

---

# **Access to Finance for SMEs in Emerging Markets**

## **Measurement and Evaluation**

Presentation at the workshop on *Monitoring and Evaluation Efforts on Design, Implementation and Resource Allocation*

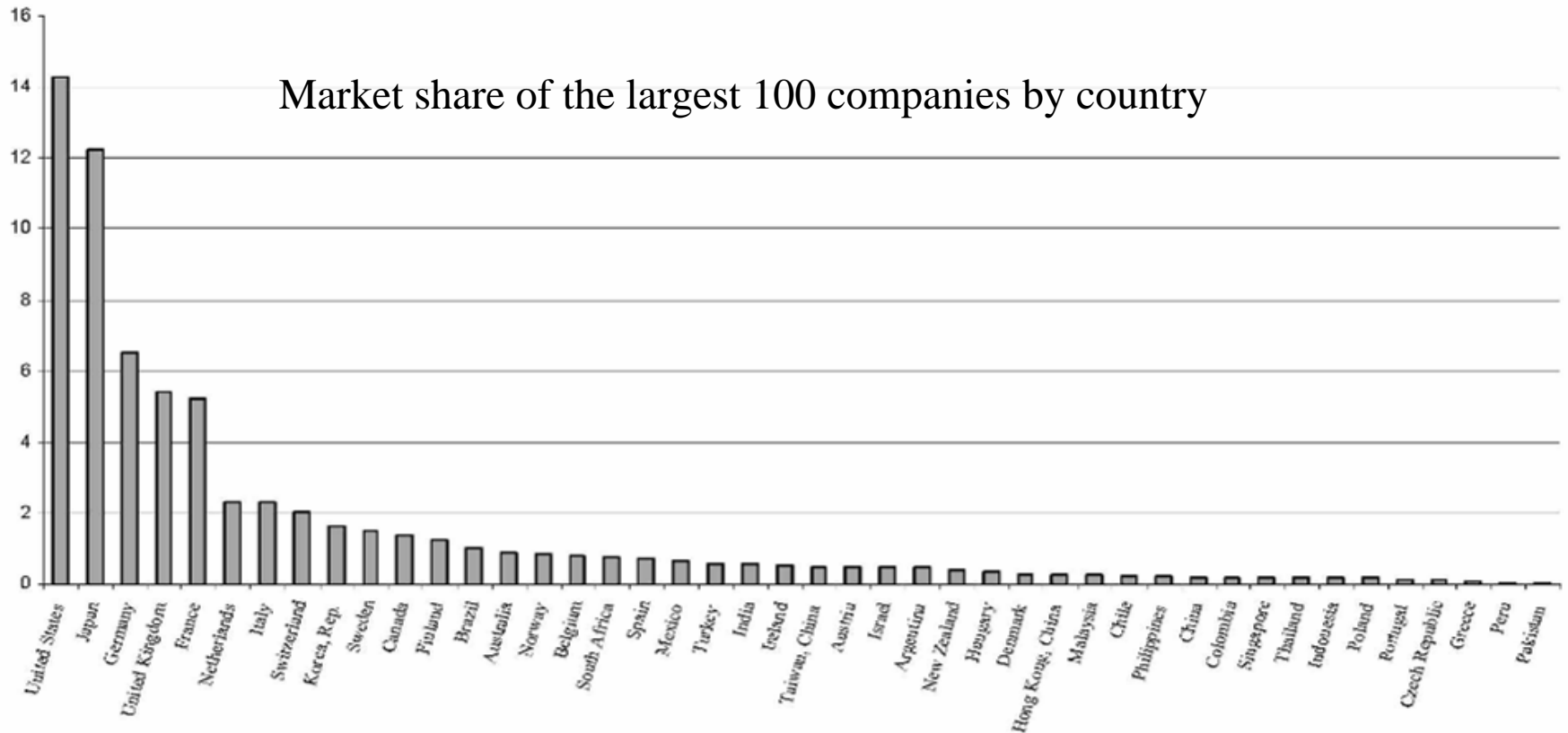
Professor Antoinette Schoar, MIT and ideas42  
December, 2008

# Agenda

---

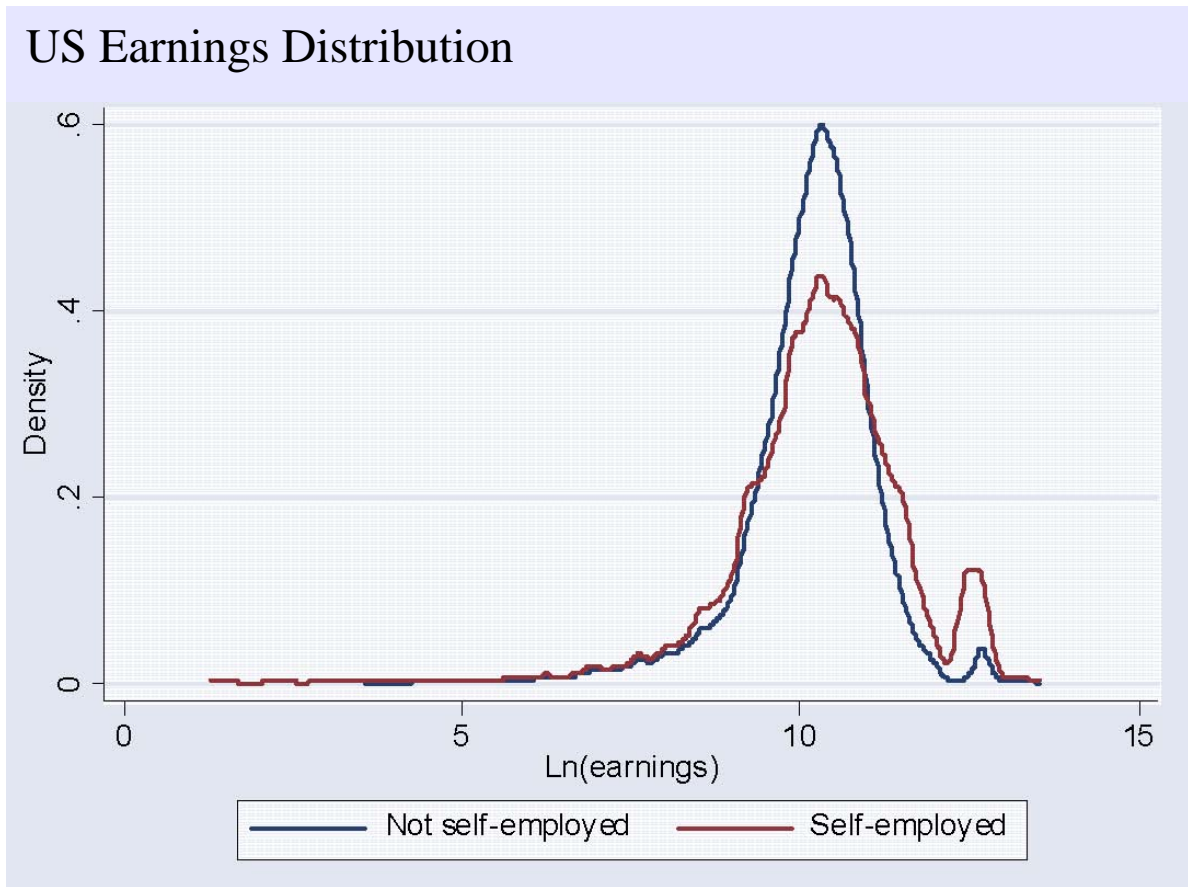
- A few facts about small businesses in developing countries versus the US
- Growth constraints for entrepreneurial firms
- Project Overview

# In developing countries SMEs play a big role in business



In the United States, bi-modal earnings distribution is most pronounced for self-employed

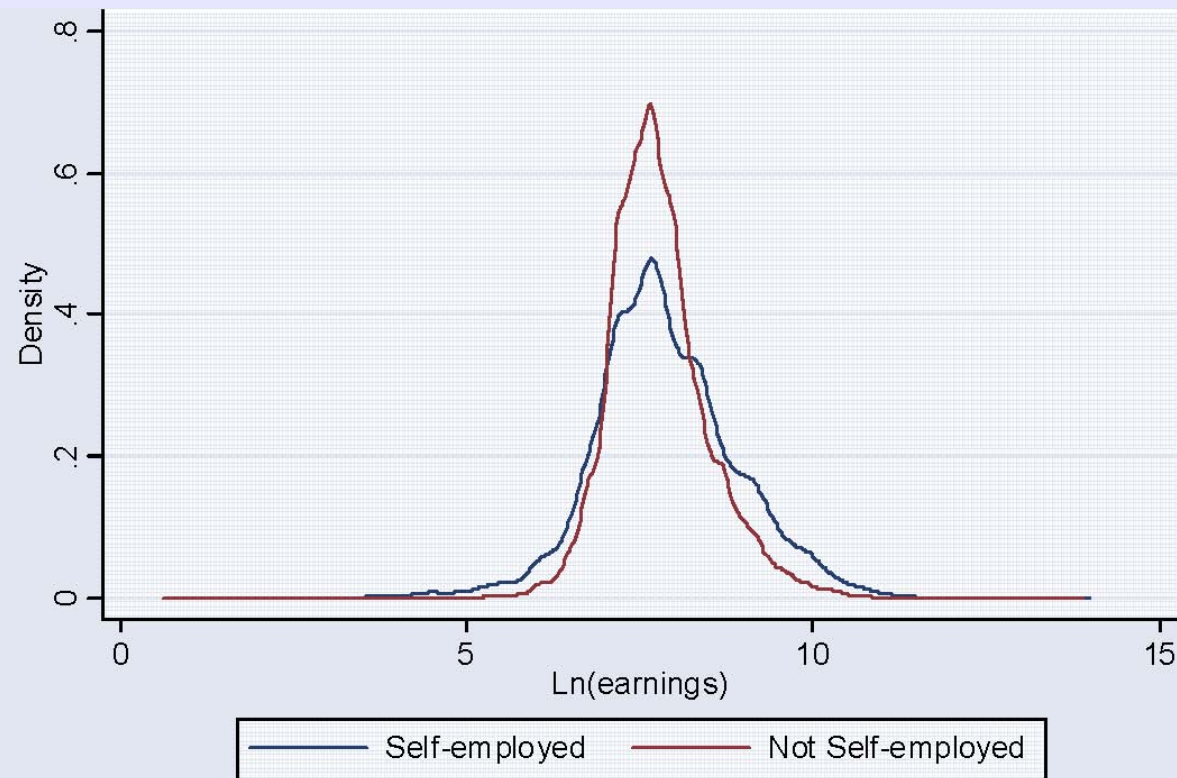
---



In India, earnings distribution is centered around the mean

---

India Earnings Distribution



## Comparison Developing Countries and United States

---

- In developing economies entrepreneurial firms are centered at the low end of the firm size distribution, in the US the distribution is much more continuous
- In developing countries a much larger fraction of the population relies on earnings from self-employment than wage earnings, across all segments of the economy

→ Small firms face limitation to growth! Why?

# Factors that can facilitate/hurt investment in small businesses

---

Screening: Identify the profitable firms

- Use sector insights to create screening rules at the bank level
- Find existing information channels to extend finance, e.g. channel financing

Business Environment: Aiding viable firms

- Electricity
- Supply chain
- Create resale market for collateral
- Business Training

Contract Enforcement: Ensure repayment

- Credit Bureau
- Monitoring and relationship building
- Alternative financial instruments, e.g. micro equity and flexible loans

# Reasons for Design Interventions

---

Private incentives to innovate may be low

- Small business lending has social benefits that a single firm/bank will not internalize
- Banks may not have *some* of the necessary human capital

Private capacity to innovate may be limited

- Best practices spread slowly
- Knowledge and application are not always matched optimally
- Banks may not have scale to innovate

Governments may under-innovate policy

- Research on optimal policy as public good
- Government can be very (sometimes the most!) important actor
- Can catalyze private action



*My question is: Are we making an impact?*

## Examples: Projects at Different Levels of Intervention

---

- ***Borrower level intervention:*** Business training programs
    - Testing accounting and bookkeeping training with ADOPEM clients in the DR
  
  - ***Bank level intervention:*** Monitoring and relationship building between the bank and its clients
    - ICICI SBL facility
  
  - ***Market level intervention:*** Impact of liquidity provision on product market pricing and bidding of firms
    - Ebay and ICICI: Market for second hand vehicles
-

## Example I: Business Training facilities for ADOPEM clients

---

- **Idea:** SMEs often do not have needed business skills prior to starting their business. This could be a function of cash constraints or missing training opportunities.
  - Can a bank profitably provide these skills?
  - What are the adequate training interventions?



**ADOPEM**  
Asociación Dominicana para  
el Desarrollo de la Mujer  
*Filial del Banco Mundial de la Mujer*

## Example I: Training Interventions

---

- **Group A:** Account separation training: relies on the idea that SMEs mix personal and business finances
- **Group B:** Full accounting training: Provides in-depth accounting skills
- **Group C:** On the job follow-up training versus in class training: Test the intensity of training needed

## Early Insights

---

- Clients rank all training offerings very highly
  - But highest satisfaction from the high end classes. Surprising since bank thought that clients would not be able to understand those
- Clients face great uncertainty about business decisions; enjoy community of classes to exchange investment ideas
- Clients have difficulty leaving their business for short amounts for training since they cannot trust anyone else to run the business

## Example II: Small Business Loan Facility of ICICI

---

- **Idea:** Many SMEs do not have sufficient collateral to get a bank loan even if they have cash flow to pay. Set up a collateral free loan and use score card to mitigate risk.



**i ICICI Bank SME Online**

**I got big success with just one smart move.**

Get SME Loan up to Rs. 10 crore

The advertisement features a man in a dark suit and light blue shirt, smiling and making an 'OK' gesture with his right hand. The background is a gradient of orange and red with a subtle grid pattern. The text is in white and yellow, providing a clear call to action for SMEs seeking loans.

## Example II: Small Business Loan Facility of ICICI

---

- **Problem:** Credit bureau information are very important in setting up reliable credit scores, but India does not have a well functioning credit bureau.
  - SBL had initially high default rates, above 7%
- **Challenge:** Design/test monitoring and incentive schemes to improve repayment rates and increase client loyalty
  - Can the incentives that bank provides substitute for the lack of financial infrastructure in the market?

## Different Hypotheses for Effectiveness of Monitoring

---

- How should ICICI set up its division to monitor and follow SME loan clients?
- Depends on the reasons behind defaults, which are not known and need to be tested.
  - Strategic default: Reduction of asymmetric information for the bank?
  - Loyalty: Build personal relationship between loan officer and clients?
  - Behavioral factors: SMEs have poor planning skills

# Monitoring Experiment Example

---

## **Group A: No monitoring treatment**

Control Group

## **Group B: Reminder treatment**

Send SMS with interest and principal due every month. Follow up with phone call if clients have outstanding balances

## **Group C: Medium touch treatment**

Random loan officers follow up with clients regularly to solve problems, understand the nature of the business

## **Group D: Personal touch treatment**

Assign individual loan officer to create “ongoing relationship” with client. Treatment as in Group C.

## Early Insights

---

- Bank is starting to see lower defaults and late payments rates for treatment group clients
  - Clients are developing relationship with bank officers; feel responsible to loan officer not bank
  - Seem to enjoy the additional attention by the bank
  - ICICI plans to expand treatment to all clients/products
- But might also create ratchet effect for high service level expectations which could be expensive to maintain
  - Long term impact still to be seen