

Social Capital Conference (SoCap09)
Fort Mason – San Francisco
September 1 - 3, 2009

Panel Topic: Small and Medium-sized Enterprise (SME) Finance in Developing Countries

Purpose:

What will it take to bring SME Finance to scale? The US Government, multilaterals, foundations, and socially-motivated investors are supporting a growing number of Small and Medium-sized Enterprise initiatives in developing countries. Successful SME approaches have concluded that money is not enough; there needs to be business advice and a supportive business environment along with financing. The developing country SME sector has used a partnership approach since its inception with a blend of soft money of philanthropy and development agencies for technical assistance and risk sharing along with hard money of development finance agencies and private financial investors. At the same time, the SME space continues to lag behind the microfinance sector for mindshare and resources. The panel discussed the challenges and opportunities for bringing this space to scale.

Design/methodology/approach: Reports and expert opinions from panelists.

Moderator: Dan Runde, International Finance Corporation

Randall Kempner, Aspen Network of Development Entrepreneurs (ANDE)
John Simon, Visiting Fellow at the Center for Global Development
Julia Novy-Hildesley, The Lemelson Foundation

Findings

Each panelist opened with an introduction about his or her organization and its work in supporting entrepreneurs in emerging markets.

Randall Kempner: ANDE believes in supporting entrepreneurs in emerging markets. The organization wants to create a movement with the same impact as micro-finance, but at the next level up with a focus on small-to-medium enterprises: “the missing middle.” He identified several reasons why SMEs are particularly important in developing countries:

1. In the U.S., employment from SME business is 60%; in developing countries, it's 20% so there's an opportunity to grow employment.
2. Entrepreneurship allows people to rise based on merit, not just on political ties.
3. Entrepreneurship also allows for assimilation of migrant populations. He pointed to Silicon Valley, where 50% of companies have foreign-born founders, as an example of this.
4. Finally, when women get engaged in entrepreneurship, the rates of abuse go down.

However, it's more work to support a small business than to microfinance. ANDE has identified three particular challenges for entrepreneurs in emerging markets:

1. Access to human capital
2. Access to knowledge capital
3. Access to financial capital

Julia Novy-Hildesley: The Lemelson Foundation provided the philanthropic foundation perspective. Joblessness relates to the unwinding of the fabric of society. She said that we need to see SMEs in the larger social context and as more than just employment. She quoted columnist Thomas Friedman, saying “we can't just fund bailouts, we have to fund startups.” The Lemelson Foundation has worked with grants, loans, and equity and has been engaging traditional investors in funding entrepreneurs that they might not otherwise fund. This has required some creative financing options, such as the “First Loss Capital Program” that it launched to absorb any losses from financing extended with its partners; this approach

worked with Calvert Social Investment Foundation, which was then able to extend financing without taking on any risk of its own.

John Simon: The importance of business development services is key. SMEs in developing countries exist in difficult environments where things don't always work out as planned. Lenders need to be willing to provide forbearance. It is important for new businesses to have access to different types of financial capital, including revenue, risk capital, and short-term cash flow financing, because businesses cannot live on debt alone. It is also important to have an exit strategy.

One of the primary challenges observed was the need to attract more equity investors and to change the incentive structures in local banks. The local financial institutions could supply financing to SMEs, but they would need to be properly incented. The local bank loan officers would need to develop strategies to counteract the inherent risk aversion and encourage financing. The local financial intermediaries would be needed to bring together the banks and the entrepreneurs.

Another key issue was that there currently aren't any models for microfinance institutions that are successful and require additional funding. According to Kempner, most microfinance institutions will not migrate to SMEs.

Effectively leveraging investments into SMEs also requires looking beyond the U.S. for angel groups or other intermediaries to invest in.

Perhaps the best illustration of the challenges that SMEs face in developing countries were the challenges that audience members faced in obtaining financing. In both cases, individuals were attempting to get local financing in developing countries and were unable to do so; one of the people in particular had been able to grow his organization and was now at the critical expansion state, unable to access needed financing. In these cases, the panelists admitted the challenges but were unable to provide specific support of what could be done in those situations.

Practical implications

SME financing in developing countries is still very much under development itself. Several challenges exist: scaling the microfinance model to apply to SMEs, working with local intermediaries to effect change in current loan policies and procedures, and securing additional financing to support entrepreneurs. The benefits for the developing countries stand to be significant if creative solutions can be found to extend SME financing.

Originality/value

The conference panel addressed key issues in SME financing, but was relatively light on the specifics about what could be done to improve this other than primarily working with local intermediaries and local banks to extend financing on their own.

Key Words

SMEs, Small and medium-sized enterprise, SME finance, microfinance in developing countries

Paper type: Review of Conference Panel

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