and then by banking sector regulators that sought to implement best practices. As banks have internationalized over the past decade, they have championed the implementation of Basel III. Pakistan is one of the few countries where all three major decision makers in the adoption of international standards—politicians, regulators and banks—have become internationally oriented, leading to substantial compliance with international banking standards.20

Bolivia is an example of competing influences. Bolivian regulators are engaged in international policy discussions and regard Basel III as the gold standard for banking regulation, while the Ministry of the Economy


17 In Malaysia, the equivalent standards are MFRS 9.


and Public Finances is more concerned with financial inclusion and domestic development than attracting foreign capital. Significant interventionist policies have been grafted onto draft legislation, such as interest rate caps and credit targets to certain economic sectors.\textsuperscript{21}

\textbf{EXAMPLE}

\textbf{REPUTATION AND COMPETITION AS INCENTIVES FOR IMPLEMENTING BASEL III}

Regulators in EMDEs do not merely adopt Basel III because these standards provide an optimal technical solution to financial stability risks. Regulatory decisions are also driven by concerns about reputation and competition, providing:

\textit{A signal to international investors}. Incumbent politicians may adopt Basel standards as a signal of sophistication to foreign investors. For example, in Ghana, Rwanda and Kenya, politicians have advocated the implementation of Basel II and III, and other international financial standards, as part of a drive to establish financial hubs in their countries. However, adoption can be selective, as seen in the case of Kenya. While the Central Bank of Kenya has sought to improve its regulatory and supervisory framework and looked to international standards as the basis for these reforms, liquidity requirements in Kenya are simpler than those of Basel III, but arguably better tailored to the country’s banking system.

\textit{Reassurance for host regulators}. Banks headquartered in EMDCs may endorse Basel II or III as part of an international expansion strategy as they seek to reassure potential host regulators that they are well regulated at home. One example is Nigeria, where large domestic banks have championed Basel II/III adoption at home as they seek to expand abroad. Their regulatory fervor has been met with reluctance among politicians who fear that a rapid regulatory upgrade may put weaker local banks in jeopardy.

\textit{Facilitating home-host supervision}. Adopting international standards can facilitate cross-border coordination between supervisors. In Vietnam, for example, regulators were keen to adopt Basel standards as their country opened up to foreign banks and wanted to ensure they had a “common language” with which to facilitate the supervision of foreign banks operating in the country.

\textit{Peer learning and peer pressure}. Even while acknowledging the shortcomings of Basel II and III, developing country regulators often describe them as international “best practices” or “the gold standard”, and there is strong peer pressure in international policy circles to adopt them. In the West African Economic and Monetary Union (WAEMU), for example, regulators at the supranational Banking Commission are planning an ambitious adoption of Basel II and III with the support of the IMF. Domestic banks, however, have limited cross-border exposure and show little enthusiasm for the regulator-driven embrace of Basel standards.

\textbf{EXAMPLES OF GOOD PRACTICE}

\textbf{BANGLADESH BANK’S SME LENDING GUIDELINES}

Until 2010, MSME credit represented just 22 percent of all loans and advances in Bangladesh. Banks and non-bank financial institutions (NBFIs) did not consider MSMEs a profitable segment due to the perceived risk associated with SME financing. However, in 2010, Bangladesh Bank issued the first comprehensive MSME lending guidelines for banks and NBFIs: SME Credit Policies and Programmes.

The guidelines stipulate target-based lending practices and development strategies for women entrepreneurs, which have significantly increased access to finance for MSMEs. The target for MSME lending is not imposed by the central bank; rather, banks and NBFIs independently determine their targets every year and Bangladesh Bank simply monitors whether they have been met using pre-determined indicators. To push the banks and NBFIs to achieve their targets and boost MSME lending, Bangladesh Bank also puts significant emphasis on target performance and achievements (including women entrepreneur financing) in determining the banks’ CAMELS rating.

Bangladesh Bank has recently issued two additional policies to incentivize MSME lending by banks and NBFIs, one that lowers the provisioning ratio of unclassified loans to MSMEs and another that raises maximum lending limits to small entrepreneurs. These interventions have had a major impact on the level of MSME financing and access to finance in Bangladesh. The annual credit disbursement to MSMEs has more than doubled, from USD 6,695 million in 2010 to $14,375 million in 2015. By 2016, more than 350,000 new cottages, micro and small entrepreneurs, including 25,000 women entrepreneurs, had gained access to credit. Bangladesh Bank’s interventions in MSME lending have resulted in an approximate two percentage point increase in the share of MSME credit to total loans and advances in Bangladesh.

Source: AFI Survey, 2016

SECURED TRANSACTIONS FRAMEWORK

OBJECTIVES
An asymmetry in information about actual credit risks and the perceived risks of lending to SMEs has led lenders to require borrowers to use their physical properties as collateral to reduce potential losses from loan defaults. However, many SMEs do not possess valuable fixed assets, such as land and buildings, to pledge as security for loans. Instead, they own “movable” collateral, such as equipment and machinery, livestock, accounts receivables, intellectual property and inventories. Having a secured transactions framework that provides adequate protection to lenders allows SMEs to leverage these types of assets and secure loans to grow their businesses. An integrated legal framework for secured transactions needs to be accompanied by a modern collateral registry for movable and intangible assets. Such registries allow a lender to take security rights in an asset without having to take physical custody of it.22

POLICY GUIDELINES23
A modern, secured transactions system will have the following elements:

a) A stand-alone law (e.g. secured transactions law or personal property law) to regulate all aspects of security interests in movable property rather than revising existing provisions in multiple laws, such as commercial and civil codes.

b) Broad scope of secured transactions law by allowing:
   i. All types of assets (both tangible and intangible, present and future) to be used as collateral for loans;
   ii. Broad pools of assets (revolving assets) with a generic description of the assets to be accepted as collateral to facilitate the use of credit revolving facilities;
   iii. Equal treatment of all transactions secured by movable property regardless of their contractual nature (financial leases, consignments, assignment of receivables, secured sales contracts, loans secured with movable property, retention of title, etc.); and
   iv. Automatic extension of security interests to products and proceeds of the collateral to protect the value of the security interest.

c) Simple procedures for creating and enforcing security interests in movable property.

d) Movable collateral registries to notify parties about the existence of a security interest in movable property and to establish the priority of creditors vis-à-vis third parties, comprising:

i. Single and centralized data source registry for all security interests, including non-consensual liens;
ii. Web-based electronic system accessible 24/7;
iii. Registrations performed by creditors or their legal representatives directly in the system;
iv. Information available to the public for searches;
v. Search criteria that includes, at least, a debtor identifier and serial numbered collateral;
vi. Flat and reasonable fees for registrations and searches;
vii. Registrar role limited to management, not to verify and modify information in the registry;
viii. Non-cash payments (debit/credit cards, electronic transfers, or pre-paid accounts);
ix. Defined liability of the registry for errors; and
x. Secured and protected registry data, with established disaster recovery sites.

e) Priority schemes for creditors to determine the sequence in which competing claims to the collateral will be satisfied when the debtor defaults.

f) Speedy and inexpensive enforcement mechanisms to satisfy security interests. Enforcement is most effective when parties can agree on rights and remedies upon default, including seizure and sale of the collateral outside the judicial process.

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23  Modern principles of secured transactions systems have been established by the international community in the UNCITRAL Legislative Guide for Secured Transactions, which is endorsed by the World Bank Group, as reflected in both the “World Bank Principles and Guidelines for Insolvency and Creditor Rights Systems (revised 2005)” and the IFC Guide on “Secured Transactions and Collateral Registries” (2010).
 THAILAND’S BUSINESS COLLATERAL ACT

Thailand’s Business Collateral Act B.E. 2558 (2015) was published in the Royal Thai Government Gazette on 5 November 2015 and became fully effective on 2 July 2016. The objective of the Act is to provide SMEs with greater access to sources of investment for their businesses and boost Thailand’s economic growth. Under the Thai Civil and Commercial Code (CCC), the only security a borrower could pledge was a mortgage, and only land and buildings could be mortgaged. Borrowers, or a pledgor, also had to deliver the pledged property to the lender to create a valid and binding pledge. A floating charge was an alien concept.

Under the Act, limitations on the types of assets that can serve as collateral have been eliminated. It is now possible to have a business, right of claim or movable property of the security provider used to operate a business, such as machinery, inventories or raw materials, real property, intellectual property or any other asset specified in the ministerial regulation as collateral. The Act creates a new type of contract, known as a business collateral contact, between a borrower or security provider who agrees to provide pre-agreed assets, and a lender or security receiver who in turn lends money against those assets.

Key provisions under the Act include:

- A security provider can be either an individual or legal entity. However, security receivers must be a financial institution (or any person specified in the ministerial regulation).
- A security provider retains the right to possess, use, exchange, dispose, transfer or mortgage the collateral, including using it in the manufacturing process, provided the security provider cannot pledge the collateral under the Act further; otherwise the pledge will be voidable.
- A business collateral contact must be made in writing and registered centrally.
- A new office, known as the Business Collateral Registration Office, is to be established in the Department of Business Development of the Ministry of Commerce, which will be responsible for the registration of security, including the amendment and cancellation of the registration records, as well as making those records public.
- A security receiver has a preferential right to debt payments from the collateral before other creditors regardless of whether the collateral is transferred/assigned to a third party or not.
- In cases of enforcement of a business that is registered as collateral, enforcement action must be undertaken by a security enforcer who is required to be licensed.
- The Act also sets out the methods of enforcement for assets and business given as collateral, which differ from the CCC. In the event the collateral under the Act is also mortgaged, the mortgagee is permitted to enforce the mortgage under the procedure under the Act.

MOVABLE ASSETS AS COLLATERAL FOR SME FINANCE: THE EXPERIENCES OF CHINA AND MEXICO

China

In 2005, China embarked on reforms of its movable collateral framework to encourage financing against valuable movable assets. Before the reforms, the use of movable collateral under Chinese law, especially intangible collateral such as accounts receivable, was a key constraint for SME financing as bank lending was largely based on real estate collateral. SMEs do not typically possess. The reform process had three phases: development of property law; creation of an electronic registry for accounts receivable and leases; and training of lenders to use movable assets as a basis for lending. Since China’s reform of a movable collateral framework and establishment of the receivables registry, SMEs can now use a wider range of assets, such as receivables, as a basis for borrowing. In the three years (2008–11) since the new system began operating, lenders have granted more than USD 1.5 trillion in loans secured with receivables to more than 100,000 businesses, more than half of which are SMEs. These system reforms have also led to the development of leasing and factoring industries, which have grown substantially over the same period.

Mexico

Mexico has progressively introduced reforms to its secured transactions legal system over the last few years. However, the one that transformed the lending scenario for SMEs was the creation of a nationwide movable collateral registry in October 2010. With the new registry, the number of loans to businesses has increased by a factor of four, to around 23,000 in June 2011. These 23,000 loans have generated more than USD 70 billion in financing to businesses, with SMEs accounting for more than 90 percent of the firms receiving those loans. The reform has also saved borrowers an estimated (cumulative) $1.3 billion in registration fees associated with the registration of security interest in the previous system. About half the loans granted have gone to agribusinesses and farmers.


Given the relatively weak financial infrastructure and human resources in EMDEs, these economies could begin with the following reform measures for secured transactions:

a) Raise awareness in the public and private sector about the importance of secured transactions and collateral regimes;

b) Develop simple laws and regulations based on best-practice principles, considering the local context and sophistication of the financial sector;

c) Develop registries that are sustainable and cost-effective based on local capacity to operate the registry;

d) Build the capacity of stakeholders to implement the reforms, including user training that focuses on the financial sector and business community; and

e) Develop out-of-court enforcement mechanisms and capacity building programs for judges and enforcement officers for security interests.

AUSTRALIA’S PERSONAL PROPERTY SECURITIES REGISTER: AN EXAMPLE OF A WELL-FUNCTIONING COLLATERAL REGISTRY

Under the oversight of the Australian Financial Security Authority, which has more than 100 full-time employees, the Personal Property Securities Register records security rights on personal property, fiduciary transfer of titles, financial leases, assignment of receivables, retention of title sales and judgment claims. Launched 30 January 2012, the registry implemented a two-year transitional period during which secured parties were provided temporary protection of security rights. In 2014, the number of new registrations reached over 2.36 million. Searches soared from nearly six million in 2012 to over 7.3 million in 2014, a sign of rising confidence in the new collateral registry and regime.

Registrations can be made against individual and organizational grantors, and physical presence is not 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, serial number or 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 the high volume of records, the collateral registry has yet to receive any complaints. An administrative mechanism known as the “amendment demand process” is in place to resolve any disputes that arise. The registrar of the Personal Property Securities Register is responsible for its administration. If the registrar receives a complaint that the registration of a party is invalid, they would be tasked with ascertaining whether the registration should be discharged from the registry.

INSOLVENCY REGIME

OBJECTIVES

The insolvency regime is a critical component of SME finance. Credit availability and terms are influenced by insolvency laws as they regulate the exit of firms from the market and ensure orderly resolution of multiple creditors’ conflicting claims. This expands opportunities for recovery for both the bankrupt entity and its creditors, and improves access to SME finance with stronger creditor rights. The failure rate for SMEs is higher than for larger firms, and insolvency frameworks play a crucial role in their life cycle. A sound insolvency framework also plays a vital role in the lending process as the time and cost of insolvency proceedings may discourage unprofitable SMEs from going to court and ultimately lead to them ceasing operations.

Regulators can make provisions in corporate bankruptcy laws for fast-track bankruptcy procedures for corporate SMEs. However, for non-corporate, smaller SMEs, this will involve either a new legal framework for personal insolvency in most countries or updates to personal insolvency legislation. Without an insolvency regime tailored to smaller non-corporate companies, SMEs are exposed to at least three risks:

1) SMEs that are viable, but find themselves in a short-term liquidity crisis, have no “safety valve”. Without a legal framework, the SME cannot seek temporary protection from its creditors, propose a reorganization plan or consolidate debts to deliver higher returns to their creditors.

2) The absence of an efficient and transparent liquidation process to repay creditors and return productive assets to the economy as quickly as possible leaves SMEs vulnerable.

3) Without a legal framework, individual SME owners cannot be discharged from their debt. When an SME fails, its outstanding obligations will be the obligations of the individual in perpetuity, unless specifically forgiven by creditors.

Insolvency regulations and mechanisms specifically focused on SME conditions, including creative methods of asset resolution, can provide sustainable solutions to SME indebtedness. However, SME-specific practices may work in some economies, but not others. The main issue is that, in many jurisdictions, these mechanisms have only been introduced recently and are not yet commonplace.

One SME-specific insolvency practice, the out-of-court workout (OCW), is a flexible mechanism used to negotiate a multilateral contractual agreement with creditors to change a debtor’s composition of assets and liabilities without judicial intervention, thereby preventing the liquidation of a viable firm. Some economies have established OCWs based on the INSOL principles, establishing a global approach to multi-creditor workouts. Despite the advantages of OCW mechanisms in facilitating lending to insolvent SMEs, very few economies have implemented specific OCW regulation frameworks, and in most jurisdictions the mechanism is rarely used in practice.

OCWs were first introduced by UK regulators during the industrial recession of the mid-1970s, when commercial banks experienced high levels of non-performing loans (NPLs). Many companies were under financial stress and the insolvency regime lacked effective mechanisms for voluntary restructuring. In response, the Bank of England (the central bank) implemented a series of informal agreements between debtors and banks, known as the London Approach, to rehabilitate distressed but potentially viable firms. These agreements consisted of a set of principles for voluntary workouts, providing general guidance to banks, companies and other creditors on how to proceed when facing financial rehabilitation. The London Approach had four guiding principles:

1. Lending banks will not exercise their rights to initiate an official insolvency process;
2. Any decision made will be based on reliable information to be shared among all lending banks and remain confidential;
3. Banks will work together to formulate a collective view on whether support for the debtor should continue and, if so, in what form; and
4. All lending banks will share the burden of supporting the debtor equally.

The success of the London Approach inspired the use of OCWs in several economies, including Indonesia, Malaysia, the Republic of Korea and Thailand, which adopted variants of the London Approach with customized solutions to restructure companies in financial difficulty during the 1998-2001 Asian crisis.

24 See Simeon Djankov, Caralee McLiesh and Andrei Schleifer, 2006, “Private Credit in 129 Countries”.
29 Malaysia, for example, established the Corporate Debt Restructuring Committee (CDRC) in 1998 with the support of Bank Negara Malaysia to provide a forum and framework for creditors and debtors to reach voluntary agreements. The CDRC was formed to provide a platform for financial institutions and corporate borrowers to work out possible debt restructuring schemes amicably and collectively without resorting to legal proceedings.
The 2008 global financial crisis prompted several other countries to adopt the London Approach as defaults and illiquidity for many SMEs led to an increase in NPLs. As the vulnerabilities and inadequacies of insolvency procedures in many economies became evident, courts became overburdened and insolvency regimes lacked the capacity for voluntary restructuring. Judicial insolvency procedures were time-consuming and expensive, either reducing the value of the company (in the case of judicial reorganizations) or preventing efficient reallocation of assets (in the case of in-court liquidations).

Another option, pre-insolvency proceedings, is employed to restructure businesses before they become formally insolvent and are defined as collective proceedings under the supervision of a court or an administrative authority that give a debtor in financial difficulty the opportunity to restructure at a pre-insolvency stage and avoid the commencement of formal insolvency proceedings. Such procedures involve a judicial or administrative authority—most often a court—and the binding effect of arrangements reached during the proceeding. The treatment of contracts is the key element in insolvency procedures. Including pre-insolvency proceedings in insolvency frameworks plays an important role in fostering a culture of early restructuring and second chance that encourages economic agents to be entrepreneurial and take sound economic risks.

The establishment of specialized insolvency proceedings—expedited and simplified judicial debt restructuring or liquidation procedures targeted to firms of a specific size or market—are another recent insolvency reform trend. While this type of mechanism has been implemented across economies in all regions, data shows there are few economies where it is used in practice.

### POLICY GUIDELINES

In broad terms, legislation on personal/SME insolvency should provide for:

- a. A transparent process by which entrepreneurs can seek to rescue their troubled businesses (including methods to propose rearrangement plans to creditors);
- b. A clear method for liquidating the business should the business fail, repaying creditors in a timely manner and discharging remaining debts;
- c. Clear protections for creditors, including lifetime limits on the number of times an individual can go bankrupt and punishments for fraudulent behavior; and
- d. A balance between debtor and creditor protection.

In more practical ways, regulators can decide whether any of these insolvency channels suits their specific conditions and put relevant regulations and mechanisms in place. Some options are outlined below.

### OUT OF COURT WORKOUTS (OCW)

The most common feature of a legal framework for OCW is a standstill period during which creditors cannot enforce their claims. This feature is found in all regions and income levels, from Chile to Greece, India, Macedonia, New Zealand, the Philippines and South Africa. The second most common feature is a good faith negotiation requirement, which is present in economies such as Malaysia and Uruguay. Finally, a commonly used feature in a variety of economies is a recommendation to disclose all relevant information (for the debtor and creditors).

Inspired by the London Approach, in 2000, the International Association of Restructuring, Insolvency and Bankruptcy Professionals (INSOL) developed a global approach to multi-creditor workouts that could be useful for AFI members. The INSOL Statement of Principles for a Global Approach to Multi-Creditor Workouts (INSOL Principles) include the following:

- a. Parties should agree on a standstill period, during which the debtor prepares a proposal for resolving its financial difficulties;
- b. During the standstill period, creditors agree to take no action against the debtor and distribution priorities remain unchanged;
- c. During the standstill period, the debtor should not take any action that might adversely affect the prospective return to creditors;
- d. Creditor should coordinate their positions, for example, via committees or professional advisers;
- e. Debtor should provide creditors and advisers with timely relevant and information about its financial situation;
- f. Proposals should reflect the applicable law and relative positions of relevant creditors;
- g. Information provided by the debtor should be treated as confidential and should be available to all creditors; and

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32 For further details, see: World Bank Group, 2018, “Improving Access to Finance for SMEs: Opportunities through Credit Reporting, Secured Lending and Insolvency Practices.” The study draws on Doing Business data obtained through a questionnaire administered by the World Bank Group to legal experts, insolvency practitioners and judges in 190 economies, as well as available literature.
33 For more details, see The World Bank’s “Principles for Effective Insolvency and Creditor Rights Systems” (the Principles), which distill international best practices on the design of these systems, emphasizing contextual, integrated solutions and the policy choices involved in developing those solutions.
**OUT-OF-COURT WORKOUTS IN LATVIA**

In 2009, faced with one of the highest levels of indebtedness in Europe, Latvian authorities designed a strategy to implement voluntary debt-restructuring mechanisms, such as out-of-court workouts (OCWs). A consultative committee was established comprised of representatives from the Ministry of Justice, the State Insolvency Administration, the Latvian Commercial Bank Association, Latvian Certified Insolvency Process Administrator Association, the Latvian Labor Confederation, the Foreign Investor’s Council in Latvia, the Latvian Chamber of Commerce and Industry and the Latvian Borrower’s Association.

The Consultative Committee approved voluntary out-of-court settlement guidelines in August 2009 that provided a set of high-level practices based on the INSOL principles and were modified to align with Latvia’s insolvency framework. The guidelines were published on the website of the Ministry of Justice, and the government organized workshops and training to raise awareness and promote the use of the guidelines among stakeholders (banks, insolvency practitioners).

Latvia’s top banks identified the OCW guidelines as pivotal in addressing the widespread debt issues in the corporate sector caused by the financial crisis. Based on information from the Financial and Capital Market Commission (FCMC), most banks in Latvia have incorporated these guidelines in their internal procedures, and creditors and debtors can now agree more easily on changes to the terms of debt repayments. This has allowed debtors to continue to do business without initiating insolvency proceedings in court, freeing up resources in the court system. The OCW also allows creditors and debtors to address collective action problems through the provision of standstills or moratoriums, and they can encourage transparency and good faith in negotiations.

In some economies, pre-insolvency proceedings are not adequately regulated or are not regulated at all by insolvency laws. Since there is no comprehensive standard for good practices, every economy adopts slightly different mechanisms. Variations between pre-insolvency procedures across economies can make cross-border enforcement difficult, resulting in financial losses for both creditors and shareholders (particularly sub-optimal debt recovery) and hampering the reorganization efforts of groups of companies with subsidiaries in other jurisdictions.\textsuperscript{15}

**SPECIALIZED INSOLVENCY PROCEEDINGS\textsuperscript{16}**

In-court corporate insolvency procedures are of paramount importance for economic growth and market stability. They allow viable businesses to be successfully preserved or efficiently closed while helping creditors achieve maximum value of their assets. However, these procedures can be complicated, time-consuming, costly and have extremely rigid structures.\textsuperscript{37} In many cases, by the time the debtor company (or their creditors) initiates insolvency proceedings, the firm is no longer viable, resulting in a loss of value, and compromising the preservation of the company at the expense of legal procedural certainty, including the protection of creditors’ rights.\textsuperscript{38}

Specialized insolvency proceedings may reduce the risk of business failure by enabling targeted, expedited and simplified judicial debt restructuring or liquidation procedures.\textsuperscript{39} Many economies have begun to implement streamlined, flexible and accessible insolvency mechanisms by customizing procedural rules and reducing the burden on firms without jeopardizing the necessary creditor safeguards.\textsuperscript{40}

Several economies are introducing specialized insolvency proceedings as part of insolvency law reforms. In implementing SME-specific insolvency proceedings, regulators can focus on features such as flexible commencement standards, streamlined methods of creditor participation and fast-track mechanisms and reduced costs in each procedural phase.\textsuperscript{41} The specialized proceedings mechanisms should also be balanced with incentives for both debtors and creditors. Incentives for debtors can include a moratorium, so that creditors cannot enforce their claims outside the insolvency process, and allowing the debtor to remain in control of business operations. Incentives for creditors can include flexibility in negotiating a settlement (reorganization plan) and securing a better return by preserving the debtor’s business (which might have ceased operations with regular insolvency procedures).\textsuperscript{42}

**DIFFERENT APPROACHES TO SPECIALIZED INSOLVENCY PROCEDURES**

Economies that have implemented regulatory reforms in this area have adopted one of two approaches. The first is to rely on the general insolvency framework and create exceptions in certain procedural steps for simple claims to make the insolvency framework more efficient and less costly. The second is to adopt a new insolvency regime explicitly tailored to the needs of SMEs.

Japan and the Republic of Korea have opted to implement specialized insolvency proceedings for SMEs. The SME insolvency regime in Japan differs from ordinary insolvency proceedings by offering a shorter timeline, specific rules for eligibility and commencement and more flexible requirements for proof and objection of claims.

Other jurisdictions, such as Argentina, Germany and Greece, have adopted exceptions to their insolvency legislation that apply to “small cases.” In Argentina, for example, the formation of a creditors’ committee is not mandatory in cases with fewer than 20 unsecured creditors for firms with under 20 employees (this is a requirement in regular insolvency proceedings). In Greece, debtors with assets of less than 100,000 euros ($123,000) are eligible to commence simplified procedures with an expedited process for verification of creditors’ claims.

Africa’s 17 OHADA economies have implemented a unified insolvency regime that introduced a simplified reorganization proceeding for small companies. Under this fast-track procedure, a reorganization plan must be decided within two months; there is no requirement to organize a general meeting of creditors or for the judge to supervise every step of the process, and there is no possibility for an appeal.


\textsuperscript{36} Typically, specialized proceedings can also be referred to as “simplified proceedings” and offer various procedural advantages, such as shorter statutory limits, fewer creditors’ meetings, limited court appearances, fewer opportunities for appeal, less judicial oversight and lower court fees.

\textsuperscript{37} Goudzwaard, T.M. 2014, “Introducing pre-insolvency procedures in the European Insolvency Regulation: A search for common grounds to introduce pre-insolvency procedures in the European regulatory field”, University of Amsterdam, Faculty of Law.


\textsuperscript{39} European Commission, 2011, “Insolvency proceedings in the context of EU company law European Parliament resolution of 15 November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law (2011/2006(INI))”.

\textsuperscript{40} World Bank, 2016, “Insolvency and Creditor/ Debtor Regimes Task Force Report”.


\textsuperscript{42} Ibid.
ALTERNATIVE SME FINANCE INSTRUMENTS: LEASING AND FACTORING

OBJECTIVES
Access to finance for SMEs can be facilitated by NBFIs, which can offer a range of non-bank instruments. Two widely used instruments are (a) hiring purchase transactions, such as leasing of machinery or equipment; and (b) factoring or discount purchasing of accounts receivable and other forms of supply chain finance.

LEASING AND FACTORING
Leasing is a complementary source of investment finance while factoring is an alternative source of working capital, particularly in countries with weak credit infrastructure.

The financial concept of factoring is defined as a type of “supplier financing in which firms (seller) sell their creditworthy accounts receivable at a discount (generally equal to interest plus service fees) and receive immediate cash from a specialized institution (factor).” The lender purchases a firm’s accounts receivables (invoicing) at a discount and, in the case of non-recourse provisions, collects invoices directly from the parties that owe money.

While more expensive than bank loans, an advantage of leasing is that it focuses on the firm’s ability to generate cash flows from its operations to service the lease payment, rather than on its credit history or ability to pledge collateral. Similarly, factoring addresses the problem of SME opacity by focusing on the quality of the obligor; in effect, a risky supplier can transfer its credit risk to a higher quality buyer.

A variation known as “reverse factoring”, or supply-chain financing, has become a popular financial instrument. Through supply-chain finance, financial institutions purchase receivables only from high-quality credit buyers rather than from a portfolio of buyers of specific sellers. This enables low-risk loans to be issued to high-risk suppliers (SMEs), which is particularly useful in countries with underdeveloped contract enforcement regimes and weak credit information systems.

The role of NBFIs in SME finance can be enhanced by reforming tax, legal and regulatory environments, and by supporting the introduction of technological platforms that enable a wider variety of financial products and services to be developed, as these lower the costs of financial access and reach previously unserved SMEs.

POLICY GUIDELINES ON LEASING
A good practice legislative framework for leasing would:

a. Define leasing and the rights and responsibilities of the parties to a lease;

b. Develop a unified registry for movable collateral where all security interests are recorded and protected;

c. Clearly define the process for registering leased assets;

d. Clearly define and enforce repossession procedures;

e. Ensure the right of the lessor (as owner) to repossess a leased asset, regardless of the type of breach by the lessee;

f. Ensure that tax laws are not biased against leasing. Income tax treatment of leasing and loans should be similar, and value-added tax rules should clarify that a leasing operation is a financial service, not the sale of a good or rental; and

g. Insolvency regimes must clarify the rights of lessors and lessees under bankruptcy. Lessors’ rights (as a secured lender) under bankruptcy should be preserved as leased assets do not belong to the insolvent company and should be returned to the owner (the lessor).

EXAMPLES OF GOOD PRACTICES

FOSTERING SME LENDING THROUGH LEASING IN JORDAN
Jordan’s Ministry of Industry and Trade, in coordination with the International Finance Corporation (IFC), introduced an initiative in 2006 that aimed to improve the leasing environment in Jordan and promote and increase the volume of leasing activities.

The project’s main activities include: (i) providing support to policymakers to draft, lobby and promote leasing legislation based on best practices; (ii) building the capacity of leasing stakeholders (e.g., financial institutions, equipment suppliers, investors) through consultations and training; (iii) raising awareness of the benefits of leasing to SMEs to finance business assets; and (iv) promoting and facilitating leasing investments.

Four laws have since been introduced: Law on Leasing, Movable Leased Assets Registration Instructions, Registration Instructions for Leased Vehicles; and Internal Procedures for Land Registration. As a result of the initiative, financial leasing has become more favorable and Jordan’s leasing market has grown substantially.


43 Here, alternative finance refers to leasing and factoring. However, alternative finance can encompass several other non-bank lending instruments, such as intellectual property (IP) financing, equity type financing for small growing firms, such as angel investing, venture capital, mezzanine financing and small business investment companies (as in the US and Malaysia). In addition, there are FinTech-enabled alternative finance instruments, such as crowdfunding, which will be discussed in Volume 2 of this Guideline Note.


POLICY GUIDELINES ON FACTORING

A good practice legislative framework for factoring should facilitate the sale, or assignment, of receivables and be less dependent on the business environment than traditional lending products. In a weak business, factored receivables are removed from the bankruptcy estate of the seller and become the property of the factor. In this case, the quality and efficacy of bankruptcy laws are less important. Nevertheless, factoring may still be hampered by weak contract enforcement and requires good historical credit information on all buyers. In many emerging markets, the credit information bureau is incomplete (i.e. may not include small firms) or non-bank lenders, such as factors, are prohibited from joining. In the case of exporters, it might be prohibitively expensive for the factor to collect credit information on firms around the world.46

EXAMPLES OF GOOD PRACTICES

THE SUCCESSFUL IMPLEMENTATION OF FACTORING PRACTICES IN MEXICO

Nacional Financiera (NAFIN), a Mexican development bank that has provided movable asset financial products since 1980, is an example of successful implementation of factoring and reverse factoring (supply chain finance). Established with the advice of the World Bank Group, NAFIN’s factoring program provides reverse factoring services to SMEs through its cadenas productivas (productive chains) program. The main feature of the program is that it links small, risky suppliers with large, creditworthy, often foreign-owned firms that buy from them. Small firms can then use the receivables from their larger clients to secure loans.

Participating SMEs must be registered with NAFIN and have an account with a bank that has a relationship with the buyer. Following a factoring transaction, funds are transferred directly to the supplier’s bank account and the factor becomes the creditor (i.e. the buyer repays the bank directly). The factor collects the loan amount directly from the buyer after a period of 30 to 90 days. NAFIN requires that all factoring services are offered without additional collateral or service fees, at a maximum interest rate of seven percentage points above the bank rate (five percentage points, on average), which is about eight percentage points below commercial bank rates. All factoring is conducted without recourse, which allows SMEs to increase their cash holdings and improve their balance sheets.

The sale of receivables from the supplier to the factor and the transfer of funds from the factor to the supplier are done electronically. NAFIN’s electronic platform provides 98 percent of its factoring services online, reducing both time and labor costs and improving security. The electronic platform allows all commercial banks to participate in the program, giving national reach to regional banks. NAFIN has grown rapidly thanks to this technology, increasing its factoring market share from two percent in 2001 to 60 percent in 2004. NAFIN’s platform also reduces fraud, which is systemic in the factoring business in the US and other developed economies. Since only large buyers can enter new receivables, sellers cannot submit fraudulent receivables. Moreover, since the bank is paid directly by the buyer, suppliers cannot embezzle the proceeds.

The success of the NAFIN program highlights how the use of electronic channels can reduce costs and provide a larger portfolio of financial services to SMEs. The case also underscores the importance of legal and regulatory support—Mexico’s electronic signature and security laws have proven critical to NAFIN’s success and could be a model for other developing economies.


SUPPLY CHAIN FINANCE: CAPITALBAY, MALAYSIA

CapitalBay is a multi-bank supply chain platform providing invoice financing and supply chain financing solutions. Based in Malaysia, the company was set up in mid-2016 to provide financing solutions that would help SMEs grow and unlock cash flow from their supply chain. The company has been growing, and in 2018 a seed round of investments raised over RM two million from Singapore-based KK Fund and Cradle, a program of Malaysia’s Ministry of Finance.

When small businesses supply to larger corporates, the money does not always flow back smoothly, with red tape and procedures typically delaying payments for 90 days after the invoice date. Meanwhile, small businesses must pay their raw material suppliers and cover operational costs, often taking out bank loans to make ends meet. CapitalBay addresses this cash flow issue through its platform, partnering with financial institutions (e.g. Leong Bank) to ensure small business invoices are paid quickly (with a small discount). The SME’s corporate clients still owe the same amount of money, but to the financial institutions rather than the small business. At the same time, large corporate buyers can extend their payment terms in a sustainable manner, reducing overall costs in the supply chain. Meanwhile, financial institutions can base credit scores on an SME’s corporate client rather than the SME’s score, which can then benefit from discounts on loans.

Source: https://vulcanpost.com/621713/startup-sme-cashflow-capitalbay-malaysia-funding/.

POLICY AND MARKET DEVELOPMENT INITIATIVES

CAPACITY BUILDING AND TRAINING

Building the capacity of the banking sector and disseminating appropriate SME data are important in SME finance for three reasons: (a) banks can identify high-value economic opportunities with SMEs and determine whether they are feasible; (b) financing systems can be developed and instruments adapted to SMEs rather than large corporates; and (c) banks can mitigate information asymmetry from the demand side and provide better information and advice to their SME customers on available services, products and schemes.

The central banks of India and Malaysia have implemented specific training programs for bankers to improve the quality of their advisory services and address the information gaps SMEs face. This will eventually enable SMEs to gain access to financial services that meet their needs and improve their capabilities, particularly in the area of financial management and business strategy.

FINANCIAL EDUCATION AND AWARENESS

Financial education is an important element of SME access to finance policies as it raises public awareness of the schemes and services available to SMEs and builds capacity in financial management, helping entrepreneurs to be more financially savvy and bankable. An SME Finance Working Group survey of 25 regulators from member institutions in 27 countries in East Asia, South Asia and Southeast Asia, combined with secondary research, found that these AFI member institutions have been strong proponents of expanding outreach for financial education and awareness.

EXAMPLES OF GOOD PRACTICES

FINANCIAL EDUCATION PROGRAMS IN BANGLADESH AND MALAYSIA

Bangladesh Bank recently implemented the Skill for Employment Investment Program (SEIP) with financial support from the Asian Development Bank (ADB) and the Swiss Agency for Development and Cooperation (SDC). The project aims to train 10,200 people in the next three years and each course has a separate module on MSMEs. Meanwhile, Bank Negara Malaysia (BNM) conducts regular outreach and awareness programs, including some in collaboration with financial institutions and other agencies. BNM has a dedicated SME Promotions team that regularly participates in events, seminars and exhibitions nationwide. Depending on the attendees and focus of the events, financial education topics are routinely included.

Source: AFI, 2015, “Guideline Note 16: SME Financial Inclusion Indicators Base Set”

MALAYSIA’S TRAIN-THE-TRAINERS PROGRAMME ON SME FINANCING

Bank Negara Malaysia’s Train the Trainers (TTT) Programme on SME Financing was developed in collaboration with financial institution associations, including SME Corporation Malaysia, Credit Guarantee Corporation Malaysia Berhad, Credit Bureau Malaysia Sdn. Bhd. and Agensi Kaunseling dan Pengurusan Kredit. The TTT program train a pool of financial institution officers nationwide to become trainers and conducts a series of briefings for internal staff and training sessions for SMEs. The program is part of a continuous effort to enhance the capabilities of financial institutions to deliver quality advisory services and address the information gaps SMEs face.

The TTT program raises awareness of the various funds and financing schemes, capacity building initiatives and financial and advisory services available to SMEs, and improves their understanding of financing requirements. This will enable SMEs to gain access to financial services and improve their capabilities, particularly in financial management and business strategy. Bank Negara Malaysia conducted a TTT workshop in December 2015, covering comprehensive modules that addressed knowledge gaps related to access to financing. A CD of the TTT modules has also been developed to support staff training and capacity building. It includes videos of presentations by resource persons, slide presentations, trainers’ notes, frequently asked questions (FAQs) and relevant e-brochures.

SME Corp, in collaboration with the Association of Banks in Malaysia, will roll out 22 SME financing seminars in all states in the country. The resource persons will be among a pool of trainers representing the associations of financial institutions. To raise awareness of TTT programs available for SMEs nationwide, BNM has developed video trailers that will be broadcast on social media platforms and partner websites.

CREDIT INFORMATION AND CREDIT BUREAUS FOR SMEs

CREDIT INFORMATION SYSTEMS (CIS)
Credit reporting systems provide lenders with accurate and credible information that reduces the risk of lending (loan losses). Credit reporting systems are comprised of Public Credit Registries (PCRs) and Private Credit Bureaus (PCBs), and have two key functions in a financial system: supporting banking supervision and promoting access to finance by reducing risks (or perception of risks) for lenders.

A PCR is a repository of data collected by the central bank or other financial regulator that incorporates information from banks and regulated financial institutions that allow banking supervisors to predict bank portfolio performance. PCRs are also increasingly becoming information providers as well as supervisors by returning the collected data to lenders in the form of basic credit reports. In contrast, a PCB collates data from a broad range of financial institutions (banks, NBFI, utility companies, telecoms, etc.), then distributes it to participating members through a common information-sharing mechanism (e.g. Experian, Equifax, Trans Union, CRIF, CreditSecure).

Lenders make use of credit reporting systems to screen potential borrowers and monitor their performance. Assessing the creditworthiness of borrowers is a major part of the cost of assessing a loan, therefore, an effective credit reporting system can also reduce a lender’s operating costs. These cost savings dramatically reduce the size at which a loan becomes profitable, which improves access to credit for small borrowers. Credit reporting systems may also facilitate non-collateralized lending by providing sufficient information about a borrower’s credit repayment history to offset, or reduce, the need for physical collateral.

PCBs that incorporate “positive” credit history data have proven a valuable tool in the prevention of overindebtedness. Without such information, lenders find it difficult to evaluate the total indebtedness of an individual or business when they apply for new credit. This often results in individuals receiving too much credit, which they ultimately cannot service.

Credit scoring is a statistical method of evaluating the probability a prospective borrower will fulfill their financial obligations associated with a loan. The predictive value of credit scores is generally higher than assessments derived from credit histories alone, especially when applied to an identified and homogeneous group of borrowers. Initially, credit scores were applied to individuals. However, the use of credit-scoring techniques has come to be extended to other borrowers, including SMEs.

POLICY GUIDELINES

a. An effective CIS requires credit-reporting service providers to collect sufficient, relevant and usable data. Mandatory data collection and real-time data access can help promote the rapid build-up of coverage and, with appropriate oversight, facilitate a more reliable database.

b. In the context of emerging or developing economies, where the information environment is relatively weak, there is a need to start collecting information from all relevant players inside and outside the financial services industry, including microfinance institutions, banks, NBFI, utilities and retailers. Credit bureaus should be encouraged to provide additional services, such as credit scores. Finally, credit-reporting service providers should be able to effectively identify borrowers, which may necessitate intergovernmental cooperation to allow access to data in public records.

c. Some key elements of a credit-reporting regulatory framework include:
   i. Establishing the scope of data and type of data contribution;
   ii. Including all relevant and available data (positive and negative data on both individuals and businesses);
   iii. Participation of non-regulated entities;
   iv. Defining the responsibilities and liabilities of each participant;
   v. Ensuring that data is detailed at the account level;
   vi. Including historical data; and
   vii. Protecting consumers’ rights, such as the right to object to their information being collected, the right to be informed, the right to access data and the right to challenge data.

Some countries, such as India, have introduced SME rating agencies and/or specialist PCBs to generate and provide more information to prospective lenders. This is a relatively recent initiative that merits consideration by other countries. There are some critical issues that need to be revisited, such as the degree of independence of the ratings provider (like those observed with credit rating agencies). It is also possible that these agencies require a critical market size to break even and become profitable. If this is the case, development finance institutions (DFIs) and governments could consider regional solutions involving regional hubs that are large enough to dilute fixed costs, but also offer national expertise.
SME FINANCE GUIDELINE NOTE

EXAMPLES OF GOOD PRACTICES

CREDIT BUREAU SINGAPORE
Credit Bureau Singapore (CBS) was created in 2002 as the country’s first commercial credit bureau, with the aim to help lenders make faster and better-informed credit decisions. With support from the Government of Singapore, CBS recognized at the beginning of the financial crisis that lending to SMEs was tightening and additional tools were needed to reduce information asymmetry. CBS is one of the few private credit bureaus in Southeast Asia that collates data on both consumers and businesses. Through its association with Dun & Bradstreet, CBS has access to the trade credit data of thousands of Singaporean companies.

In May 2010, in association with Fair Isaac Corporation, CBS launched a custom credit scoring solution designed to accurately quantify the risk (probability of default) associated with SMEs’ credit applications. The algorithm behind the score incorporates credit history data from the business, including trade credit experience, and blends this with the personal credit history of the business owner and/or key stakeholders. This blended score is especially useful in assessing the risk profile of smaller businesses, when detailed financial information is either not available or often unreliable.


CUSTOMIZED PRODUCTS FOR SMES IN THAILAND
SME credit scores
In May 2016, the National Credit Bureau of Thailand began offering FICO SME scores to banks and financial institutions to allow them to better assess the creditworthiness of SMEs. The FICO SME Score, which predicts the probability of delinquency of more than 90 days in the next 24 months, is computed using an empirically derived model supplied with data collected by the National Credit Bureau of Thailand and Business Online Public Company Limited, a private research firm. It generates a three-digit number between 490 and 813 in eight risk bands from AA to HH, which rank orders SMEs according to risk.

The higher the score, the lower the risk
Up to five “reason codes” are returned to the lender to help interpret the score. Using the scores, lenders can make lending decisions that are faster, more accurate and more consistent. Lenders can also use the FICO SME Score to support their “Internal-Ratings-Based” (Retail-IRB) approach to calculating the required minimum regulatory capital. The score applies to different types of products and lenders and can be used to make decisions across the entire life cycle of an account.


COMPANIES DATABASE: FIBEN
Companies Database (France) FIBEN is a corporate database set up in 1982 and managed by the Banque de France to facilitate the implementation of monetary policy and verify the credit quality of bills issued for rediscounting. Credit institutions and public economic bodies have access to the FIBEN database, which contains data necessary for the analysis of credit risk (identity, legal event, management, indebtedness, financial appraisal) and is an important tool for analyzing risk, making decisions and monitoring companies. Companies may also gain access to refinancing through the banking system, using private bills as collateral and supported by the central banks’ payment systems operations. As of November 2009, the total amount of credit issued to SMEs in France was USD 262.4 billion. Credits granted by the banking sector to SMEs increased by over 1.9 percent between November 2008 and November 2009, whereas credits granted to the private sector in general decreased by 0.9 percent over the same period.


CREDIT REGISTRY: BANK NEGARA MALAYSIA
Following the 1997 Asian financial crisis, Bank Negara Malaysia recognized the importance of sharing credit data to improve the quality of lending decisions and prevent overindebtedness. The bank initiated the Central Credit Reference Information System (CCRIS) project, which today provides perhaps the most comprehensive repository of financial data in the region. The data set incorporates information on both individuals and companies and is used by practically all lenders in Malaysia. The CCRIS database is among the best examples of a modern public registry, but while it adequately serves the needs of the retail sector, it has limitations in the SME sector. Recognizing these weaknesses, Bank Negara Malaysia is exploring ways to develop more SME-centric services in cooperation with the Credit Guarantee Corporation of Malaysia and the private sector.

CREDIT GUARANTEE MECHANISMS FOR SMEs

OBJECTIVES

A common public intervention to increase access to credit for SMEs is credit guarantee schemes (CGSs) which, in return for a fee, provide third-party partial credit risk mitigation to lenders by absorbing a portion of the lender’s losses (risks) on the loans made to SMEs in case of default. As lenders assume part of the risk for default, CGSs involve less room for distortion in credit markets than more direct forms of intervention, such as state-owned banks.

CGSs can be a particularly useful instrument to address information gaps in the medium term (especially in countries where the institutional environment is weak) in coordination with credit registries, and to build the capacity of lenders to originate credit and manage risk (e.g. technical assistance to set up SME units in banks). CGSs can also be leveraged to provide countercyclical financing to SMEs during an economic downturn and the accompanying risk aversion and potential credit crunch. CGAs may also have some advantages relative to lenders in spreading and diversifying risks. If lenders face restrictions preventing them from diversifying their loan portfolios (e.g. because their portfolios are geographically concentrated or focused on certain types of borrowers), guarantors may be able to spread out and diversify the risks by providing guarantees to several lenders.

CGSs can be established by either the private sector or public sector. A popular form of private CGA is a mutual guarantee association (MGA) in which members of small business organizations deposit money into a fund that guarantees loans to members of financial institutions. The advantage of MGAs is that member firms have better information about each other than lenders, as MGAs typically evaluate their members carefully and can thus act as a screening device, reducing asymmetric information problems. The fact that other firms are willing to accept joint responsibility for a loan to a firm sends a positive signal to lenders about the quality of its credit. Moreover, MGAs have a group liability structure because all borrowers backed by the scheme have a financial stake in the guarantee fund—there is a cost for all members if other members default and therefore incentives to monitor each other, reducing moral hazard issues.47

If private CGSs can address information asymmetries and risk diversification issues, why are public CGAs prevalent in so many countries? Governments often get involved in these schemes in two different ways: by providing funds to private guarantee schemes, such as MGAs, and by setting up a public credit guarantee scheme.48 Unlike MGAs, public CGSs do not typically have better information about borrowers than lenders, and thus do not directly reduce information asymmetries. In addition, while credit guarantees can serve as a substitute for collateral, they do not reduce moral hazard and adverse selection as collateral does because borrowers are not pledging their own assets and thus do not face an additional cost in case of default. On the other hand, public CGSs might reduce information asymmetries, at least in the long run, by acting as a subsidy for lenders to learn about new groups of borrowers.

In short, public CGSs can be a useful instrument to enhance access to finance for certain groups of borrowers, but their success and financial sustainability hinge on proper design. From a regulator’s perspective, it is important to ensure that CGSs are designed and operated to achieve both outreach and additionality in a financially sustainable way.49 Reaching SMEs that are credit constrained involves risk taking and financial losses. Public CGSs are not expected to make a profit, but they should be financially sustainable in the long term (i.e. able to contain losses and ensure an adequate equity base vis-à-vis its expected liabilities) through sufficient funding, effective risk management and sound operational rules. CGSs are established to address market failures that prevent SMEs from accessing credit at socially desirable levels. Hence, they are not an end in themselves, but a means to solve a problem. It is therefore essential that market failures are analyzed comprehensively to identify and define the problems to be addressed, and to determine whether there is evidence that government intervention through a CGS is justified. It is also important that CGSs are phased out as information asymmetries (i.e. banks’ perceptions of SME risks versus actual risks) are addressed over time.

Public CGSs around the world differ by design, notably management structure operating rules, and by the characteristics of their guarantees, such as the coverage ratio and pricing. These design choices can be critical for the success and financial sustainability of CGSs because they influence the participation of financial institutions, administrative costs and loan default rates.50

48 According to a survey of CGSs around the world conducted by Beck, Klapper and Mendoza (2010), the majority of CGSs in developing and emerging economies are public-schemes, while the majority of CGs in developed countries are MGAs. MGAs are particularly common in Europe. For example, Italy has about 950 MGAs, Germany 24, Spain 20, and France 10.
49 “Outreach” refers to the number of guarantees issued by CGs and the number of outstanding guarantees. In principle, the greater the outreach, the stronger the impact of the CGS on SMEs. However, the impact of the CGS on the supply of credit to SMEs will also depend on whether guarantees are mainly extended to SMEs that are credit constrained, either in terms of access or unfavorable conditions, such as cost and maturity (financial additionality).
POLICY GUIDELINES

The World Bank Group and the Financial Sector Reform and Strengthening Initiative (FIRST) have developed a set of principles for the design, implementation and evaluation of public CGSs for SMEs, which are summarized below.\textsuperscript{51} As noted by the World Bank/FIRST, the success of CGS depends on several preconditions, including: (a) regulations to ensure contract enforcement, fair resolution of contracts and those related to insolvency, collateral, consumer protection and private property; (b) independent judiciary and well-regulated legal, accounting and auditing systems; (c) a comprehensive set of accounting standards and rules; and (d) a sound financial system that can originate and manage credit effectively. With these preconditions, World Bank/FIRST has set forth the following Guidelines:\textsuperscript{52}

> **Principle 1:** The CGS should be established as an independent legal entity based on a sound and clearly defined legal and regulatory framework to support effective implementation of its operations and achieve its policy objectives.

> **Principle 2:** The CGS should have adequate funding to achieve its policy objectives, and the sources of funding, including reliance on explicit and implicit subsidies, should be transparent and publicly disclosed.

> **Principle 3:** The legal and regulatory framework should promote mixed ownership of the CGS, ensuring equitable treatment of minority shareholders.

> **Principle 4:** The CGS should be supervised independently and effectively based on risk-proportionate regulation scaled by the products and services offered.

> **Principle 5:** The CGS should have a clearly defined mandate supported by strategies and operational goals consistent with its policy objectives.

> **Principle 6:** The CGS should have a sound corporate governance structure, with an independent and competent board of directors appointed according to clearly defined criteria.

> **Principle 7:** The CGS should have a sound internal control framework to safeguard the integrity and efficiency of its governance and operations.

> **Principle 8:** The CGS should have an effective and comprehensive enterprise risk management framework which identifies, assesses and manages the risks related to its operations.

> **Principle 9:** The CGS should adopt clearly defined and transparent eligibility and qualification criteria for SMEs, lenders and credit instruments.

> **Principle 10:** The CGS’s guarantee delivery approach should appropriately reflect a trade-off between outreach, additionality and financial sustainability, taking into account the level of financial sector development of the country.

> **Principle 11:** The guarantees issued by the CGS should be partial, providing the right incentives for SME borrowers and lenders, and designed to ensure compliance with the relevant prudential requirements for lenders.

> **Principle 12:** The CGS should adopt a transparent and consistent risk-based pricing policy to ensure that the guarantee program is financially sustainable and attractive for both SMEs and lenders.

> **Principle 13:** The claim management process should be efficient, clearly documented and transparent, providing incentives for loan loss recovery and aligned with the home country’s legal and regulatory framework.

> **Principle 14:** The CGS should be subject to rigorous financial reporting requirements and have its financial statements externally audited.

> **Principle 15:** The CGS should periodically and publicly disclose non-financial information related to its operations.

> **Principle 16:** The performance of the CGS, in particular its outreach, additionality and financial sustainability, should be evaluated systematically and periodically and the findings publicly disclosed.

\textsuperscript{51} For more information, see: The World Bank Group and FIRST Initiative, “Principles for Public Credit Guarantee Schemes for SMEs.”

\textsuperscript{52} Ibid.
EXPERIENCE WITH CGSS: DESIGN ISSUES

In designing a publicly funded credit guarantee scheme, the first question is whether the scheme should be entirely publicly managed or if all or some of its activities should be outsourced to the private sector. Beck, Klapper, and Mendoza (2010) have found that, in most countries, government is heavily involved in the management of the guarantee fund. However, loan assessment and recovery are typically undertaken by the lenders whose loans are being guaranteed. This approach appears to promote the financial sustainability of credit guarantee schemes. Schemes in which the government chooses borrowers and recovers loans typically have higher loan losses than schemes in which the lender performs these tasks.

The second question concerns assessing the creditworthiness of borrowers. International experience suggests that it might be more cost-effective for lenders to assess the creditworthiness of the borrowers being guaranteed, as lenders already have a credit appraisal infrastructure in place. The Korea Credit Guarantee Fund (KODIT), which appraises every loan itself, had operating costs of 7.7 percent of its guaranteed loans by the end of the 1990s (Honohan, 2009). Colombia’s Fondo Nacional de Garantías (FNG) initially appraised all loans in-house and had operating costs of 4.2 percent of the value of outstanding guarantees. It then switched to a system in which lenders can appraise most loans themselves, lowering operating costs to less than two percent of the guaranteed amount.

Another design issue is the coverage ratio, that is, the fraction of the value of an individual loan that the scheme guarantees. When the scheme guarantees less than 100 percent of the value of a loan, part of the credit risk remains with the lender. This helps align the incentives of the guarantor and the lender because it encourages the lender to carefully screen and monitor the loans covered by the guarantee scheme.

Another important consideration is how claims are processed. Costly and time-consuming claims procedures can make the scheme less transparent and credible and might discourage lenders from participating. Therefore, setting clear rules on when and how to pay out guarantees, as well as paying claims without a long and costly verification process, are important considerations. Green (2003) points out that in many developing countries, early guarantee schemes did not have clear conditions under which a guarantee could be claimed by lenders, leading to disputes between financial intermediaries and these schemes. Another key design issue for public credit guarantee schemes is how to determine the fees charged for guarantees. There are two main considerations. First, how to structure the fees. Some credit guarantee schemes charge a flat fee that is the same for all types of guarantees, while other schemes charge fees that vary depending on the characteristics of the guarantee or guaranteed loan. For example, Brazil’s SEBRAE charges higher fees for longer maturity loans (Green, 2003) while Colombia’s FNG charges fees that increase with the coverage ratio.

Yet another design issue is financial sustainability. The performance of public credit guarantee schemes in terms of financial sustainability has been mixed at best. As mentioned above, most of these schemes cannot cover operating expenses with the fee income. For instance, Beck, Klapper, and Mendoza (2010) found that, of the 15 public credit guarantee schemes in their survey reporting complete financial information, 11 have operating losses. The median public credit guarantee scheme in their survey charges 1.5 percent of the guarantee amount in fees, has administrative costs of nine percent and credit losses of five percent. Even if fee income does not fully cover the total costs, public credit guarantee schemes can in principle be financially sustainable because they can make up for operating losses with the investment income from their guarantee funds.


The experience of CGSSs in the UK and US illustrate that, without close monitoring, there is a tendency for financial institutions to take advantage of loopholes or lack of oversight. This would be a particular risk in emerging and developing economies where capacity for close monitoring is limited.
THE UK’S SMALL FIRMS LOAN GUARANTEE SCHEME (SFLG)

Under this small business guarantee scheme, which commenced in 1981, banks could lend up to £250,000 to eligible businesses and have 75 percent of any default losses met by the government. However, as the scheme matured, losses mounted. In 2004, the Graham Report documented bad debt losses of approximately 20 percent. However, an ex post review published in 2010 commissioned by SFLG concluded that it had been highly successful, with a substantial amount of additional, and the positive effects of the “loans obtained in 2006 show the overall benefits outweigh the cost to the economy in terms of gross value added.” The report did not fully analyze the cost of the defaults of the scheme against the purported benefits. In 2009, SFLG was replaced by the Enterprise Finance Guarantee scheme, which increased the size of eligible loans to £1 million. However, just three years later, an investigation by The Guardian newspaper (February 23, 2013) concluded that the scheme had misused over £200 million ($300 million) of the funds that had been used for the guarantees.53 Further investigations reached similar conclusions,54 and there were reports that the scheme was being investigated by public prosecutors for misuse of funds by the banks.


PRESHIPMENT EXPORT FINANCE GUARANTEES (PEFG) FOR SME EMERGING EXPORTERS55

Many SME emerging exporters in developing countries have inadequate access to short-term working capital to finance their export transactions. To help improve access to capital, several countries have established preshipment export finance guarantee (PEFG) facilities.

THE PROCESS OF EXPORTING AND EXPORT FINANCE

When financing trade transactions, financial institutions face at least three types of risks, or perceptions of risk, associated with preshipment and postshipment export financing:

> Nonpayment risk or buyer risk: The risk that the foreign buyer does not pay exporters.
> Nonperformance risk or supplier risk: The risk that the exporter will not fulfill the order, cannot make the product for technical reasons, or cannot deliver it on time and according to the price and quality standards identified in the export order or the letter of credit (L/C).
> Third-party risk: Other risks in the transactions process, such as transport risks.

If these actual or perceived risks are high relative to the return on lending, financial institutions will not provide financing for export transactions. In response, credit enhancement instruments have been developed to cover part of the risks during both the pre- and post-shipment stages of export transactions. For example, export credit insurance insures banks against nonpayment risks, while preshipment export finance guarantees cover a portion of nonperformance risk. Insurance related to transport, fire, etc., covers other risks.

AVAILABILITY OF PRESHIPMENT EXPORT FINANCE

Enterprises require preshipment financing to fulfill export orders. This can come from the exporter’s own resources, buyer credit, or short-term credit from financial institutions, which provide the bulk of preshipment financing needs. However, financial institutions may prefer to serve the preshipment finance needs of large, well-known exporters than emerging and small exporters (ESEs). One reason is that banks in many countries have underinvested in the systems and training

54 Postshipment finance is finance provided against shipping documents (exchange bill purchasing). It is also provided against duty drawback claims. The guarantees described in this Guideline Note do not cover postshipment financing. In providing postshipment finance, banks or other providers rely on the exporter’s access to export credit insurance, which is usually provided by the export credit agency of the exporting country.
necessary to adequately appraise nonperformance risks, especially for ESEs. Instead, they mainly favor collateralized lines of credit, which firms use at their discretion. As such, large and well-known exporters can generate preshipment working capital from bank overdraft facilities backed by the exporters’ collateral. ESEs, on the other hand, do not have adequate internal resources and lack access to short-term bank loans or credit because of their perceived high credit risks. Even if these exporters hold a confirmed L/C, banks may still require a pledge of the exporter’s assets before they extend the preshipment loan.

The reasons behind this market failure are information asymmetries on the part of banks about ESEs’ ability to execute export orders according to buyers’ standards of quality, cost and delivery (i.e. nonperformance). Export credit insurance and guarantees, offered by most export insurance agencies, do not address this market failure. Instead, they protect exporters and banks granting export finance against foreign buyers’ nonpayment risks rather than exporters’ nonperformance.

OBJECTIVES AND PRINCIPLES OF PRESHIPTMENT EXPORT FINANCE GUARANTEES

The objective of PEFGs is to encourage financial institutions to provide preshipment financing to ESEs with viable export contracts whose perceived nonperformance risk is greater than the actual risk. The PEFG does this by guaranteeing a portion of short-term preshipment export loans, thus assuming a portion of (perceived) risks temporarily. As such, it allows financial institutions to evaluate the nonperformance risks of ESEs over time, serving as a catalyst for developing sustainable preshipment financing for ESEs. The PEFG approach is different from other SME guarantee schemes in that it is transaction-based and self-liquidating. PEFG facilities could be established, operated and administered by a government agency (normally the export credit insurance agencies or Ex-Im banks).

POLICY GUIDELINES

In addition to an appropriate incentive regime that does not penalize exporters, the following seven principles are key to the success of PEFG schemes:

a. **Assure simplicity.** PEFG designs must be simple so that participation by banks does not increase transaction costs or create too much of a burden for ESEs through the guarantee fee charged. The information required from exporters interested in PEFGs should be focused on the export transaction rather than the detailed asset, liability and net worth information of the firm.

b. **Maximize social benefits.** PEFGs should not be thought of as profit-making instruments. Instead, the social benefits of a PEFG operation must be higher than its social costs. Social benefits are additional value-added exports, tax revenues and jobs. Social costs include net defaults (gross defaults minus recoveries), administrative costs and the opportunity cost of the PEFG fund.

c. **Minimize moral hazard (loan misuse).** Exporters must self-finance part of their preshipment export finance needs. Similarly, commercial banks must assume some of the preshipment export finance default risks.

d. **Make PEFGs easily accessible.** ESEs, including indirect exporters, should be able to benefit from PEFGs as long as they possess one of the following: (a) confirmed export L/Cs issued in buying countries with little political risk; (b) export credit insurance coverage for non-L/C-based exports or exports to politically risky countries; or (c) back-to-back domestic L/Cs.

e. **Rapidly reimburse banks in case of default.** The PEFG should cover both the perceived and actual risks of exporters’ manufacturing nonperformance. When default occurs due to nonperformance or bad faith, the PEFG would bear that cost rather than the banks.

f. **Assess risk, but on an ex post basis.** The PEFG agency would screen out exporters with inadequate production facilities through enterprise visits by guarantee officers and the support of well-developed information networks. It would also screen out, on an ex post basis, exporters with loan misuse risks (bad faith). However, the PEFG agency or banks should not attempt to evaluate individual exporters’ manufacturing nonperformance risks on an ex ante basis. Accurately evaluating such risks would require significant capabilities and expertise, which are normally too costly to develop in a PEFG agency.

g. **Establish credibility, a good reputation and trust with exporters and banks.** Four conditions must be met to achieve these objectives: (a) a strong and proactive management team with aggressive guarantee officers; (b) availability of sufficient resources to cover claims; (c) clear rules for PEFG coverage and payments, and (d) speedy and transparent processing of guarantee applications and claims based on these rules.

While some PEFG facilities have been implemented successfully and encouraged banks to provide preshipment finance without guarantees, others have not had the same success. Tunisia’s experience illustrates the importance of applying the above principles when implementing a PEFG facility.
EXAMPLE

TUNISIA’S EXPERIENCE WITH PEFG

In 2000, a $5 million PEFG facility in Tunisia was established under the World Bank-supported Export Development Project. The project also provided technical assistance and advice in the early stages of the development of the facility, mainly to make Tunisian counterparts aware of best practice preshipment export finance guarantees worldwide, and to advise on the operational, managerial and skill requirements to implement the facility.

Tunisia’s experience demonstrates that PEFG performance and success depend critically on the extent to which the above principles are applied. When the principles were strictly applied at the inception of the PEFG facility, the scheme performed well, but later performed poorly when they were not. The facility design was simple: it guaranteed up to 90 percent—with an average of 50 percent—of nonperformance risks associated with preshipment export loans made by participating banks to ESEs with maturities of up to 180 days. A premium of 0.15 percent per month was paid by the borrowers; the premium was set at this level to ensure it did not constitute a major financial burden on exporters.

The scheme, which was administered by the Export Insurance Agency (COTUNACE), did not cover buyer nonpayment, buyer country risk, maritime disasters and other risks. The application process for the guarantee was simple, and information was required on the export transaction rather than the financial position of the borrower. Initially, a proactive and skilled management team was put in place to market and operate the facility. The PEFG facility was expected to generate substantial socioeconomic benefits. The present value of net social benefits over five years was estimated at $277 million.

The key assumption for this estimate was that all PEFG principles would be applied, ensuring that demand for the facility would increase over time and loan defaults would decline. Increased demand would imply that the guarantee coverage ratio (the ratio of outstanding guarantees to initial fund) would gradually increase from two in the first year to 15 in the fifth year. It was further assumed that 100 jobs would be created for every $1 million of additional exports.

However, the performance of the PEFG in Tunisia was mixed (see Table 3).

The facility went through two distinct phases:

1. Stellar performance during the first six months. In the first six months, the facility issued 43 guarantee certificates, exceeding performance targets for the facility for that period (this represented $2 million of loans guaranteed and $3.4 million of additional exports generated). During that time, the management team was strong and proactively led by the CEO of COTUNACE. The team regularly visited enterprises and initiated the development of a risk information database on clients. As the head of the Risk Agreement Committee (RAC) of the Ministry of Finance, the CEO of COTUNACE ensured adherence to all operational modalities and principles for PEFGs. He also led an extensive marketing and awareness raising campaign for banks and enterprises about the availability, objectives and principles of PEFGs.

2. Sharp decline in performance after initial success. After six months, the facility performed far below expectations. The facility’s management team was redeployed to another task and replaced with a less-skilled team consisting of a part-time manager with little institutional backing, no business plan and no clear understanding of, or commitment to, PEFG principles. The coverage and outreach of the facility declined, and banks lost confidence in the ability of the facility to share nonperformance risks. Many banks reverted to ex ante evaluation of nonperformance risks, which not only delayed the financing process, but also increased administrative costs and substantially reduced outreach to emerging exporters. The lack of proper supervision and follow-up by the PEFG management team even led a few banks to use PEFG as a supplemental guarantee for experienced exporters (one firm used it 28 times, and two used it 18 times), instead of using it as a catalyst to help new exporters access preshipment finance. A decision by the RAC not to reimburse the banks for two cases of loan defaults due to the bad faith of the borrower also had a negative effect on the credibility of the PEFG scheme. At PEFG closing, of 57 total claims, 27 were rejected, only 22 were fully repaid and eight remained open.

### TABLE 3: OVERALL FUND PERFORMANCE: COMPARISON OF OBJECTIVES AND RESULTS

<table>
<thead>
<tr>
<th>PERFORMANCE EVALUATION</th>
<th>2000</th>
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<th>2002</th>
<th>2003</th>
<th>2004</th>
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<tr>
<td><strong>TOTAL AMOUNT OF GUARANTEE COVERAGE</strong> ($ MILLION)</td>
<td>Estimate</td>
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<td>10.0</td>
<td>15.0</td>
<td>20.0</td>
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<tr>
<td></td>
<td>Actual</td>
<td>2.1&lt;sup&gt;a&lt;/sup&gt;</td>
<td>2.6</td>
<td>2.0</td>
<td>5.1</td>
</tr>
<tr>
<td><strong>ADDITIONAL EXPORTS GENERATED</strong> ($ MILLION)</td>
<td>Estimate</td>
<td>7.4</td>
<td>14.8</td>
<td>22.2</td>
<td>29.6</td>
</tr>
<tr>
<td></td>
<td>Actual</td>
<td>3.7&lt;sup&gt;b&lt;/sup&gt;</td>
<td>4.1</td>
<td>3.4</td>
<td>10.0</td>
</tr>
<tr>
<td><strong>ANNUAL RATE OF DEFAULT</strong></td>
<td>Estimate</td>
<td>7.0%</td>
<td>5.0%</td>
<td>4.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td></td>
<td>Actual</td>
<td>5.7%</td>
<td>24.7%</td>
<td>23.5%</td>
<td>2.5%</td>
</tr>
</tbody>
</table>

Source: Tunisia Export Development Project files. a. $1.8 million during the first 6 months of 2000. b. $3.1 million during the first 6 months of 2000.
POLICY GUIDELINES

1. **PEFG performance and success depend critically on the seven principles outlined earlier.** In theory, enormous economic benefits can flow from appropriate use of PEGFs, but for these benefits to be realized, all PEFG principles must be applied.

2. **The success of preshipment export financing schemes requires high levels of management expertise and dedication.** Capricious administration can be the downfall of any otherwise sound instrument. A strong and credible management team cultivating good relations with financial institutions is critical for schemes like PEGFs that aim to be a catalyst for addressing export financing constraints. Proper promotion and marketing of the scheme are also important, particularly by the banks, which are the ultimate beneficiaries of PEGFs.

3. **PEFG facilities must incorporate mechanisms to reduce the risk of loan misuse, but if there is a loan default due to bad faith on the part of the borrower, the lending bank should be reimbursed by the facility.**

4. **PEFG coverage decisions should be based mainly on the underlying export transaction.** Ex ante evaluation of exporters’ manufacturing nonperformance risks would delay the process and run counter to the objectives of PEGFs.

EXAMPLES OF GOOD PRACTICE

PAPUA NEW GUINEA: SME ACCESS TO FINANCE PROJECT

**Background**
The Government of Papua New Guinea (PNG) aims to increase the size and economic contribution of the domestic private sector, which consists mainly of SMEs, with a focus on generating employment. Despite large external investments in PNG’s resource sector, private-sector activity in the formal economy is low. Women and young people are especially dependent on small-scale informal businesses for their livelihoods. There are significant constraints to SME growth and investment, primarily access to credit, despite sufficient liquidity in the banking sector. There are two main reasons for this. First, SMEs often lack the collateral, information or guarantees to meet commercial bank requirements for lending. Second, banks perceive high levels of risk in lending to SMEs. Addressing these impediments should enable SMEs to engage more actively in economic growth, job creation and poverty reduction across PNG.

With the support of the World Bank Group’s International Development Association (IDA) and International Finance Corporation (IFC), the Government of PNG established a risk-sharing facility and technical assistance mechanism for SMEs, commercial banks involved in SME lending and relevant government agencies that support the growth of SMEs.

About the Project
For the Government of PNG, the primary objective of the Small and Medium Enterprise Access to Finance Project is to provide access to sustainable credit for SMEs, and thereby contribute to growth in SME employment and incomes. The project will provide support to develop the managerial and financial skills of SMEs, with particular attention to women entrepreneurs, and to enhance the capacity of commercial banks to manage credit risks.

There are four components to the project:

1. **Developing a risk-sharing facility (RSF) in partnership with local financial institutions** - This will partially guarantee a portfolio of new loans from commercial banks to SMEs up to USD 116 million. This is expected to immediately accelerate commercial bank lending to emerging and established SMEs. The Government of PNG (through the IDA credit) and the IFC will cover 50 percent of all principal losses in the portfolio of new SME loans.

2. **Technical assistance for financial institutions** - Performance-based technical assistance will be provided to private banking institutions. It is expected that this will allow commercial banks to develop long-term procedures for sustainable lending to SMEs.

3. **Capacity building for SMEs** - This will consist of four sub-components: (a) training SMEs in management and financial skills; (b) focused mentoring and coaching for SMEs; (c) targeted training for women entrepreneurs; and (d) training for provincial government commerce division staff.

4. **Capacity building for Government of PNG** - This will improve the government’s capacity to implement and monitor the project, and to develop an updated SME strategy and policy.
DIRECT MONETARY INTERVENTION

Direct monetary intervention (DMI) through subsidized credit and refinancing programs provides lending at below-market rates to targeted SMEs. This type of financing allows SMEs to lower the cost of doing business and, for the government, could offer an effective strategy for spurring entrepreneurship, reducing poverty, lowering income inequality and stimulating economic growth. The survey highlights that these programs have been primarily implemented by government agencies other than the financial regulator.

An enabling regulatory framework and supportive financial infrastructure are essential to facilitate sustainable, viable and significant improvements in access to SME finance. However, SME credit markets are plagued by market imperfections, including information asymmetries, inadequate or lack of recognized collateral, high transaction costs and the perception that small-scale lending is high risk. To address these market failures and information gaps, many governments intervene in SME credit markets in various ways.

Direct government interventions are typically in the form of grants, subsidies and tax breaks, and are often delivered through dedicated government agencies. Some governments also provide financing assistance via commercial/state banks or other institutions, such as cooperatives. This assistance can be in the form of soft loans, interest subsidies/ceilings, credit guarantees and/or credit insurance, seed capital, venture capital, loan quotas, loan waivers and promotion of promissory notes. The rationale for government intervention is clear.

Well-designed government interventions may be necessary when there is a lack of financial resources for particular groups (for example, start-ups with little collateral and credit history, and women entrepreneurs) due to market failures. Time-bound special interventions may also be warranted during periods of instability and crisis, when there is potential for financial intermediation to collapse.

However, public interventions in SME financing also typically cause unwelcome market distortions, side effects and long-term losses to the financial sector or public purse. First, it is often difficult to ensure that financial support reaches the target group. This is especially problematic when the target group cannot be well defined. Second, public interventions may lead to weaker financial discipline in the SME debt market because, with grants and subsidies, both lenders and borrowers suffer less direct losses when defaulting. As a result, a ‘non-repayment culture’ may develop among beneficiary enterprises. ‘Moral hazard’ issues may also arise that inhibit financial institutions from implementing and improving risk management techniques. Third, such measures may reduce market competition in the financial market and have a ‘crowding-out’ effect, as they discourage firms from using non-subsidized financial institutions and non-subsidized forms of financing. This can produce the opposite of what is desired: in the long term, a robust and commercially viable banking and finance sector that is willing and able to serve the SME sector.

The question, therefore, is which interventions have proved effective and which regulations should govern them before market imperfections are addressed. While government intervention can play an important role in expanding SME finance, especially in emerging and developing countries, it is equally important to guard against undesirable market distortions brought by improper actions. Identifying the market (or regulatory) failure and setting intervention boundaries is a key prerequisite for the design of any appropriate strategy.

In all cases, government intervention should be carefully designed to avoid disincentivizing private sector providers of financial services to serve the SME segment. They also need to be monitored and evaluated carefully to measure impact and ensure the desired effects are being achieved. Finally, public intervention should focus on tackling market imperfections and information asymmetries, and should, in general, remain temporary and be phased out as desired effects on SME access to finance are achieved. Some interventions may remain valid in cases where some groups remain difficult to reach, even when efficient financial infrastructure and regulations are in place.

SUBSIDIZED CREDIT AND REFINANCING PROGRAMS

Interest rate ceilings designed to make finance more affordable may actually depress SME lending volumes, while directed lending, such as through requirements for banks to set up branches in rural areas or to lend to certain SME sectors, can add costs and risks to SME lending. While these schemes reduce the cost of debt for the eventual beneficiaries, they do not address the underlying challenges to SME finance (information asymmetries, high cost of operation in some countries due to lack of proper infrastructure or high cost of energy, etc.).
In general, the cheaper the financing, the less likely it will reach the target group. The main problem is interest rate subsidies. Cheap loans are rationed, and rationing opens the door to political considerations. There is also a risk that borrowers will expect permanent subsidies, which would be costly and unsustainable. In most cases, regulators may wish to focus on the basics. Interest rates include a risk premium, which means untested client groups (such as SMEs) may have to pay a little more. Instead, it could be better to subsidize training, transaction costs (see Box 23: Mexico’s SIEBAN Program), technology and new product development—just not the interest rate.

World Bank financial sector policies and good practices underline the following approaches to smart subsidies:

- Transparent, targeted, time limited and capped;
- Funded explicitly through the government budget or other sources subject to effective control and regular review;
- Fiscally sustainable;
- Aimed to maintain a level playing field, so they should not give an unfair advantage to some public financial institutions (PFIs) compared to other qualified and directly competing institutions; and
- Economically justified or shown to be the least expensive way to achieve access to finance objectives.

EXAMPLE OF GOOD PRACTICE

**MEXICO’S SIEBAN PROGRAM**

To address the transaction costs of lending to small borrowers, the Mexican development agency (FIRA) has introduced SIEBAN (Sistema de Estimulos a la Banca), a program that provides subsidies to cover the administrative and screening costs of serving small borrowers. This subsidy applies to loans to low-income rural producers from commercial banks, credit unions or financial firms for the first time. The subsidy is a fixed amount that varies with the size of the loan (a maximum of 16.7 percent of the amount borrowed in the case of smaller loans).

These subsidies can be used to obtain credit from different financial institutions, thereby fostering competition. In turn, financial institutions are required to provide borrowers’ information to the credit bureau to help them establish credit history. The subsidy decreases over time and is temporary—three years in duration—based on the premise that once borrowers have established a credit history, screening costs for financial institutions should be significantly lower, tackling information asymmetries and eliminating the need for subsidy.

ANNEX 1: GOVERNMENT PROGRAMS TO INCREASE PRIVATE INVESTMENT IN SMEs

This Annex is based on a background note prepared by Tom Gibson in 2013 during the design of the Malaysia Small Investment Programme (HIP3).

Governments can increase the amount of capital available for investment in SMEs either by investing public funds or making it more attractive for private capital to invest in these companies. The most successful government support programs have been based on public-private partnerships (PPP) in which investment decisions are made by independent fund managers, and where there is significant equity participation by private investors. The objective of investors is to generate the highest risk-adjusted rate of return on their capital. Consequently, government can attract private capital either by increasing the potential rate of return to investors in a venture fund or by reducing the investor’s risk of loss. Specific plans include:

> Direct investments in SMEs or venture capital financing. Many governments have started with this approach, but most have concluded they have neither the staff nor the motivation to manage such a program, which involves a high number of individual investment decisions and continuing support for investee companies.

> Direct participation, or “seeding” of venture funds, as France provides for investors in younger companies. Government invests on the same basis as private investors, thus increasing the size of the fund and allowing greater diversification of its investments. Germany offers a variation of this, which involves co-investment with venture funds.

> Government loans or loan guarantees to licensed venture funds that would invest within government guidelines, or guarantees of fund borrowings. The US Small Business Investment Company program (SBIC) and the program of the US Overseas Private Investment Corporation (OPIC) use this kind of support, offering loans or loan guarantees in an amount twice the private capital of the fund. Since the interest rate on the government debt is well below the profit expectations of a venture fund, excess returns flow to private investors, increasing or leveraging their potential rate of return.

> Leveraged equity participation by government in private equity funds. This practice has been offered as an option by the SBIC program since 1994, and by the Australian Innovation Investment Program. Government provides two-thirds of the capital of a venture fund, but takes only a government interest rate plus 10 percent of the fund’s profits. Any excess profits flow to equity investors that have provided only a third of the fund’s capital. This again enhances, or leverages, the profit potential to the private investor.

SME INVESTMENT PARTNER (SIP): HIP 3 - SME MASTERPLAN 2012-2020

A successful variation of this was Israel’s Yozma Fund, which invested in early venture capital funds 10 years ago. Investing 40 percent of the total, the Israeli government agreed that the funds could repurchase the government share within five years, at cost plus a nominal interest rate. This again provided leverage for private investors without subjecting them to the risk of an obligation that would take precedence over their own investment in the fund.

> Loss insurance: Governments have provided guarantees against loss for investors as a way of encouraging them to invest in venture funds. The US state of Oklahoma guarantees investments in state-sponsored seed and early-stage investment funds. OPIC guaranteed the principal and interest on two-thirds of the investment in some of its funds, thus assuring investors they would, at worst, recover their investment at the end of the ten-year fund life.

> Tax credits, as Canada has offered, directly offset a percentage of an investor’s capital investment so long as the fund invests in target sectors of the economy. Other governments have offered reduced tax liability on profits earned from investments in SMEs. Based on trends in these countries and discussions with those responsible for many of these programs, we conclude that best practices in government support have been based on PPPs in which investment decisions are made by independent fund managers and where there is significant equity participation by private investors. This allows the following balance:

> Government can generally target the investments of the fund to areas where there is a public policy objective, by size or industry sector, geographic location or other criteria, as a condition of providing financing.

> Private capital increases the total amount available for investment so government does not have to provide all the funding.

55 This Annex is based on a background note prepared by Tom Gibson in 2013 during the design of Malaysia Small Investment Programme (HIP3).
high-tech firms, plus a 50 percent equity guarantee for the first five years of an investment.

> Hungary: Two state-owned venture funds have been invested, but have not produced meaningful results. The government is now organizing additional funds in combination with the European Union, regional development agencies, international development organizations and private sources.

> India: The Small Industries Development Bank of India (SIDBI) set up a venture fund in 1994 to invest directly in small companies and to invest in venture funds. The total size is now USD 27.5 million. More recently, SIDBI has concentrated on supporting investment funds (see next section).

> Ireland: Enterprise Ireland, is a new government agency that consolidated three former agencies and which together have invested in over 500 companies in Ireland. Due to the difficulty and cost of managing a direct investment program, Enterprise Ireland has moved steadily toward support of investment funds with private investors and managers (see next section).

> Mexico: Two development banks, NAFIN (manufacturing) and Bancomext (export financing) promote SME development by providing capital and business assistance. NAFIN invests directly in SMEs and in venture capital funds (SINCAS), along with wealthy individual investors and public market listings.

**INTERNATIONAL PRACTICES IN GOVERNMENT-SUPPORTED INVESTMENT**

These government interventions can be further divided into the following seven categories:

**DIRECT INVESTMENT**

> Canada: Canada has a tradition of government involvement in the promotion of business. This is evidenced in the venture capital arena by its two principal programs. The Business Development Bank invests directly in SMEs.

> Germany: Germany’s BJTU program provides matching funds for individual investments in small companies.

TABLE 4: GOVERNMENT SUPPORT PROGRAMS FOR SME EQUITY FINANCING AND VENTURE CAPITAL

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>DIRECT INVESTMENT</th>
<th>INVESTMENT IN FUNDS</th>
<th>LOANS / GUARANTEES</th>
<th>LEVERAGED INVESTMENTS</th>
<th>LOSS INSURANCE</th>
<th>TAX CREDITS</th>
<th>TAX ADVANTAGE</th>
<th>DISCONTINUED PROGRAMS</th>
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In partnership with the Bank of Ireland, an “Enterprise 2000” fund has been established to make small investments and loans to young companies.

**Mexico** (see previous section)

**FUND LOANS/GUARANTEES**

- **Germany:** (see previous section)
- **Korea:** The Korean Government will loan up to 20 percent of the capital for Start-up Promotion Funds, which receive their capital from private investors and are managed by private fund managers. These funds are required to invest 40 to 50 percent of their assets in start-up companies, but are free to invest the remainder as they choose.
- **United States:** The Small Business Investment Company (SBIC) program, administered by the US Small Business Administration (SBA), is the largest and oldest government-support program for venture capital in the world. In over 40 years of operation, SBICs have invested over $21 billion in nearly 120,000 financings to US small businesses, including successes like Intel Corporation, Apple Computer, Federal Express and America OnLine.

- **Brazil:** The Brazilian development bank, BNDES, has made direct equity investments and loans to SMEs. It is now shifting its focus to investing in funds managed by independent managers.

**INVESTMENT IN FUNDS**

- **Belgium:** Belgium’s Investment Company for Flanders (GIMV), established in 1980, is credited by OECD as pioneering the concept of government-funded venture capital run by independent private management. Most of its investments have been in high-tech companies, and it has been successful enough to attract private capital, which now represents a minority ownership of the fund. The other two regions of Belgium have government-funded investment funds, but these are principally (but not exclusively) investing in industrial companies. Operations of these two funds are more closely controlled by the government.
- **Brazil:** As already noted, the Brazilian Development Bank is shifting from direct investment to investment in independent investment funds.
- **Canada:** In addition to direct investment in SMEs, Canada invests in seed capital funds and makes loans to these companies. About half of all venture capital investments in Canada are made by Labor-Sponsored Venture Capital Corporations (LSVCCs), which are mutual funds that make direct equity investments and are managed by private fund managers. Provincial governments also sponsor privately managed venture capital funds.
- **France:** Using a portion of the proceeds of the privatization of France Telecom, the French government will provide up to 30 percent of the capital for a private venture capital firm, providing it agrees to invest at least half its funds in concerns less than seven years old. The government investment is proportional to the fund’s agreement to invest in such companies, i.e. if half the funds are invested, the government will invest 15 percent of the total fund capital; if all the funds are invested, the government will invest 30 percent.
- **International financial institutions:** Virtually all international development finance agencies invest in direct equity investment funds in emerging markets to support economic development. The IFC (World Bank), European Bank for Reconstruction and Development, and the national development agencies of the US, UK, Germany, Sweden, Norway and Switzerland are among this group. Typically, these organizations invest on the same terms as other investors in funds managed by independent managers.
- **Ireland:** Enterprise Ireland has co-invested in funds with private investors, and together with the European Union has established 16 private sector funds investing in seed and venture capital.
ANNEX 2: EXAMPLE OF A SIMPLIFIED QUANTITATIVE DEMAND-SIDE SURVEY ON SMALL BUSINESS CREDIT CONDITIONS – INDUSTRY CANADA, 2010

CREDIT CONDITIONS SURVEY 2010

Hello my name is (interviewer) and I am calling from XXX on behalf of Industry Canada to conduct a short 15 minute survey on the financing of small and medium-sized businesses. Are you the person who would be in charge of corporate finances, the owner, chief financial officer, or accountant?

(Note: If the respondent replies “no”, ask: “May I speak to the person who would best be able to answer the survey?”)

We are conducting a national survey on the growth characteristics of small and medium-sized businesses; the results of the survey will be used to guide public policy. The survey should take less than 10 minutes.

Can I continue or schedule a better time?

Yes (Rebook if requested)
No

[Persuaders:
Let me assure you that we are not trying to sell you anything and that this interview is completely confidential.

Your participation is voluntary and the information you provide will not identify you or your business.

We are calling on behalf of Government of Canada, and this survey is registered with the Canadian Research Registration system of the Marketing Research and Intelligence Association.

It is important that we speak with as many different businesses as possible; your opinion will help us with future policy issues]

Number of questions:
Section A (Screening): 4
Section B (General Financing): 4
Section C (Debt Financing): 6
Section D (Lease Financing): 2
Section E (Equity Financing): 2
Section F (General Business Information): 5
Section G (Owner Information): 4
Total: 27 questions

A. SCREENING QUESTIONS

The following are screening questions to determine if the business is in scope.

A.1 Just to confirm, are you:
(Note: Read all)
a) The Business Owner
b) The person in charge of finance in your business
c) Other
d) Refused
If A.1= “c” or “d”  ➞  Go To A.2,
Else  ➞  Go To A.3

A.2 We are looking to speak with the person who is knowledgeable about the business characteristics finances. Are you the correct person?
Yes [Continue]
No [Ask to speak to the correct person]

A.3 Is your business classified as a non-profit organization, a co-operative, a joint venture or a government agency?
Yes
No
Don’t know / Refused
If “yes” or “don’t know / refused” ➞ READ: Since this survey is for private for-profit businesses, we will not need to proceed with the survey. Thank you for your participation.

A.4 Excluding the owner(s) of the business, how many paid full-time and part-time employees did the business have in 2010?

[NOTE: Do not include contractors or sub contractors, e.g. in construction industry builders use sub-contractors, plumbers, etc. who have their own business. They are not employees and should not be counted.]

Full-time ______ Part-time_______
Don’t know / Refused

GENERAL FINANCING

B.1 What types of external financing did your business seek in the 2010 calendar year?
(Note: Read list and MARK ALL THAT APPLY.)
a) Did not seek any external financing
b) New mortgage or refinancing of an existing mortgage
c) New term loans
d) New line of credit or increase in existing line of credit
e) New credit card or increase in existing credit limit
f) Leasing
g) Trade Credit
h) Equity
i) Other, please specify:___________
j) Don’t know / Refused
C.1 In the most recent debt financing request in the 2010 calendar year, what was the dollar amount requested?
(Prompt: Please provide your best estimate)
a) $__________
b) Don’t know
c) Refused

C.2 What was the amount that was authorized as a result of your 2010 request?
a) $________
   Note: Write $0 if the loan was rejected
b) Request is still under review
c) Don’t know
d) Refused
If C.2a = "$0", ➞ Go To C.3
If $0 < C.2a ➞ Go To C.4
If C.2=b ➞ Go to section D

C.3 Which of the following reasons were given as to why the loan was rejected?
[Read list and mark all that apply]
a) No reason given by credit supplier
b) Insufficient sales or cash-flow
c) Insufficient collateral or security
d) Poor credit history or lack of credit history
e) Project was considered too risky
f) Other reason
   (Please specify)_________________ 
   [Do not read]
g) Don’t know / Refused ➞ Go To section D

C.4 What was the annual interest rate on the loan?
[Respondents can answer a percentage or a prime plus a percentage.]
a) _________% – Ask if it is a fixed or variable rate?____
   fixed ____variable ___ Don’t know / Refused
b) Prime + ______
c) Don’t know
d) Refused

C.5 What was the length of term of the loan?
a) _______months
   [Please make sure to enter the right number.]
1 year = 12 months
2 years = 24 months
3 years = 36 months
4 years = 48 months
5 years = 60 months
6 years = 72 months
7 years = 84 months
8 years = 96 months
9 years = 108 months
10 years = 120 months
b) Not applicable
c) Don’t know
d) Refused
C.6 What collateral were you asked to provide to obtain the loan?  
(Note: Read list and MARK ALL THAT APPLY.)  
(Prompt: Collateral are any assets pledged as security for the payment of a debt.)  

a) None  
b) Business Asset (including land, buildings, materials and equipment, inventories, accounts receivable, financial assets)  
c) Personal Assets  
d) Intellectual Property  
(Prompt: Intellectual Property is intangible property that is the result of intellectual activity and includes patents, trademarks or copyrights.)  
e) Other (Please specify: __________) [Do not read]  

D. LEASE FINANCING  
If B.1f = “YES”, → Go To D.1  
Else → Go to Section E  

D.1 In the most recent lease financing request in the 2010 calendar year, what was the dollar amount requested?  
(Prompt: Please provide your best estimate)  

a) $__________  
b) Don’t know  
c) Refused  

E. EQUITY FINANCING  
If B.1h = “YES”, → Go To E.1  
Else → Go to Section F  

E.1 In the most recent equity financing request in the 2010 calendar year, how much financing was requested?  
(Prompt: Please provide your best estimate)  

a) $__________  
b) Don’t know  
c) Refused  

E.2 What was the amount that was authorized?  

a) $__________  
b) Don’t know  
c) Refused  

F. GENERAL BUSINESS INFORMATION  

F.1 In which sector does your business primarily operate?  
Goods-Producing Sector:  
a) Agriculture, Forestry, Fishing and Hunting (NAICS 11)  
b) Mining and Oil and Gas Extraction (NAICS 21)  
c) Construction (NAICS 23)  
d) Manufacturing (NAICS 31-33) Please specify:__________  
Services-Producing Sector:  
e) Wholesale Trade (NAICS 41)  
f) Retail Trade (NAICS 44-45)  
g) Transportation and Warehousing (NAICS 48-49)  
h) Professional, Scientific and Technical Services (NAICS 54)  
i) Accommodation and Food Services (NAICS 72)  
j) Other Services (Please specify:__________)  
k) Other than goods and services, (Please specify:__________)  
l) Don’t know / Refused  

F.2 How many years has the company been in existence?  
a) _______ year(s)  
b) Less than one year  
c) Don’t know  
d) Refused  

F.3 What was the value of the following business financial figures for your 2010 fiscal year?  
(Prompt: Please provide your best estimate.)  

a) Total business revenues $__________ / Don’t know / Refused  
b) Profit/net income, before taxes $__________ / Don’t know / Refused  
c) Total Assets $__________ / Don’t know / Refused  
(Prompt: What is the approximate total amount of all financial and non-financial assets that the business owns?)  
d) Total Liabilities $__________ / Don’t know / Refused  
(Prompt: What is the approximate total amount of all short-term and long-term debt that the business owes to its creditors?)  

F.4 In 2010, estimate the percentage of the total sales that came from the following geographic market regions:  
(Prompt: Please provide your best estimate)  
(Note: Should add up to 100%, but if it does not, do NOT correct this with the respondent as it can easily become too time consuming – Calculate but not forced. As long as it equals between 90% and 110%.)  

a) Your market (same municipality or region) _____% / Don’t know / Refused  
b) Rest of your province/territory _____% / Don’t know / Refused  
c) Rest of Canada _____% / Don’t know / Refused  
d) United States _____% / Don’t know / Refused  
e) Rest of the World _____% / Don’t know / Refused  

F.5 In the 2010 calendar year has the business developed or introduced:  
(Note: Read every option and mark all that apply.)  

a) Product innovation (Prompt: a new or significantly improved good or service to the market)  
b) Process innovation (Prompt: a new or significantly improved production process or method)  
c) Organizational innovation (Prompt: A new organizational method in your business practices, workplace organization or external relations. It
must be a result of strategic decision taken by management)

   d) Marketing innovation (Prompt: A new way of selling your goods or services this requires significant changes in product design or packaging, product placement, product promoting or pricing)

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**CONCLUSION TEXT:**

Léger Marketing & Industry Canada thanks you for your participation

Thank you for taking time to participate in our survey. It provides us with pertinent information on the financing of Canadian small businesses.

Please note any comments you have regarding this questionnaire:

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**G. OWNER INFORMATION**

**G.1** What is the age of the majority owner?  
(Prompt: In the case of equal partnership, please report the average age of the partners)

   a) _________years  
   b) Don’t know  
   c) Refused

**G.2** How many years of experience does the majority owner have in owning or managing a business?  

   a) _________years  
   b) Less than one year  
   c) Don’t know  
   d) Refused

**G.3** What is the gender of the majority business owner?  

   a) Male  
   b) Female  
   c) Equal ownership (50-50 ownership)

**G.4** What is the highest level of education attained by the majority owner?  

   a) Less than high school diploma  
   b) High school diploma  
   c) College / cegep / trade school diploma  
   d) Bachelor degree  
   e) Master degree or above  
   f) Don’t know / Refused

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**H. QUESTIONNAIRE CONCLUSION**

**H.1** In the event that we conduct a short follow-up questionnaire in the next two years, would you be willing to complete it?

   Yes_____ No______

   If H.1=yes → Go to H.2  
   If H.1=no → Go Conclusion Text

**H.2** As the follow-up survey will be electronic, could you please provide us with your email address?

________________________________________________