

How can EDFIs more effectively support SME development?

EDFI Workshop
for EDfI SME Finance and Development Effectiveness Practitioners
The Hague: June 4, 2014

Findings and recommendations

Introduction

Triggered by the outcomes of the EDfI-sponsored evaluation on “The Effectiveness of EDfI support for SMEs through FIs in Africa”¹ conducted last year, an EDfI SME Finance Workshop was organized. This Workshop aimed for providing participating EDfIs with a forum to share experiences and knowledge on this subject, whilst discussing new solutions for sustainable and well-documented financing of SMEs.

The meeting commenced with an opening speech from FMO’s Chief Investment Officer, Linda Broekhuizen. Her introduction was followed by three presentations on evaluation studies of SME financing: a) “Evaluation of the Effectiveness of EDfI Support to SME Development through Financial Institutions in Africa (2013)”, presented by Julian Frede, DEG; b) “Effectiveness of FMO support to SME development in South Asia (2013)”, presented by Nico Mensink, FMO; c) “Evaluation of DEG’s Eastern European and Central Asian Financial Sector Engagements (2012)”, presented by Meike Goetze, DEG.

The main objective of this meeting was to facilitate an open discussion on the potential for ensuring that EDfIs more effectively support SME development, whilst looking for desirable cooperation amongst EDfIs to improve and harmonize reporting by FIs on their SME outreach. The EDfIs that were represented at the workshop are; BIO, Cofides, DEG, Finnfund, FMO, Norfund, OeEB and Proparco, as well as EDfI director Jan Rixen.

Major findings and recommendations

The main session of the workshop focused on a practical discussion of four topics in separated break-out groups. The bullets under each topic reflect the major findings arrived at by workshop participants.

- 1. Through which types of financial intermediaries and with what products can we most effectively stimulate access to finance for SMEs?**
 - Suitable intermediaries can be varied: young and small financial institutions or established banks, specialist SME lenders or universal banks. Key requirements are whether these institutions and their management are genuinely committed to expanding their SME business, and want to work with DFIs in this area.
 - Whether equity or debt / credit lines are to be provided depends on the needs of the financial intermediary at any point in time. Medium term loans can provide funding needed to make medium term investment loans. Equity enables more growth of the institution and can come with influence on the bank’s policy (through a board seat).
 - It was generally felt that more efforts should be made to provide funding for SME-lending in local currency, as end-borrowers typically do not earn dollars and would otherwise be saddled with forex risk. Offering local currency at workable prices remains a challenge.
- 2. Can we be more effective in promoting SME finance by also offering capacity development?**
 - Much CD/TA to SME lenders is in the areas of E&S or ALM, while help on SME lending should also be prioritized. It was felt that clients would appreciate help with their SME market development, as well as access to (peers in) EDfIs’ network.
 - Our financial intermediaries often need more than funding in order to become better SME-lenders. What they need most differs from case to case (a better MIS, trained loan officers, appropriate credit

¹ Please follow the link on EDfI.be to find the full report: <http://www.edfi.be/news/news/32-evaluation-of-the-effectiveness-of-edfi-support-for-sme-development-in-africa.html>

technology, organizational change, etc.). Before offering assistance in any area, it is, therefore, good to carry out a needs assessment;

- Not all EDFIs can offer CD/TA, so it is good to explore this together when several EDFIs finance the same intermediary.

3. What conditions in our agreements are helpful in ensuring that our funds are used for SME finance?

- Many forms of 'use of funds' provisions are not really effective to better reach SMEs, but only serve to satisfy our institutions' internal requirements. That is, they aren't needed with specialized SME financiers, and in universal banks they are ineffective since money is fungible.
- It is, however, still helpful to specify the objectives for(SME)loans, and to agree on reporting requirements that can be used to monitor the intermediary's SME portfolio performance.

4. Can better SME data and reporting help effectiveness?

- A wide variety of SME definitions is used, and intermediaries should use what best suits their operational requirements. Their MIS should enable them to do segment reporting on their SME business – also to provide them with insight on the importance of SMEs to their business.
- To the extent that (E)DFIs needs standardized reporting on banks' (SME) portfolios to aggregate impact indicators, it will help these banks if (E)DFIs can really harmonize their requirements.

Conclusions for EDFI cooperation and follow-up

Participants also explored the desirability of further cooperation among EDFI SME Finance practitioners and Development Effectiveness specialists in this area.

EDFIs are heterogeneous but many engage in indirect SME finance through financial intermediaries, and participants identified a need for further knowledge exchange on SME Finance, particularly among practitioners, but also with effectiveness specialists, than could be provided through this half-day workshop. It was proposed to organize a **follow-up EDFI Roundtable** for further sharing of knowledge and experience, to discuss best practices and lessons learned, exchanging views and seeking to cooperate in the area of CD/TA, and to further harmonize on legal requirements and reporting. In the latter area, participants also encourage **active EDFI participation in the IFI harmonization initiative.**