Small and Medium Enterprise Finance

The small and medium enterprise (SME) sector is critical because it contributes significantly to employment and GDP.

Despite the recognized importance of the SME sector, SMEs continue to be undersupplied with the financial products and services that are critical to their growth. IFC provides a combination of investment and advisory services to financial institutions committed to working with SMEs in Latin America and the Caribbean. Investments may take the form of a loan, a guarantee, equity and/or quasi-equity depending on the partner institution’s needs.

Typical challenges for financial institutions working in this market include:

- **Strategic focus**: Many banks are interested in entering the SME space, but often lack the strategic focus that is integral for success at the operational level. Without this focus, it is challenging to work with SMEs effectively and profitably.

- **Market segmentation**: SMEs differ from large businesses and individual customers in their needs, preferences, and in what it takes to serve them. Understanding the market is fundamental to SME banking because growing a portfolio requires that banks be responsive to client preferences. The nature of demand and risk varies by segment and sub-segment.

- **SME product strategy**: Without a product strategy specific to the segment, banks often offer products that do not meet SMEs’ unique needs. While lending is a central offering in SME banking, the universe of ways in which banks can generate revenue from SMEs extends far beyond lending. SMEs are more likely to be loyal clients when they feel their needs have been understood and met. Thus, increasing market share and customer loyalty depends in many cases on having an appropriate product strategy in place.

- **Credit analysis methodologies**: Banks tend to use corporate policies and procedures in the analysis of SME loans, which are not appropriate for the maturity-level of growing SMEs. Lack of adequate credit methodologies makes it difficult for SMEs to meet bank requirements, and as a result they are unable to obtain financing.

**IFC’s SME Finance Approach**

Success in SME banking requires a financial institution to develop a tailored approach to the segment. To this end, IFC has developed an approach to address the following key areas:

- **SME market strategy**: Developing a plan that reflects a bank’s goals, value and competitive advantage. The strategy must target the segment clearly, identify operational capabilities, and include management systems to be addressed.

- **Market segmentation**: Reviewing the FI’s client base in an effort to define the SME target market; designing and rolling-out products (e.g., lending, deposit, and transactional products) based on segment needs.

- **Sales culture and delivery channels**: Providing adequate training and ensuring that the appropriate channels are implemented.

- **Credit risk management**: Reviewing SME credit policies and procedures based on market realities and a bank’s strategy and risk appetite.

- **IT and MIS**: Assisting banks in determining how to reconfigure or overhaul their IT and MIS systems so that the information they collect and analyze is useful for decision making and supports responsive SME procedures and processes.
IFC’s SME Finance Experience

The financial crisis brought attention to the critical need for financial institutions serving the SME market to strengthen risk management and corporate governance practices, and IFC has developed tools and resources to do so. Our risk management diagnostics have resulted in partner institutions’ revising or developing risk management policies and processes. Analytic tools, such as financial simulation models, have also been developed as have data collection systems that enable the calculation of metrics. IFC also has a progression matrix to assess FIs’ corporate governance practices. By maturing in this area, FIs can benefit from improved access to funding, a better corporate reputation and more transparent operating conditions.

Program Results

- **Global Program:**
  - Committed portfolio: 58 projects amounting to $55.7 million (June 30, 2010)
  - Outstanding loan portfolio: 1.5 million in number and $101.3 billion in volume (December 2009)
  - Coverage: 60% of projects in IDA or IDA Blend, and 13% of projects in fragile and conflict-affected countries

- **LAC Program:**
  - Committed portfolio: 8 projects amounting to $2.7 million (June 30, 2010)
  - Outstanding loan portfolio: 6,172 in number and $244 million in volume (June 30, 2010)
  - Coverage: 78% of program funding is devoted to IDA or conflict affected countries

Project Highlights and Results:

- **Haiti:** IFC is working with Sogebank to re-engineer its nascent SME department, building risk controls and IT systems, as well as training new and existing credit analysts. As a result of these efforts, SME banking has grown to be core part of Sogebank’s business. Despite suffering considerable damage in the earthquake, Sogebank remains committed to implementing the SME program and views it as being even more important in light of current conditions.

- **Honduras:** IFC is helping Banco Atlantida to develop its SME business by evaluating operations, defining the segment and target market, revising SME credit policies and procedures based on the bank’s strategy, and designing new products and services to target this client segment. IFC is also conducting a thorough diagnostic on the Bank’s risk management practices.

- **Mexico:** IFC is assisting FinTerra to further strengthen its credit risk management tools and take a leading position as an innovative lender to SMEs in Mexico’s agribusiness sector. In addition, IFC is also supporting FinTerra’s growth with a credit line in the amount of 15 million Mexican Pesos (about $1.2 million*).

- **St. Lucia:** IFC assisted Bank of St. Lucia to establish a dedicated SME Business Unit, which is staffed by officers that are trained on the latest technology in SME lending and fully dedicated to attending to SME client needs. In addition, IFC conducted a risk assessment and designed and implemented an appropriate financial simulation model.

* US dollars equivalent based on 1/19/2011 exchange rate.

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