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Promoting Access to Credit for MSMEs through Effective Government Interventions

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EFInA commissioned Genesis Analytics to conduct an evaluation of public interventions in Nigeria that promote MSME development

- MSMEs play a pivotal role in emerging economies, driving equitable development and employment.
- They often face a number of challenges one of which is access to credit.
- The Nigerian government has launched a number of interventions to support MSME's access to credit.

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- The study focused on constraints in the supply of services from financial institutions and effectiveness of public interventions to address these constraints.
- Research was gathered through interviews with an array of the key stakeholders* and an analysis of international best practice.
- The findings are presented here and the full report will be available on EFInA's website.

* Diamond Bank, First Bank of Nigeria, Lateral Links, DFID, GIZ, World Bank Micro, Small and Medium Enterprise (MSME) Project, Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), Rural Finance Institutions Building Programme (RUFIN), Central Bank of Nigeria (CBN), Bank of Industry (BOI)

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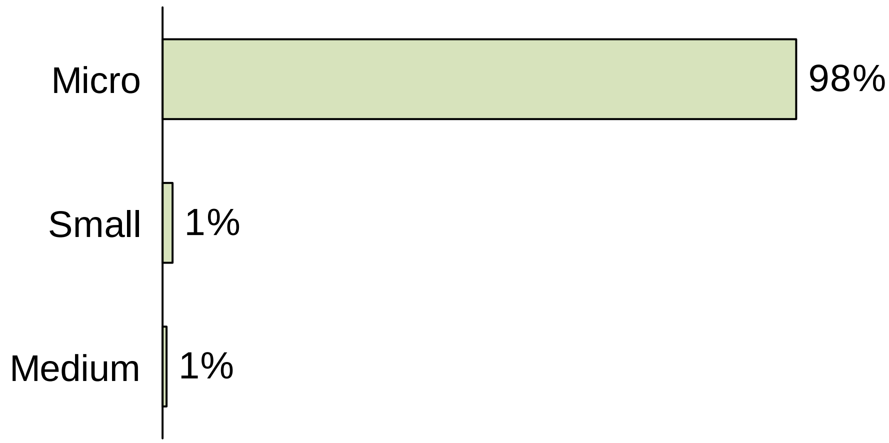
In Nigeria, 98% of the MSME sector is made up of micro businesses…

Split of MSMEs in Nigeria



The number of MSMEs in Nigeria is estimated between 10-50million*

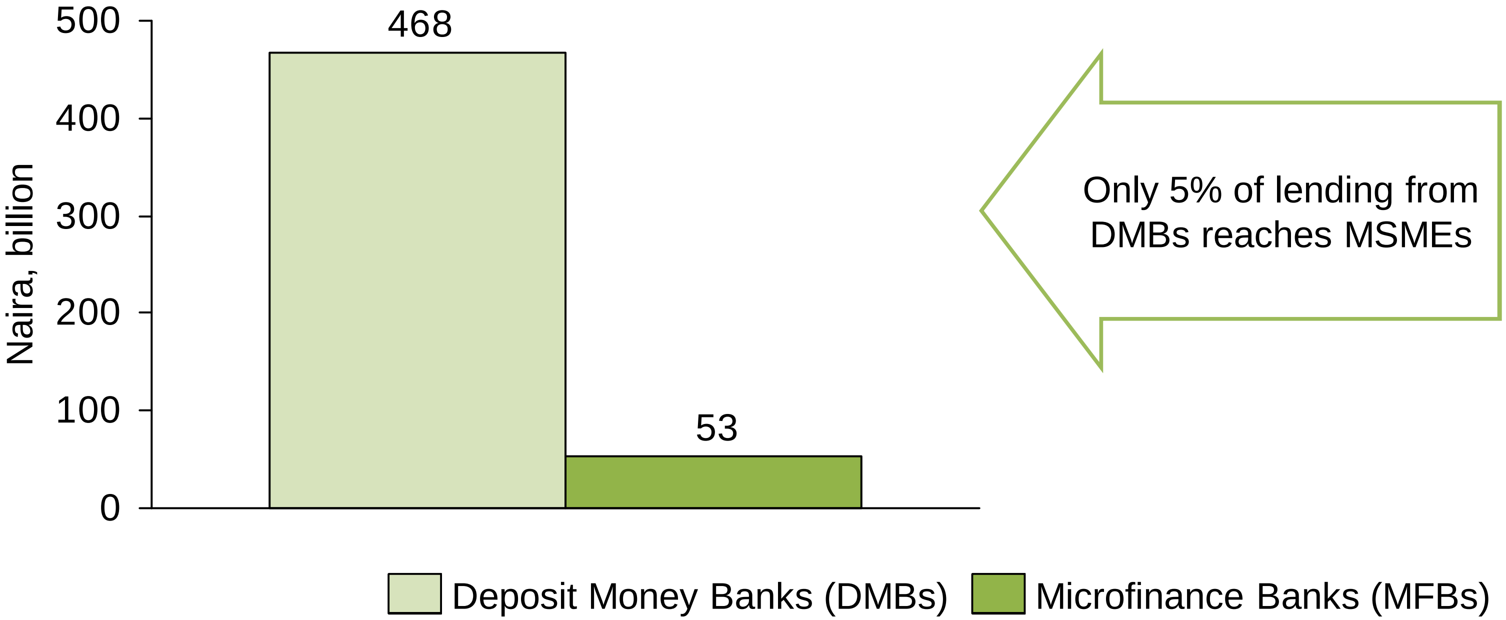
Official definitions currently used in Nigeria:

	Employees	Turnover (annual N)	Turnover (annual USD**)	Asset Value (N)	Asset Value (USD)
Micro	0-10	0 – 10 million	0 – 65 000	5 million	32 000
Small	10-49	10 - 100 million	65 000 – 650 000	5-50 million	32 000 – 320 000
Medium	50-199	100 - 500 million	650 000 – 3.2 million	50 – 500 million	320 000 – 3.2 million

* The nature of the MSME sector makes an exact number hard to quantity
** An average exchange rate of 155N to 1USD has been used.
Source: IFC, 2010, The SME Banking Knowledge Guide
Federal Republic of Nigeria, (undated) National Policy on Micro, Small and Medium Enterprises

… and although the lending portfolios of financial institutions are sizeable, MSMEs have access to very little

Total lending portfolios to MSME
2010, Naira billion, Nigeria



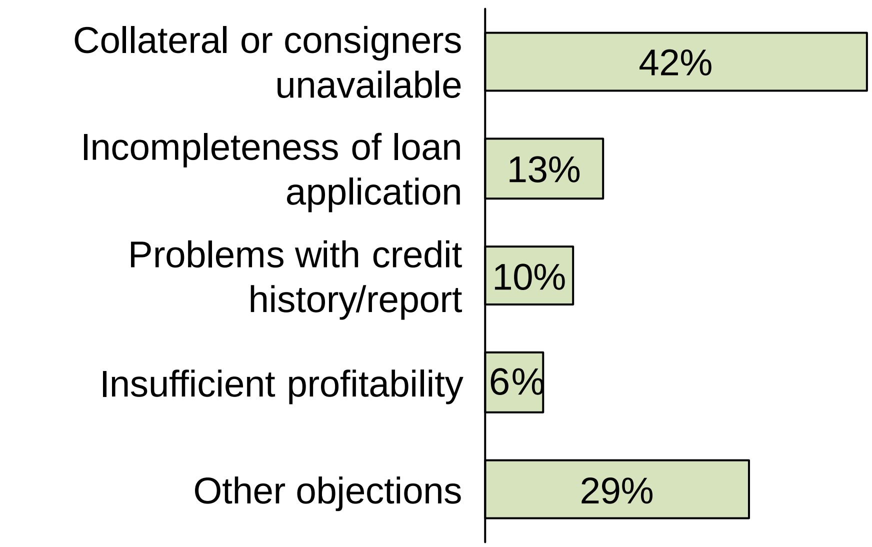
DMB SME statistics

- Average SME loan size: N6 million (USD40 thousand)
- Average interest rate charged for the lowest risk SME customers: 20%
- Average loan maturity for SME loans: 12 months
- Average non-performing loan (NPL) ratio for SME:16 % (with large variations across the industry)

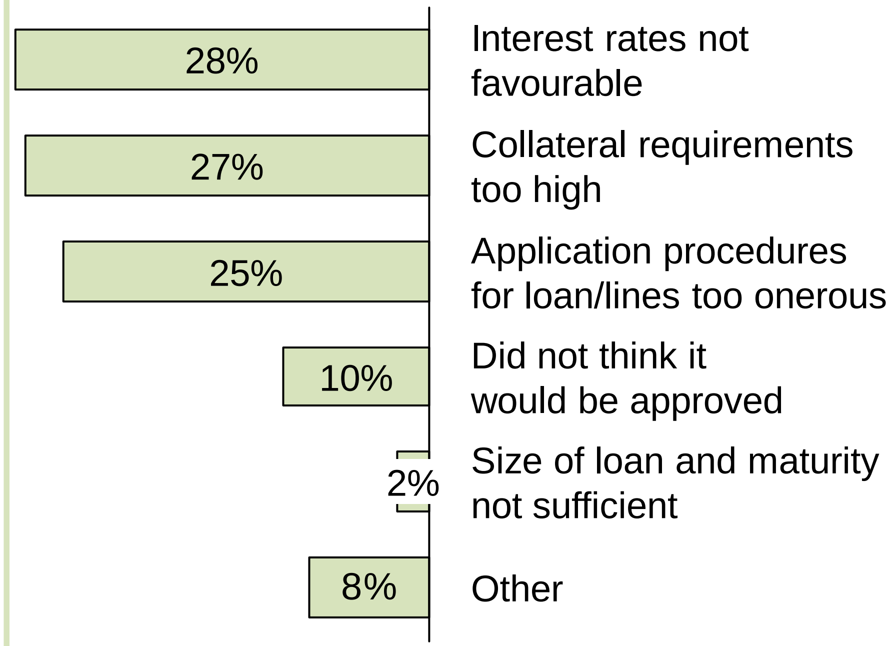
Source: World Bank, Nigeria SME Finance 2011 – 2012 Survey Results & Conclusion Central Bank of Nigeria, 2011 speech by the governor, Banks in Nigeria and national economic development: a critical review

An effective intervention needs to understand the constraints of both banks and SMEs to bridge the gap*

Common reasons for banks' rejecting SME loan applications



SMEs most common reasons for not applying for loans**



An effective intervention needs to bridge the gap between the constraints of banks and MSMEs

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Source: World Bank, Nigeria SME Finance 2011 – 2012 Survey Results & Conclusion
* The World Bank survey refers to SMEs not MSMEs, Banks refer herein to DMBs
** Sample of 47 SMEs interviewed

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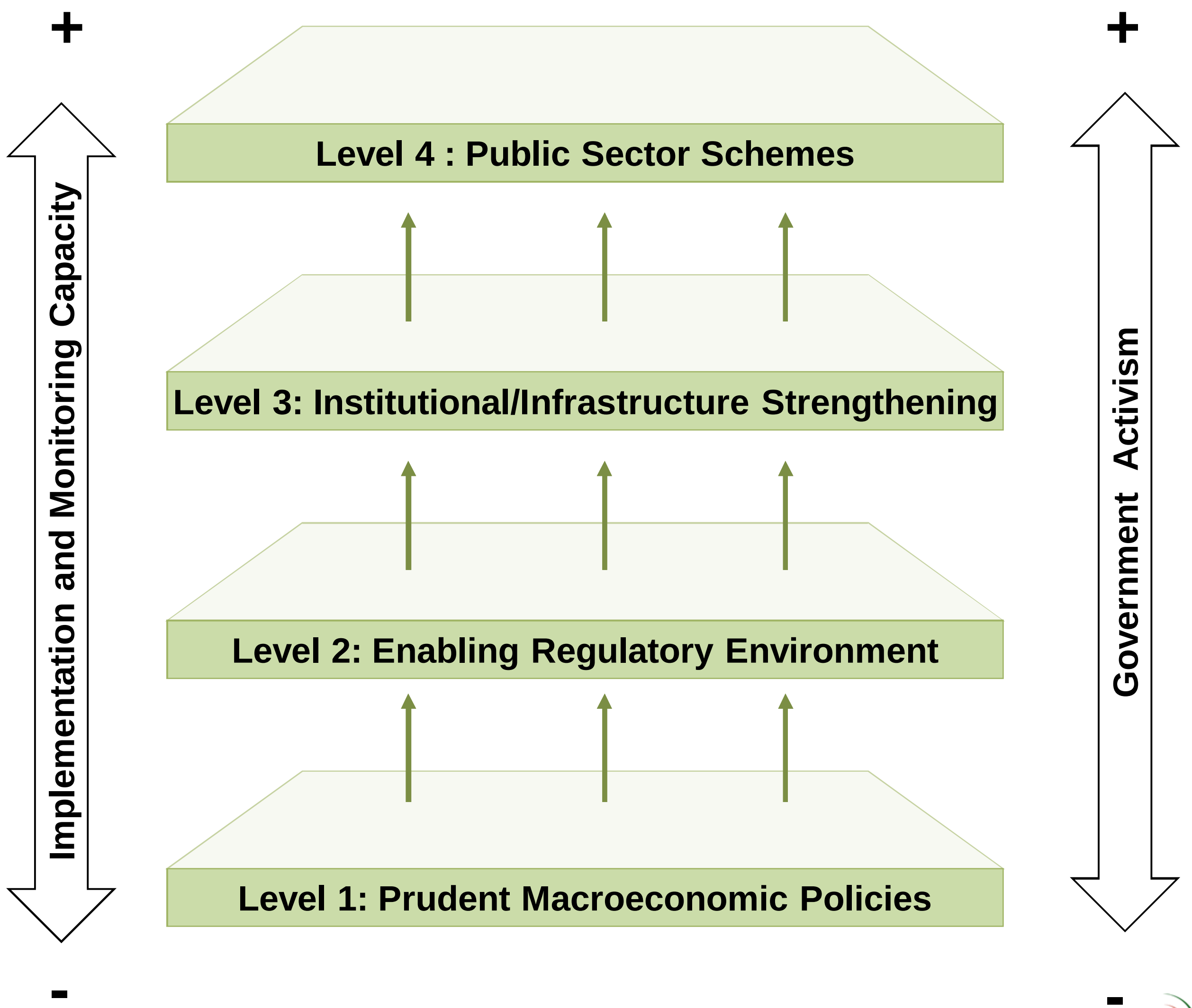
Creating a thriving environment for MSMEs requires sound policies on four levels



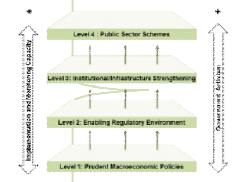
Source: Genesis Analytics Team Analysis 2012

Our focus is on interventions that address the supply side

What interventions can the Government design that successfully encourage banks to lend more to MSMEs?

1 Supply-side interventions

	Intervention	Level
a	General Regulatory Environment	Level 1
b	Enabling Environment	Level 2
c	Partial Credit Guarantee Schemes	Level 4
d	State banks and development finance institutions	Level 3
e	Apexes and wholesale funding	Level 4
f	Supply Side Capacity Building	Level 4
g	Encouraging Innovation	Level 4



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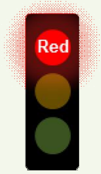
The regulatory /policy environment defines the terrain for intervention

Intervention	Key components	Recommendations/Implications
1a Regulatory environment	1 **National Policy on MSMEs:** • Launched in 2007 • Maps the MSME regulation landscape • Defines the MSME segments (due to be revised)	• Current proposed revisions to segment definitions (by SMEDAN) should be done with caution – to **avoid** adversely **shifting the banks' targets**. 
	2 **Revised Microfinance Policy:** • Launched 2005, revised in 2011 • Categorizes MFBs in Nigeria according to whether operating at a Unit, State of National level. • The CBN stipulates 80% of MFB lending portfolio must go to Micro	• Important given the structure of the market • Important for the policy to achieve the right trade off between focus and scale and risk 
Discontinued	3 **SMEEIS:** • Launched in 2001, terminated in 2008 • Mandated all bank set aside 10% after tax profit to invest as equity in SMEs (defined more broadly than the national definition above)	• SMEEIS failed to achieve its developmental aims as it did not match banks capabilities . • There is no indication SMEEIS will be reinstated. 

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Source: Genesis Analytics Team Analysis 2012; Federal Republic of Nigeria and CBN brochures
Definition: SMEEIS: Small and Medium Enterprises Equity Investment Scheme

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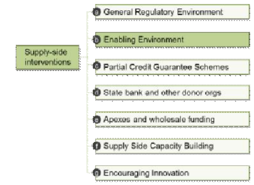
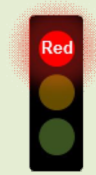
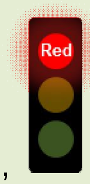
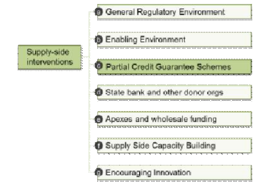


Some of the biggest constraints to MSME lending are environmental

Intervention	Current Nigerian Initiatives	Recommendations/Implications
1b Enabling environment	1 **Credit bureaus:** • There are currently 3 (Credit Reference Company, Credit Registry, XDS Credit Bureau) • Current regulatory requirement is that institutions register with at least 2 credit bureaus	• Credit bureaus will help to ease information uncertainty • Need to monitor effectiveness • **Encouraging and regulating** use of the bureaus will be important. 
	2 **Collateral Registries:** • Registration and realisation of collateral is a major challenge/ obstacle for financial institutions	• This is an important area for reform and modernisation 
	3 **Customer identification (ID):** • The lack of an uniquely identifying national ID system in Nigeria has limited banks' ability to know and identify their customers and extend credit	• This is a important national project that will bring enormous benefits to the financial sector 
	4 **Taxation laws:** • Nigeria's complex State and Federal taxation laws can be a burden on MSMEs requiring time to understand and pay the various taxes; multiple taxation can occur.	• Whilst simplifying tax laws is complex, it would be beneficial to **partner with expert organisations** to remove redundant processes, ensure unique taxpayer IDs. 

Source: Genesis Analytics Team Analysis 2012; Federal Republic of Nigeria and CBN brochures

PCGs globally have been shown to be critically important in encouraging lending



Intervention	Current Nigerian Initiatives	Recommendations/Implications

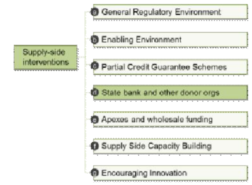
1c Partial Credit Guarantee Schemes (PCGs)	1 **SMECGS:**
	• Launched 2010, fund of N200bn, managed by CBN
	• Eligible borrowers: SMEs (using national definition)
	  • Max loan size: N100m, 7 year tenure, “adequate collateral” required
	  • Lending rate for banks: prime
	  • 80% guarantee
		• The eligibility criteria and modalities matter hugely to adoption
		• Low level of confidence in the banking sector that they will be paid out by the CBN
		

	2 **ACGSF:**
	• Launched 1977, fund of N3bn, managed by CBN, currently value N8.5bn
	• Eligible borrowers: Agricultural industry
	  • Max loan size: For cooperatives: N5m; For corporate: N10m; unspecified tenure
	  • Variety of collateral options available, uncollateralised allowed for less N20 000 loans
	  • Lending rate: not stipulated
	  • 75% guarantee
		• 3 banks (Union Bank, First Bank and Bank PHB) have taken up 96% of the scheme.
		• Developing agricultural capabilities across more financial institutions may require adjusting the modalities
		

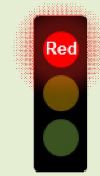
Not yet active	3 **NIRSAL:** • NIRSAL has not yet been officially made active, fund of N45bn, managed by CBN • Eligible borrowers: Agricultural industry • Modalities: Not yet specified	? • Regular monitoring and evaluation will be important to assess outreach and success. • Consolidating agricultural schemes ACGSF, innovation, technical assistance.

Source: Genesis Analytics Team Analysis 2012; CBN website, ACGSF Annual report, NIRSAL brochure; Definitions: SMECGS: Small and Medium Enterprise Credit Guarantee Scheme, ACGSF: Agricultural Credit Guarantee Scheme Fund; NIRSAL: Nigerian Incentive-Based Risk Sharing System for Agricultural Lending

State owned institutions are complex to evaluate and manage



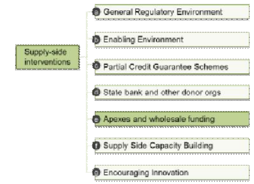
Intervention	Current Nigerian Initiatives	Recommendations/Implications

1d State banks and development finance institutions	1 **BOI:**
	• Goal: Supporting enterprise development with new focus on SME
	  • In 2010, 96% of retail values disbursed went to SME or large corporations with MSME links
	• Network: 5 branches
	• Total balance sheet: N191 bn
	  • 50% on deposits at commercial banks
	  • Balance sheet is one tenth of the size of largest Nigerian bank
	• Development fund administrator for a range of foundations and funds (eg Dangote)
		• State banks need wide scale infrastructural distribution if they are to lend directly
		• BOI principally providing refinancing and **liquidity to financial institutions**.
		• Refinancing activities do not expand access, but reduce and concentrate losses
		

	2 **NERFUND:** • Established in 1989 • Received N200bn from the government in 2010 • Goal: Provide loans to eligible SMEs • Network: Unknown, although applications for loans can be solicited directly with the NERFUND committee or through a number of development agencies • Total balance sheet unknown • No annual report available online.	• Given the significant funding NERFUND receives, **transparency is vital** and it would be beneficial if annual reports were made available online. 

Source: Genesis Analytics Team Analysis 2012; BOI Annual report 2009 and NERFUND website; Definitions: NERFUND: National Economic Reconstruction Fund

Wholesale funding schemes are needed when institutions struggle with liquidity



Intervention	Current Nigerian Initiatives	Recommendations/Implications

1e Apexes and wholesale funding	1 **N200bn manufacturing refinancing facility:**
	• Approved in 2010, fund of N200bn
	• Issued by BOI (on behalf of CBN)
	• Fund used for loans made to the manufacturing sector
	  • Max loan size: N1bn
	  • Max interest chargeable by bank: 7% (per annum)
	  • Interest charged by BOI: 1% (per annum)
	  • Maximum tenure: 15 years
		• The fund has assisted banks refinance manufacturing loans – alleviating pressures on the short term.
		• This has also **helped SMEs** in the manufacturing sector who had **existing loans**, but has not extended additional loans.
		Amber

	2 **NERFUND:**
	• Approved in 1989, fund of N200bn
	• Managed by the NERFUND committee
	• Fund used for loans to SMEs wholly Nigerian owned, some local sourcing requirements
	  • Max loans size and tenor: not specified
	  • Max interest rate chargeable by banks: 2% above MPR (per annum)
		• Whilst a full analysis was not possible without an annual report, to achieve maximum reach (to MSMEs instead of just SMEs) NERFUND may **consider providing funding to MFBs** specifically (rather than DMBs).
		?

Potential new launch	**Microfinance fund** Discussions on-going over a potential MFB fund, size and modalities currently unknown*	Green

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Source: Genesis Analytics Team Analysis 2012; CBN website, ACGSF Annual report, NIRSAL brochure
* Information gathered through interviews with SMEDAN and CBN, January 2012

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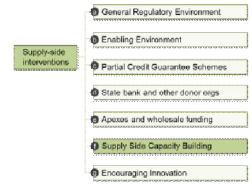
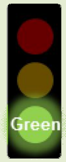
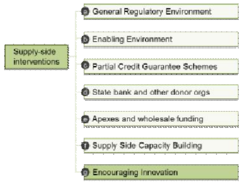
The size of the Nigerian population makes scalability vital in the capacity building initiatives



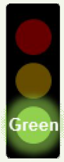
Intervention	Current Nigerian Initiatives	Recommendations/Implications
1f Supply side capacity building	1 **SMEDAN:** • Operational since 2005, funded by the Federal Ministry of Trade and Industry, BOI and NERFUND • Goal: facilitate growth and development of MSMEs • Plays a role in policy formulation and data collection • 15 Business Support Centres, 37 Business Info Centres; trained 9, 000 MSMEs in 2011. • Currently focuses more on demand side capacity building	• Outreach is currently very limited • Mainly a demand side intervention so outside of the core scope of the study.
	2 **RUFIN:** • Operational since 2010, funded by IFAD and Federal Government of Nigeria • Goal: Actualizing food security, employment and wealth creation in the rural areas • Has helped bring together cooperatives for MSMEs and delivered MFB training to 33 MFBs – promoting information sharing via MixMarket and the benefits of an MFB ratings system	• Has been effective at formalising cooperative structures and promoting rating • Key challenge is to ensure the sustainability of such structures and that they receive appropriate funding 

Source: Genesis Analytics Team Analysis 2012; BOI Annual report 2009 and NERFUND website

Whilst NIRSAL has not yet been launched it has the capacity to boost innovation if well managed



Intervention	Examples in Nigeria context	Recommendations/Implications
1f Encouraging innovation	1 **NIRSAL:** • Launch date undecided, facilitated and designed by CBN • NIRSAL incorporates two innovation schemes: 1. Insurance facility N4.5bn 2. Agricultural lending • Bank rating mechanism (rating effectiveness in developing long term agricultural lending): costing N1.5bn • Cash reward for banks that develop long term lending: N15bn	• Innovation funds have the **potential for far reaching impact** (given the necessary monitoring and assessment criteria). • Innovation funds can serve as the springboard for new and innovative ways of lending in constrained for complacent markets.



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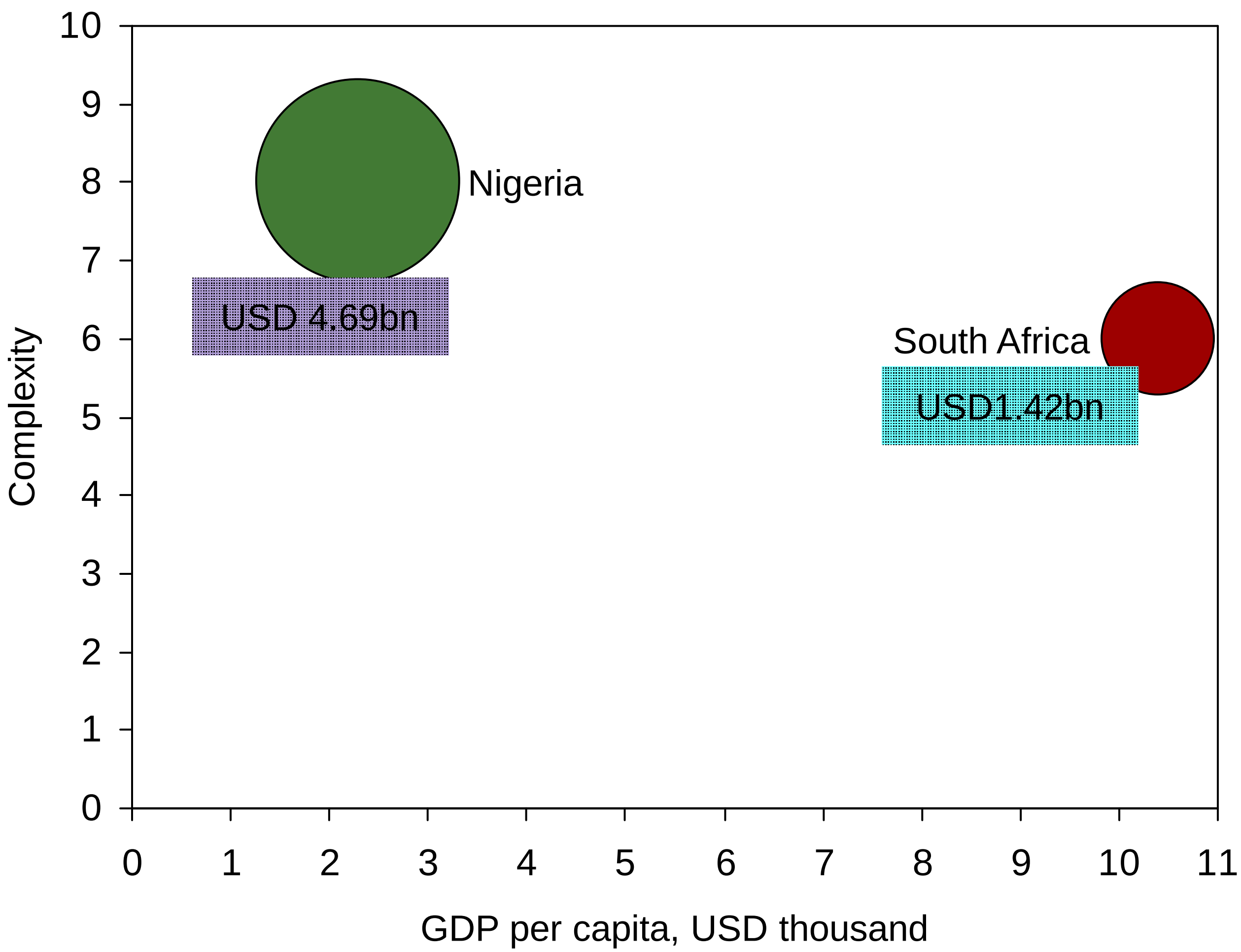
Nigeria is making a very substantial commitment to promote MSME development

Comparison of total cost of interventions in Nigeria and South Africa



The total value for Nigeria was calculated by summating the cost of all the interventions analysed in the report.

Unfortunately given the range of interventions there is no standard comparative international measure of the level of Government support for MSME development

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Source: Genesis Analytics Team Analysis 2012, World Bank 2010 figures

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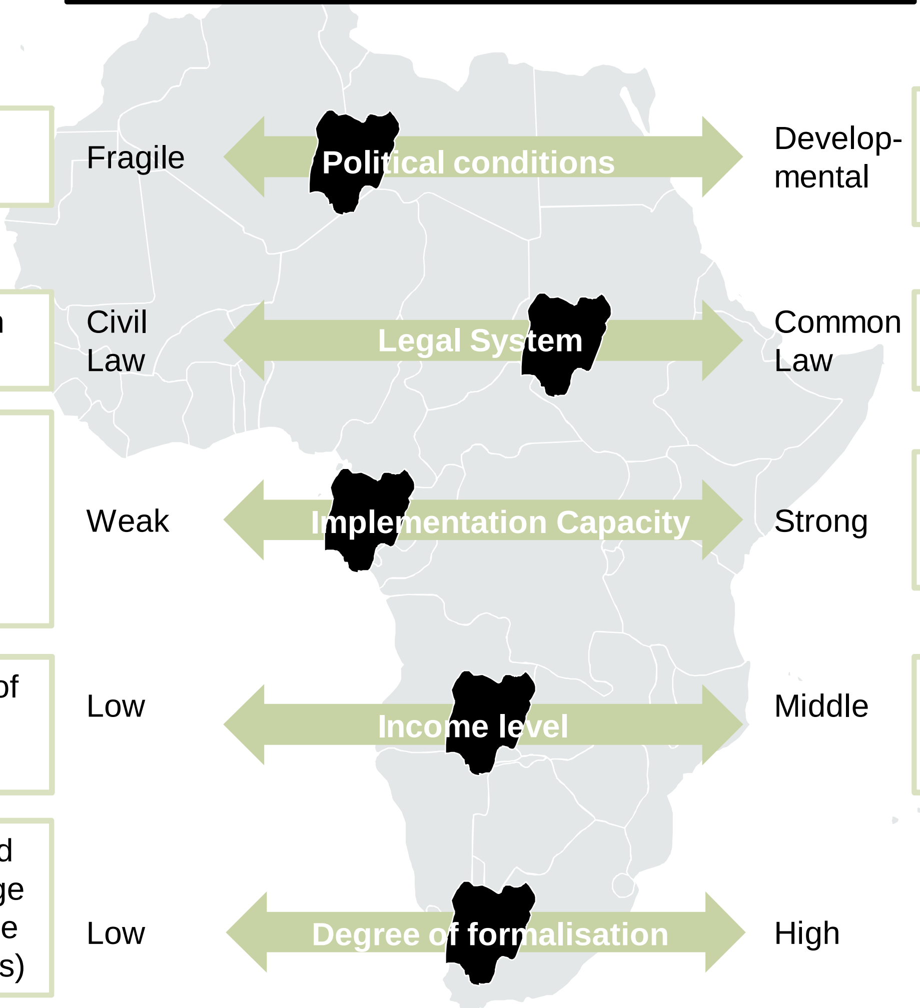
How appropriate these interventions are given local conditions will determine their effectiveness…

Types of Interventions Relevant to the Local Context



Strengthen basic legal and enabling environment	Fragile	Political conditions	Develop-mental	Implement specific public support initiatives* to support MSMEs
Design non-judicial resolution systems	Civil Law	Legal System	Common Law	Strengthen courts and enforceability
Focus on less complex interventions. Seek donor support and expertise when implementing public initiatives	Weak	Implementation Capacity	Strong	Empower state organisations to design and manage the interventions
Promote innovation and use of unsecured lending, leasing options	Low	Income level	Middle	Extend credit to funding constrained financial institutions and PCGs to support SMEs
Promote mobile platforms and use of cooperatives. Leverage existing financial infrastructure (providing credit to rural MFBs)	Low	Degree of formalisation	High	Promote partnerships with retailers and distributors

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* Initiatives such as PCGs, directed wholesale funding, supply side capacity building and innovation funds

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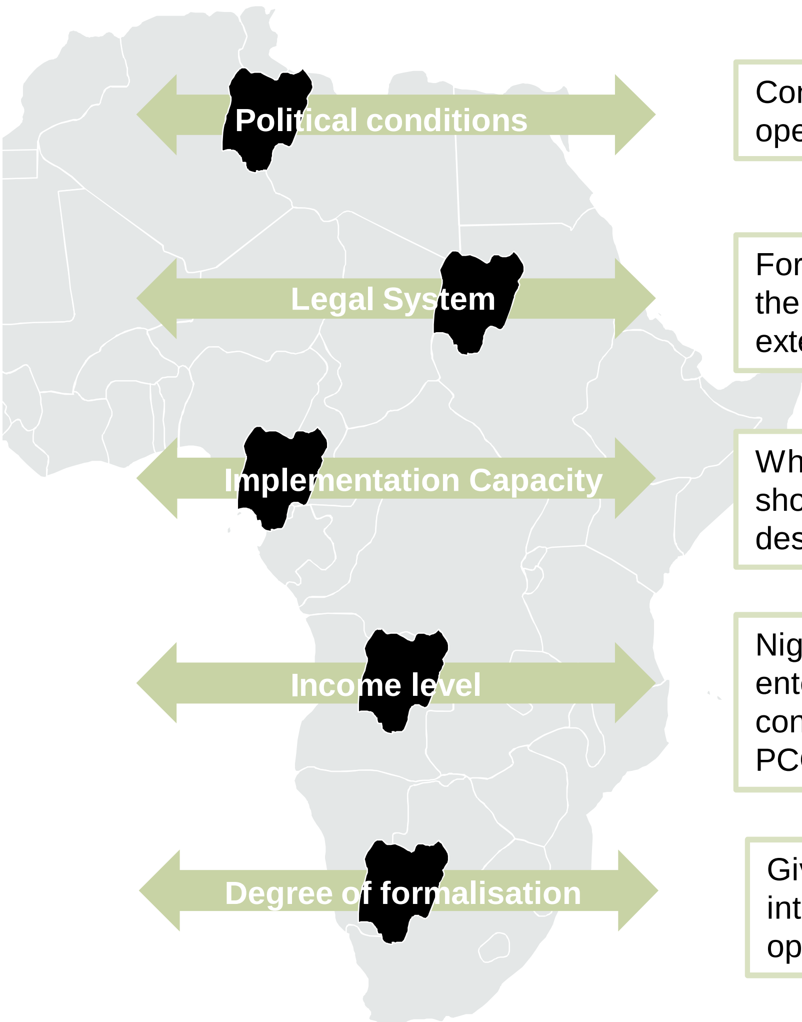
… and reveal the types of interventions on which Government should focus



Considerable benefit will be achieved by improvements in the overall operating environment

For lending to small and medium sized businesses the functioning of the legal system and registry process is critical to the level of credit extension..

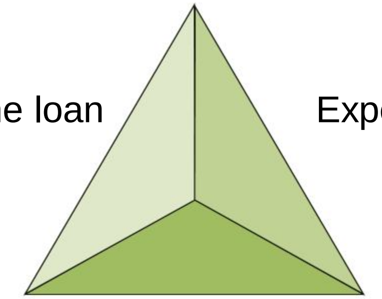
When the state has a weak implementation capacity interventions should focus on those that leverage the private sector, are simple to design and execute and have a low monitoring requirement

Nigeria needs to provide finance to the huge number of micro-enterprises, but it can also help institutions to overcome some of the constraints that arise from the environment through the provision of PCGs.

Given the very low level of formalisation in many business segments, interventions should focus on the development of microfinance, co-operatives and mobile payment services

An effective intervention should aim to positively influence a financial institution's decisioning process…

Expected revenue from the loan



Expected costs to provide the loan

Risks involved to provide the loan

Intervention in Nigeria	Effect on credit decisioning		
	Revenue	Costs	Risk
Enabling environment			
• ID system	-	½	✓
• Credit bureaus & registries	-	✓	✓
Partial Credit Guarantees	-	½	✓
State banks	-	-	-
Apex and wholesale funding	✗	✓	-
Supply side capacity building	-	½	✓
Encouraging innovation	-	½	✓

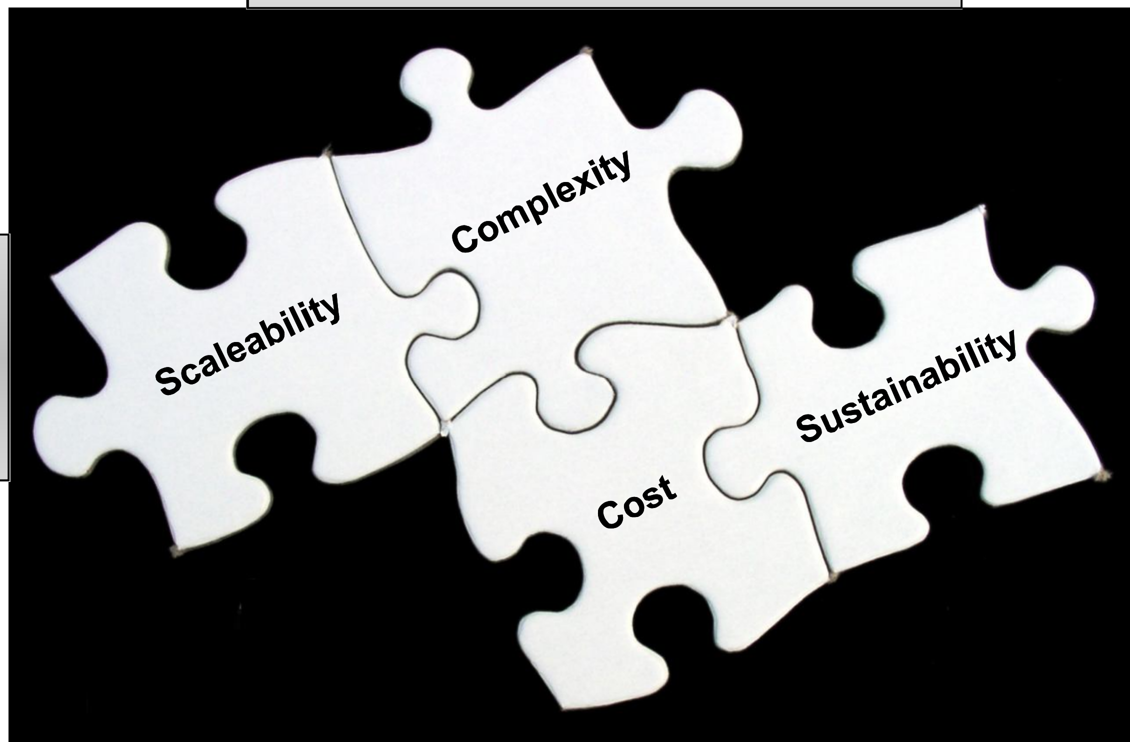
Scale

Positive effect:	✓
Semi-positive effect:	½
No effect:	-
Negative effect:	✗

… and represent an effective use of state resources

Complexity
Degree of complication required in the design and implementation

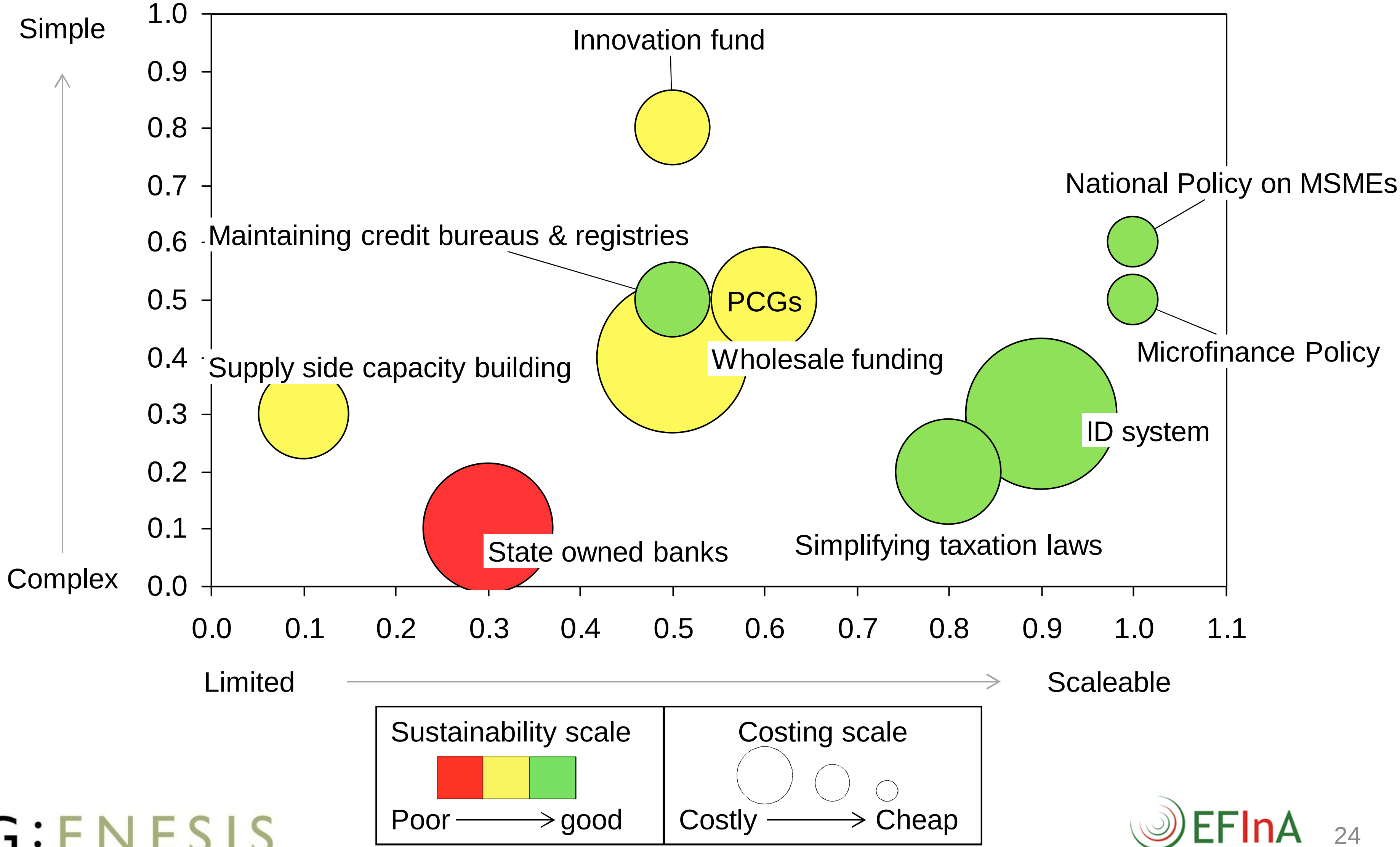
Scaleability
Ability of the scheme to reach a large number of users



Sustainability
Ability of the scheme to endure in the future

Cost
The total cost to design, implement and sustain

The best interventions are simple, scaleable, sustainable and affordable



Different interventions are appropriate for different segments

Intervention	Segment relevance		
	Micro	Small	Medium
General Regulatory Environment			
• National Policy on MSMEs	H	H	H
• Microfinance Policy	H	M	L
• Taxation laws	L	H	H
Enabling environment			
• ID system	H	M	L
• Credit bureaus & registries	L	M	H
Partial Credit Guarantees	M	H	H
State banks	L	M	M
Apex and wholesale funding	H	L	L
Supply side capacity building	M	M	M
Encouraging innovation	M	H	M

Scale	Low:	L	Medium:	M	High:	H

The banks demonstrated limited awareness of the interventions except for the PCGs and wholesale funding

Partial Credit Guarantee Schemes	"Although we are informed about the PCGs, we don't subscribe because the eligibility criteria are too stringent" "we don't believe Government will payout, timeously"
State banks and other donor organisations	"The wholesale funding provided by the BOI has been a help in managing troubled deals"
Apexes and wholesale funding	"Although we subscribe to the wholesale funding options such as the manufacturing N200bn fund this hasn't really incentivized us to extend additional loans to SMEs"
Supply Side Capacity Building	"We are not aware of the work of RUFIN or SMEDAN"
Encouraging Innovation	"Our bank would respond positively to greater funding available for innovation – it would help to focus innovation in key areas"

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Progress is required on all four levels

Intervention	Recommended changes			
	Change	Detail	Organisation	Likely impact
General Environment				
• National Policy on MSMEs	-	Revised definition?	Federal Government of Nigeria, SMEDAN	Adjust banks' measurement parameters for interventions
• Microfinance Policy	↑	Enforce	Federal Government of Nigeria, CBN	Boost MSME credit access through MFBs
• Taxation laws	↑	Simplify	Federal Government of Nigeria, CBN	Lower burden MSMEs
Enabling environment				
• ID system	↑	Introduce	Federal Government of Nigeria	Lower risks associated with lending to MSMEs
• Credit bureaus	-	Maintain	CBN	Lower risks and costs associated with lending to MSMEs
• Registries	↑	Introduce/ reform	CBN	Lower costs associated with lending to MSMEs

Scale	Increase funding/focus: ↑	Maintain funding/focus: -	Decrease funding/focus: ↓

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Source: Genesis Analytics Team Analysis 2012

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Progress is required on all four levels (cont.)

Intervention	Recommended changes			
	Change	Detail	Organisation	Likely impact
Partial Credit Guarantees	↑	Review criteria (see next slide)	CBN	Improved utilisation
State banks and development finance institutions	↓	Maintain role as liquidity provider if needed	CBN, BOI and NERFUND	Reduced refinancing to the DMB
Apex and wholesale funding	-	Adjust to reach MFBs	CBN	Extend reach to the micro segment through the MFBs
Supply side capacity building	↑	Adjust to amplify scale	SMEDAN, RUFIN	Amplify impact
Encouraging innovation	↑	Monitor NIRSAL; Design MFB Development Fund	CBN/ Federal Government	Encourage new and innovative ways of lending to MSMEs

Scale	Increase funding/focus: ↑	Maintain funding/focus: -	Decrease funding/focus: ↓

Source: Genesis Analytics Team Analysis 2012

Importantly, making some adjustments to Nigeria's current PCGs could increase efficiency and amplify their impact in the market

1 Adjust the monitoring mechanism:

Currently in the event of an NPL, both the bank and CBN conduct an evaluation process.

- Time consuming and can create moral hazard

Consider…
- The CBN conducts due diligence on the financial institution to identify eligible financial institutions who can access the PCG.
- No need thereafter to conduct dual monitoring in the event of an NPL.

Implications:
- Shorten assessment times for CBN to cover the loan.
- Lower moral hazard – encourage banks to take ownership of risk

2 Extend PCGs to the small segment:

Currently, by design, the PCGs target the SME sector excluding the micro segment

Consider…
- Relaxing collateral requirements to enable access for smaller firms.
- To compensate for the added risk:
  - Implement loan ceilings
  - Introduce a fee paid by banks to CBN

Implications:
- Increase the reach of the PCGs

Promoting credit extension for MSMEs therefore rests on developing strong foundations and promoting sustainability and scaleability

Developing strong foundations

- Strengthening the regulatory and enabling environment:
    - Simplifying tax laws
    - Implementing a national ID system
    - Collateral processes

Promoting sustainability and scalability

- Tailoring the design of PCGs to achieve optimal reach
- Providing wholesale funding to credit constrained MFBs not DMBs
- Strengthening MFB capacity building and promoting greater coordination across training organisations
- Improve monitoring and evaluation and disclosure on all schemes

Fostering innovation

- Utilising well-designed development funds to promote new innovations within the banking sector

Source: Genesis Analytics Team Analysis 2012