

Chair's Summary

of the G20 Workshop



“Helping SMEs Go Global – Moving Forward in SME Finance”

on 23–24 February, 2017

Introduction and Summary

On February 24, 2017, the workshop “Helping SMEs Go Global – Moving Forward in SME Finance” at KfW in Frankfurt am Main, Germany, brought together more than 150 experts from G20 countries, development finance institutions, and the private sector to discuss questions related to financing for small and medium-sized enterprises (SMEs). The workshop was a key event in the Finance Track of the German G20 presidency and was organised jointly by the Federal Ministry of Finance, the Federal Ministry for Economic Cooperation and Development, KfW, and the SME Finance Forum. KfW hosted the event. The outcomes of this workshop will feed into discussions in the G20 going forward.

Session 1: Fostering SME Finance in Sustainable Global Value Chains

This session focussed on the growing importance of sustainability standards and how innovative financial models can help to integrate SMEs into sustainable global value chains (GVCs). To promote this goal, the G20 Global Partnership for Financial Inclusion (GPFI) is conducting a stocktaking study under the German presidency with support from the World Bank Group (WBG) and the German Development Institute (DIE) to identify, map and analyse existing financing models, good practices and policies and partnerships with regard to SME integration into sustainable GVCs.

Large international corporations are increasingly seeking to guarantee social and ecological standards in their global value chains which to a large extent consist of SMEs. SMEs need to respond to these demands and invest in their production processes. Several examples of innovative financing solutions were presented.

A large multinational company introduced its vendor financing programme which it implements within the framework of the IFC’s Global Trade Supplier Finance programme, embedded in a supply chain platform. The idea is to set incentives to implement sustainability standards by reducing financing cost for sustainable suppliers. IFC adopts a financing structure with tiered pricing of short-term working capital, offering lower costs for those suppliers that meet social and environmental standards.

A software company’s digital tracing tool (used on smart/mobile phones) for agricultural commodities makes farmers more bankable through increased data availability and thus helps them access finance. It was stressed by an investment firm focused on sustainable and socially responsible micro-, small and medium-sized enterprises in developing countries that having a viable business case is the key element in SME financing and that usually SMEs welcome additional capacity building and support to further develop their enterprise.

It was emphasised that it is important for development finance institutions to help local banks to promote social and environmental standards for their SME clients. Representatives of the B20 highlighted that one of the biggest challenges for SMEs is that they rarely have enough collateral to access finance, and suggested that using big data to reduce the need for collateral could be worthwhile. They recommended governments should put an emphasis on the implementation of existing policies, especially in Africa. They also underlined the importance of: 1) improving the financial infrastructure for SMEs, in line with the G20 Action Plan on SME Financing, and better assessing the impact of financial regulations on lending to SMEs; 2) improving SMEs' access to diversified financial instruments, especially by developing appropriate risk-sharing and mitigating; 3) fostering the financial inclusion and financial literacy of SMEs through digital technology innovation. SMEs' access to data was also mentioned as a restraint.

To sum up, key elements to help SMEs invest enough in raising their environmental and social standards include:

- Setting up a sound legal and regulatory framework for SMEs and effectively enforcing these laws and regulations in all countries and on all levels.
- Exploring existing financing models and developing new models that reward positive environmental and social practice.
- Discussing the potential of sector-wide sustainability ratings (for SMEs) that would provide common standards and hence be comparable.
- Encouraging public and private sector to work hand in hand.

All panellists and speakers agreed that successful approaches need to be replicated and scaled. Consumers play a vital role: their demand creates a perceived need to adhere to social and environmental standards.

Session 2: The Role of Innovative Finance in SME Development

Several fintech companies were able to demonstrate the value that fintech can have in helping SMEs access finance.

A searchable database of capital providers was presented which aims at mapping all types of alternative capital including crowd funding, venture capital, impact funds, angel investing networks and semi-public funds, helping SMEs in developing countries to identify providers of finance. The tool also helps to understand which sectors and countries are relatively strong or weak in various types of financial sector development. Another fintech company drew lessons on the difficulty of addressing fraud and collusion and the costliness of collection when serving SME clients directly. As a result, the company shifted the focus of the business model away from lending and collection towards services for financial institutions.

A third fintech company's franchise system allows individual entrepreneurs to start providing financial services in their communities where these were previously lacking. This benefits both individuals and SMEs, and has helped in particular to take women out of poverty. The fourth and final fintech company that presented its business model offers a mobile banking

solution with biometric identification and credit scoring for unregulated microfinance institutions in Africa. This allows them to digitise their business easily and exchange individual credit information on borrowers among each other, reducing loan defaults, non-performing loans and fraud.

In a panel discussion between private and public sector representatives there was agreement that banks and fintech companies are likely to become even more closely integrated in the future. At the same time, financial stability, cybersecurity and consumer risks have to be monitored closely.

The experiences of several of the fintech firms showed that women were investing strongly in their communities and that access to finance (including through fintech) could have transformational impacts on the communities. Another lesson learned from the fintech companies was the importance of understanding how local markets work in order to learn how to export fintech business models to foreign markets. It was also emphasized that the personal element, for example through having agents to collect payments, remains important, and cannot be replaced entirely by technology.

A discussion of big data highlighted that there are rapid developments in this field and that a far broader range of data is being collected and used in SME financing. Good data is essential to lowering barriers to financing for SMEs, but the right balance needs to be found between data access and privacy. It was suggested that the G20 could help serve as convening power on questions of regulation regarding data protection.

In his lunchtime speech, a prominent angel investor emphasised the importance of having an entrepreneurial culture. Being successful should not be punished, he said; neither should failure imply stigmatisation.

Session 3: Best and Avoidable Practices of Enabling SME Access to Finance: The Role of Development Banks

During this session, which was co-organised by the International Development Finance Club (IDFC), development banks presented lessons learned on what works best in SME financing. Within the IDFC, 23 like-minded national and sub-regional development banks around the world have bundled their expertise and knowledge. Fourteen IDFC members are from G20 countries. Furthermore, selected members of the IDFC which offer SME financing agreed on a Lessons Learned summary, which is contained in an annex available on <https://www.gpfi.org/>.

A special focus was on the diversification of products, especially digital solutions: An online loan facilitation platform by a development bank created a market place with 20,000 participating banks which has considerably sped up the process of finding suitable financing options for MSMEs and generated greater market transparency. It was emphasised that development finance institutions (DFIs) can take on the role of market makers and focus on areas where the market is not yet developed, creating an ecosystem for innovation and helping the private sector to “test the water”. At the same time, DFIs need to strictly adhere to the principle of subsidiarity to avoid crowding out the private sector, e.g. by limiting their

market share. Purpose-specific product development and integrated SME financing services combining loans with capacity development of SMEs were further priorities.

Lessons learned from de-risking SME financing were also described. A holistic approach linking measures to improve the business environment (macro level) with the support of intermediary organisations, e.g. chamber of commerce and incubators (meso level), as well as risk sharing mechanisms, capacity development and refinancing lines to financial institutions (micro level) proved successful.

Another example for de-risking SME financing and the mobilisation of private capital is via structured funds, especially in a highly underbanked region such as Africa. Banks' risk perception towards SMEs is distorted to some degree and risk aversion is sometimes increased by regulation. Commercial banks lack knowledge about SMEs, particularly in typical sub-sectors such as agriculture. Specialised investment funds are a vehicle to bring in finance and business knowledge, as well as the private sector capital to jointly serve SME needs. While the cost of doing business is rather high for the banking sector due to small ticket sizes for SMEs, these fund structures cover their costs.

Further lessons learned were:

- While digital platforms help to close the gap in SME financing, data infrastructure and data regulation on citizen information and data protection still need to be developed further.
- Monitoring and data collection is crucial to follow up on the development of the SMEs receiving support, particularly to assure additionality.
- Local presence is key.
- Regulators need to keep the regulatory environment open for structures like specialised funds to continue financing SMEs in underserved regions.

The panellists also agreed on certain areas that need to be developed further:

1. For common currencies, a market for hedging is available, e.g. via funds like the Currency Exchange Fund (TCX), but for “exotic” currencies, new approaches to provide local currency financing at a competitive cost need to be developed, e.g. by subsidising hedging costs. At the same time, regulatory reforms and institution building are essential to develop local capital markets.
2. There is a strong need for building up domestic financial and capital markets as well as local bond markets.
3. There are an increasing number of African private equity firms ready to invest in SMEs: There is no lack of capital, but there is a lack of good projects to be funded. Therefore development banks could work with those firms to support the preparation of bankable projects.

Session 4: SME Finance – The Role of Public Policy

Participants stressed the importance of the G20 work on effective implementation approaches for the G20/OECD High-Level Principles on SME Financing as well as the G20

Action Plan on SME Financing and its Implementation Framework (developed by the World Bank Group) as guiding documents for policy makers. The G20 Action Plan on SME Financing focuses on credit infrastructure to promote access to finance to SMEs and reduce the cost of financing. The policies that are emphasised are: firstly, improvements of the credit reporting framework for SMEs; secondly, reforms that allow banks and non-banks to lend to SMEs against movable collateral; and thirdly, insolvency reforms. This year, under the German presidency, G20 countries are undergoing a benchmarking exercise regarding their current practices in these policy areas compared with international standards. This will help to identify priority areas for reforms to be implemented at the national level, as well as for monitoring progress in the implementation of such reforms. Furthermore, G20 countries will support non-G20 countries who wish to make improvements in these areas.

The G20/OECD High-Level Principles on SME Financing are a set of 11 high-level principles which broadly cover multiple policy areas affected by SME financing. G20 and OECD members are currently collecting effective implementation approaches to support these principles.

The OECD presented the initial results of the survey on Effective Approaches to Support the Implementation of the G20/OECD High-Level Principles on SME Financing. The survey indicates that all participating governments are working to identify gaps and improve the evidence base on SME financing. Several countries have developed databases on credit ratings to improve bank financing for SMEs. The report on effective implementation approaches will be presented to the G20 Finance Ministers and Central Bank Governors.

Some of the main policy reforms that Turkey has implemented include improved credit infrastructure, particularly for secured transactions, and a moveable collateral registry, promotion of equity-based financing especially for innovative SMEs and a credit guarantee scheme.

The UK's bank referral scheme, which was launched last year, requires traditional banks to refer small businesses to alternative lenders if they are rejected for a loan. A UK fintech company presented its approach to match SMEs to alternative lenders.

Fintech companies were found to have a critical role as a market disruptor. They have helped banks become more efficient and improve their ability to serve customers by forcing them to invest in innovation, research, and understanding customer demand.

Both private-sector participants and policymakers agreed that holding discussions with the private sector before implementing a reform is beneficial for identifying bottlenecks and for increasing the acceptance and effectiveness of reforms.

Summing up, some of the policy efforts proven to promote SME access to finance are:

1. Developing country specific diagnostics and strategies,
2. Strengthening the financial infrastructure, which includes payments systems, credit reporting, secured transactions and collateral registries and insolvency regimes,
3. Designing effective government support mechanisms such as guarantee schemes,
4. Building consistent and reliable data sources on SME finance

Another issue raised in the discussion was lack of access to insurance for SMEs. It was suggested that the G20 include this issue in its SME agenda.