



LEVERAGING TECHNOLOGY FOR MSME FINANCING IN NIGERIA

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FORWARD

Leveraging Technology for MSME Financing In Nigeria

Financing has been routinely described as the lifeblood of commerce and rightly so. However, while funds make the world go round - technology certainly makes it spin faster. The principal effect of technology is to democratize, enable and improve the efficiency of systems, leading to better outcomes. These fundamentals informed the hosting of this event to explore ways in which technology can be deployed as a catalyst for identifying viable MSMEs, improving their standard operating procedures, and connecting them to sources of finance.

At Enhancing Financial Innovation & Access (EFInA), we understand that MSMEs are not at the front of the line in terms of consideration for credit facilities. This may be owing to the historical skepticism by financial institutions, the inability of the MSMEs to get their ducks in a row, or most times, a combination of both. As a financial sector deepening organisation, our job is to deconstruct these challenges and create feasible business models amongst other things that all but guarantee the matching of ideas and financing.

Together with our partner, Microsoft Africa Development Centre, we tried to double down on addressing these mitigating factors by distilling the practical solutions from the ideation-hackathon we also organized. Having the knowledge that owing to MSMEs being responsible for absorbing a significant chunk of the employment pie, the success of this campaign solves not just an economic issue but also a social conundrum. These challenges are multi-causal, and so is our approach – developing hybrid solutions instead of monoliths or silver bullets.

The stakeholder session was designed to exchange perspectives on the big ideas that move the needle, and the emerging roles that new technology and financial products can play in upscaling production and productivity. The importance of managing the relationship of MSMEs with external stakeholders such as regulators is also highlighted, and policy positions were also proffered about the market realities of the Nigerian business ecosystem. The brutal inevitability of data was reinforced, and the digital infrastructure that is needed to lay the foundation for innovation was identified as the cornerstone for a revolution in inclusion.

The implementation of these submissions will ensure that the ecosystem is more scientific; making risk assessments more predictable and profitable for the players on the supply side of the credit and more accessibility for the players on the demand side owing to conformity to best practices and the heightened confidence in the system to protect their interests. Development organizations and donor agencies are not left out of this blueprint; their interventions are critical to unlocking the massive potential embedded in the ecosystem. Through their partnerships, the gospel of financial inclusion continues to be preached and practised in places where it otherwise wouldn't be propagated.

Indeed, it takes a village to make dreams come through – the good news is that we're committed to this cause. I believe that this very interactive session is one of many more that our organization will use in deepening literacy, engagement, and feedback from the MSME community.

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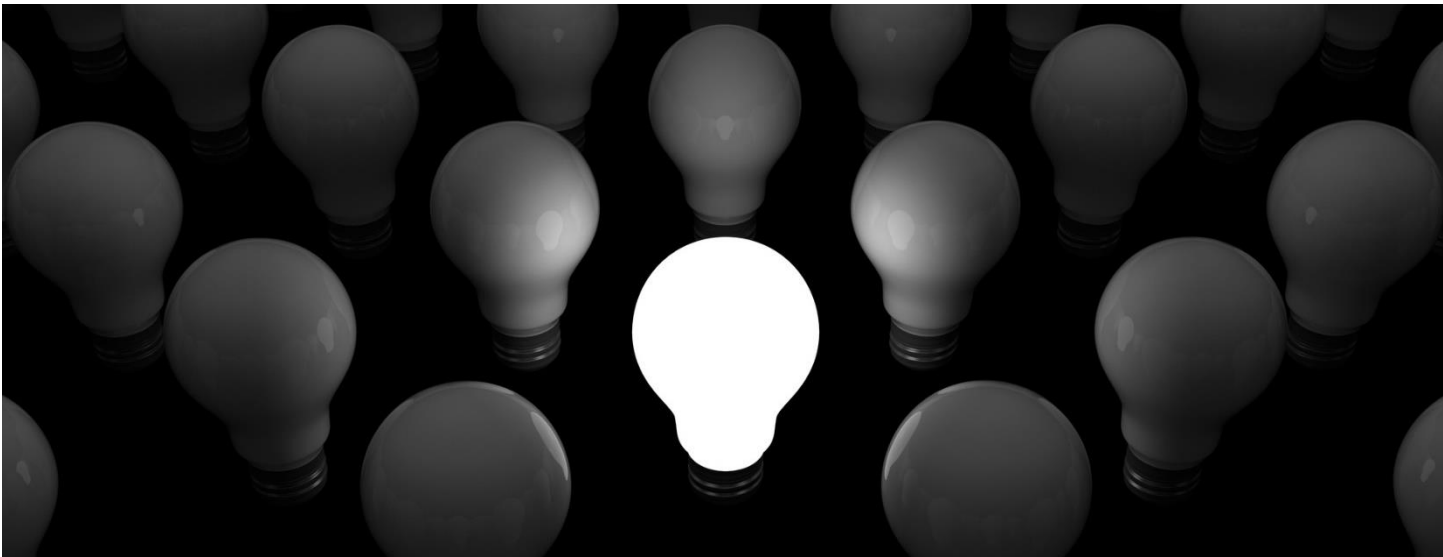
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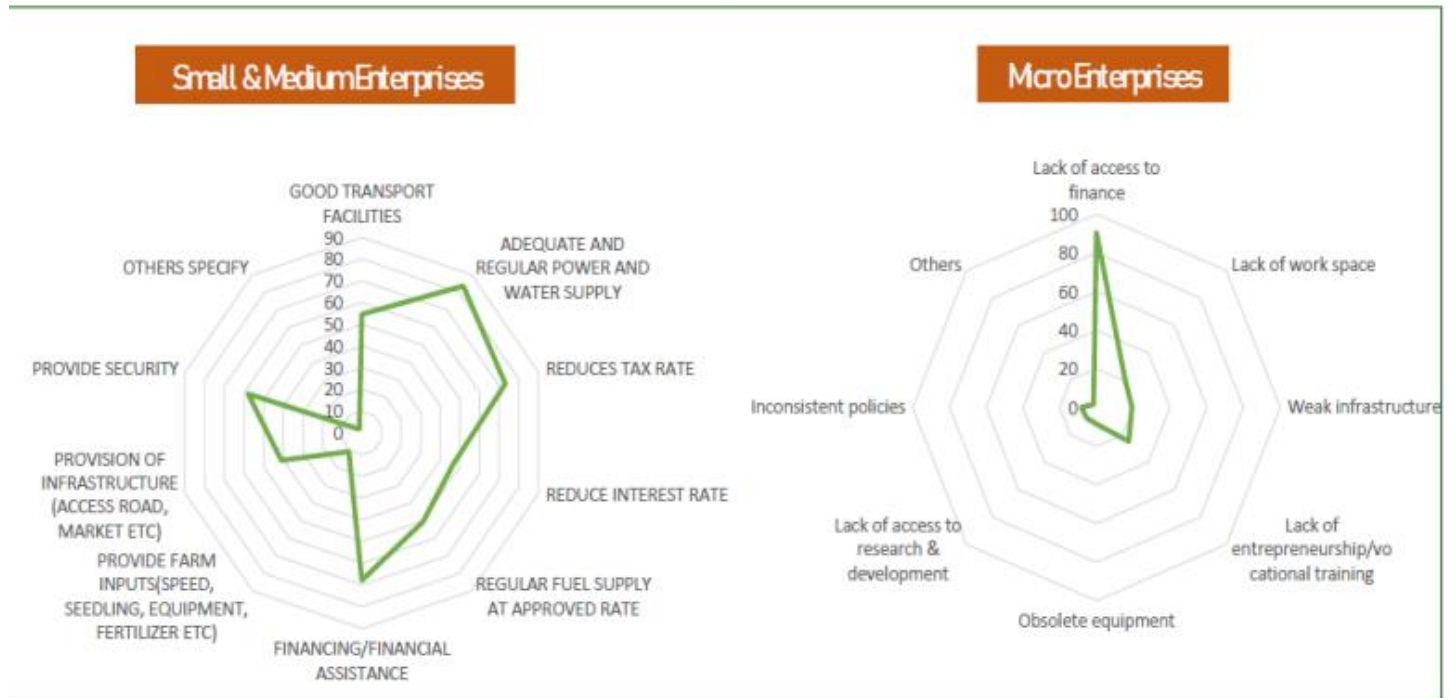


INTRODUCTION

EFInA in partnership with Microsoft Africa Development Centre (ADC) organised a stakeholder session in September 2022 tagged “Breaking the Barriers of Access to Finance for MSMEs in Nigeria”. The event was organised to facilitate discussions among key stakeholder groups on how technology can be used as an enabler to drive access to finance for MSMEs regardless of the challenges (from the supply side, demand side, and others). Furthermore, lessons learned from other climes that could be implemented in Nigeria were discussed.

The session also provided the opportunity for the top 3 MVPs from the recently concluded Ideathon-hackathon to be awarded. The competition was put together to tackle some of the challenges hindering access to finance for MSMEs. The winning solutions addressed the following challenges: Lack of credit history & rating, Inability to meet up with collateral requirements, Manual/rigid credit reporting system, and Lack of proximity to financial service access points. It is anticipated that these winning solutions will be promoted by interested and committed financial service providers within the coming months.

CHALLENGES HINDERING ACCESS TO FINANCE FOR MSMES IN NIGERIA



The MSMEs sector is one of the most important sectors of the Nigerian economy currently representing 96 percent of businesses in Nigeria, contributing significantly to employment and the national GDP. According to the SMEDAN/NBS 2020 Survey, the Nigerian economy has about 39.7 million MSMEs, however, the sector has not been able to deliver on its potential due to several critical challenges. If well nurtured and structured appropriately, the Nigerian MSME sector has the potential to create jobs, increase productivity and income, and reduce poverty. Access to finance has been highlighted as a key challenge inhibiting the capacity of the MSME sector from making significant contributions and playing the expected and vibrant role in the economic growth of the country.

Despite the proliferation of credit providers in Nigeria - both regulated and non-regulated, the financing gap for MSMEs in Nigeria persists due to several issues categorised into 3 main groups:

**Demand-
Side
Challenges**

- Inability to fulfil requirements (financial records, collateral)
- Lack of financial management skills
- Lack of technical skills
- Low-level awareness of existing finance products/interventions (National Collateral Registry, CBN/Govt loans)
- High-interest rate/ Long process timing/ Lack of transparency (hidden charges, repayment schedule/plan)
- Perception that that loans are bad/ FSPs will threaten business owners for missed repayment/ Low level of trust
- Lack of proximity to financial service access points

Supply-Side Challenges

- Lack of an innovative credit appraisal system
- Ineffective customer address verification system
- High cost to serve/ High default rate
- Lack of a centralised credit database/ Inconsistent reporting to credit bureaus
- Lack of technical skills in specific segments (e.g., Agric)
- Crowding out effect due to the wrong perception of government loans and interventions

HIGHLIGHTS FROM THE STAKEHOLDER'S SESSION

A keynote address titled “Technology as an enabler for driving access to finance for MSMEs in Nigeria” was delivered by the Chief Economist of the Development Bank of Nigeria; Mr. Joseph Nnanna ably represented by Mrs. Arume Tsekiri. The following insights were shared:

1. The entrepreneurial potential and critical role MSMEs play in economic growth and development is clear, however, the financing gap experienced by MSMEs has delayed the actualization of the huge potential making the economic and social impacts of the economic crisis more severe and long-lasting.

2. New technologies are rapidly transforming the financial services sector and addressing several challenges that can help close the financing gap for MSMEs.
3. The main technology innovations that are having the biggest impact on the financial services sector and ultimately helping MSMEs are in two major categories:
 - a. Infrastructure - the foundations that new business models and financial products can be built and/or developed on)
 - b. Enabling tools and channels - innovations that can serve as distribution channels enabling the use of digital financial products and/or serve as tools in the development of new business models and financial products
4. As a result of these technological innovations, new digital financial products are being developed and offered to MSMEs, Software solutions and tools that MSMEs can use to digitally transform their businesses and new business models such as e-commerce, open banking that have been introduced to spur growth and digitalization of MSMEs.
5. Policy options should be considered that address the challenges MSMEs face and promote a more conducive environment for facilitating MSME access to finance through digital technologies, across three core areas:
 - a. Develop a strong digital infrastructure base
 - b. Promote a literate, informed public with privacy protection and cyber risk management
 - c. Build open and competitive markets, in which partnerships are encouraged, to accelerate responsible innovation



Image: Fireside Chat with Olu Akamu, President and Co-CEO OPay-Nigeria

Olu Akamu, President and Co-CEO OPay-Nigeria highlighted that there were 3 key challenges we need to tackle to break the barrier in access to finance for MSMEs in Nigeria

1. Inclusive and pervasive digital identity that works: Digital identity is the foundation stack in the financial system. It implies that an inclusive payment or financial system for MSMEs will be constrained by the reach, pervasiveness, and inclusion of Nigeria's formal digital system. MSMEs businesses are typically unregistered, and informal and run their business under their personal names. Hence the basic digital identity for individuals is also what the MSMEs also need as their personal and business lives are significantly intertwined.

Formal digital identity is also the first data point in credit scoring in digital finance which along with payment and cashflow data of a formally identified customer, provides the information for the credit stack of the digital finance system

.....” *The government of Nigeria and the National Identity Management Commission (NIMC) must be commended for the very significant progress made over the last four years in pushing the reach of the Nigeria National Identity Number (NIN).... The pace of growth of the NIN database in the last four years suggests that there would be 100 million Nigerians registered on the NIN database by 2023. This will be a real, big historical milestone for the Nigeria digital identity system with wide ramifications for inclusive digital finance. 100 million Nigerians with formal digital identity by 2023 imply that we can theoretically have 100 million formal financial accounts (bank or wallet) by 2023 if we can provide all NIN holders with formal financial accounts” ... (Olu Akamu, President and Co-CEO OPay-Nigeria)*

Experience suggests that there are still significant challenges with the quality of the NIN database. These challenge needs to be fixed for the benefits of the NIN database to be fully harvested for financial inclusion. The tech ecosystem should also work with the NIMC to build an address verification system that complements the biometric and phone number information of NIN. Using geospatial and geolocation technologies, how can we verify the claimed addresses on the NIN database where necessary to improve identity records and do so with the speed and agility of the low transaction cost that digital technology enables?

2) Accessible and affordable merchant collection solutions that can scale and reach millions of MSMEs: Current card and offline traditional Point of Sales (POS) terminals that are deployed in Nigeria for merchant collections, where the POS terminals cost about 60 dollars per terminal are expensive and cannot scale to serve millions of small merchants. This cost implies that current merchant collections solutions are exclusive and only available to large merchants where the unit economics of terminal

cost could be justified. Yet providing digital solutions that enable millions of MSMEs to get paid conveniently offline could be a powerful method to get millions of informal MSMEs to digitise their offline payment collections and establish a digital payment footprint for their business.

3) Smartphone, affordable internet, and USSD: Smartphone penetration in Nigeria is increasing, helped significantly by more affordable pre-owned phones, estimated currently at 37%. Data however needs to be more affordable to get more of our MSMEs to consistently use their phones for digital and micropayments. Because of expensive data, quite a significant number of lower middle- and lower-income demographics in Nigeria would switch off their WhatsApp connection and only turn it on periodically. This suggests that data costs are expensive relative to the income of lower-income demographics in Nigeria and would constrain the consistent use of digital payments even as smartphones get more affordable.

Also, USSD pricing per session charges N6.98 plus a minimum of N10 per payment implies that a minimum USSD payment cost of about N17 at the minimum. This would be very expensive for millions of nano-enterprises and MSMEs and those who might want to pay them for very small or micro-payments. It would constitute a disincentive for the usage of the USSD platform that should be ordinarily offering inclusive payments given that the USSD phone is the most accessible and affordable for millions of MSMEs and their customers.

PROPOSED SOLUTIONS FOR CONSIDERATIONS

Regulators & Government Agencies

1. Build a robust digital identity infrastructure by accelerating the harmonization of various digital ID systems and expanding access to the infrastructure required for ID registration.
2. Expand the infrastructure for disbursing government intervention funds to include Fintechs as they have created more digital footprints in the informal MSME sector. Furthermore, there should be regulations enforcing the digitisation of disbursements of intervention funds for the informal sector.
3. Regulators should be more open to leveraging technology to develop legal requirements and establish a standardized procedure for monitoring and supervising the operations of non-traditional financial service providers offering alternative financial instruments.
4. Although current regulation applies a risk-based approach, the documentation requirements do not effectively take into consideration the risk profile of a client. Regulation should allow flexibility in documentation requirements taking into consideration the risk ratings of customers.
5. While the success of linking markets depends on the issue of a centralized ID system, access to information about the MSMEs sector should be accessible to a wide range of providers. Regulations administering open banking in Nigeria should be implemented and strategically coordinated such that it facilitates MSMEs' access to a variety of formal financial services.
6. Tackling the challenge of address verification, especially in the peri-urban and rural areas will positively influence and drive access to

formal financial products. For example, providers need to be able to identify geographic locations with high MSME concentrations in addition to other important information.

7. Considering the unwillingness of some financial services providers to serve the informal micro business segment due to the high risks involved, policies and/or interventions that can incentivize providers to be more committed to serving the sector should be implemented.
8. Developing and facilitating a credit reporting system that is standardized and provides useful information that providers can rely on when appraising loan credits.

Financial Service Providers

1. Leverage alternative credit scoring models for appraising loan requests from the informal MSME sector, considering that these microbusinesses have little or no interaction with the formal financial sector.
2. When choosing the right technology for a merchant collection system for the micro business target market, factors such as the context, business model, cost, investment appetite, risk appetite, etc must be considered
3. While setting the price of loans for the MSME market, players should consider incentivizing good borrowers; first-time borrowers and returning borrowers should not be treated alike.
4. Engage in literacy initiatives that increase knowledge of key financial concepts and facilitate the usage of formal financial services addressing perceptions of mistrust and fear. In addition, FSPs need to disclose all the necessary information about their products/service in languages easily understood by the last mile.

5. Collaboration among the various sectors/players within the financial sector would promote increased usage of formal financial services as services & products
6. Financial services providers should leverage technology to address some of the key consumer protection issues such as fraud, cybersecurity risks, and financial integrity risks.

Development Organisations & Donor Agencies

1. Incorporate financial literacy and access to finance objectives in interventions focused on promoting economic and social development.
2. Encourage the disbursement of funds for regulations enforcing the digitization of disbursements of intervention funds for the informal sector.
3. Continue to play a significant role in the development of valuable products/services targeted at the MSMEs segment. Concerns about high risks from the perspective of the financial service players can be addressed through various strategic initiatives (Grants, capacity building, etc).

NEXT STEPS

The following immediate steps have been outlined

1. Develop a technological framework that allows regulators to monitor financial service providers in the MSMEs space effectively, addressing the stifling of innovation as well as consumer protection issues.
2. Contribute to the open banking framework to facilitate innovation among players in the sector such that micro businesses experience better financial opportunities.
3. In collaboration with relevant government agencies, build on the existing framework for harmonization of ID information by NIMC to include other government bodies with universal ID data systems. This

may include providing the technology that supports the centralization/harmonization of ID.

4. Conduct research that highlights the size of the potential revenue pool in the sectors in which MSMEs in Nigeria operate and the distinctions as well as financial needs across each sector.
5. Developing a model leveraging technology that allows for synchronization of data across several sectors that can be used to ascertain the creditworthiness of persons in marginalized groups.

PICTURES FROM THE EVENT



A cross-section of speakers at the event: Left – Right (1. Marcus Wauschkuhn, Coordinator of the Sustainable Economic Development Cluster of GIZ Programmes in Nigeria and Head of SEDIN 2. Isaiah Owolabi, CEO EFINA 3. Tsekiri Arume, Head, Monitoring and Evaluation, Development Bank of Nigeria 4. Olu Akamu, President and Co-CEO OPay 5. Nkem Nweke, Engineering Innovations Lead, Microsoft Africa Development Centre (ADC)



A cross-section of participants at the event



Participants of the stakeholder engagement session on breaking barriers in access to finance for MSMEs in Nigeria at the Microsoft Garage