

Downscaling with commercial banks in Africa: Opportunities and challenges – some lessons from experience

1. Microfinance and SME finance

2. A wider view of « downscaling » - two models

3. Downscaling in the narrow sense

4. Indirect downscaling

5. Some lessons

1. Microfinance and SME finance

- Lack of access to finance remains major obstacle for MSME development in most African countries
- → “Downscaling” should target the provision of credit to MSME

	Microfinance	SME finance
Loan sizes	USD 50 – USD 10,000 ??	USD 10,000 ?? – USD 1,000,000
Risk management	<ul style="list-style-type: none"> • Information management (transparency) • Trade off between cost of information and cost of risk • → Specific risk analysis and risk management methods 	
Organization and cost structures	<ul style="list-style-type: none"> • Limited number of financing models • High degree of standardization • High intermediation costs 	<ul style="list-style-type: none"> • Market segmentation • More financing models • Less standardized

- Microfinance is retail but with very specific organization and cost structures

2. A wider view at “downscaling” - two models

Approach	Downscaling in the narrow sense: “do it yourself” approach	Downscaling via equity link
Examples	EDFI-financed banks in Africa	Société Générale / Advans Group

3. Downscaling in the narrow sense



- Evaluation of the effectiveness of EDFI support for SME Development in Africa: <http://www.edfi.be>
- Small sample: 6 banks in Ghana, Kenya, Uganda, Tanzania (not CRDB) and Zambia
- Projects: provision of funding (equity / debt) and TA to selected commercial banks; SME-targeted funding in most cases (16 of 25 examined loans)

3. Downscaling in the narrow sense

■ Main findings of the evaluation

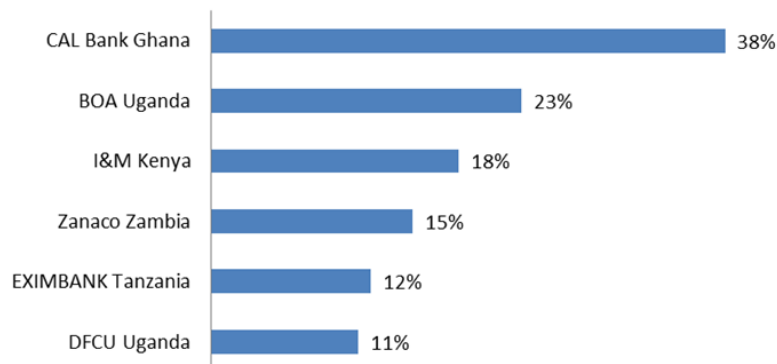
○ Approach

- Chose partner FI that wants to target SMEs
- Provide inputs (debt, equity, some TA) to strengthen partner FI

○ Targeted banks

- Mostly medium-sized banks with significant growth prospects
- All banks had “SME strategy” but with very different SME definitions

Yearly average asset growth 2007 - 2012



Banks' definitions of SME (maximum values)

	Turnover/y in USD m	Assets in USD m	Staff	Loan size in '000 USD
BOA Uganda	n/s	7,00	n/s	386
CAL Bank Ghana	1,25	n/s	n/s	250
Zanaco Zambia	3,60	n/s	n/s	1 000
EXIMBANK Tanzania	4,75	n/s	n/s	n/s
I&M Kenya	5,50	n/s	100	850
DFCU Uganda	11,50	11,50	100	n/s

n/s: not specified

3. Downscaling in the narrow sense

- **Environment:** macro-economic environment rather bad; business environment and financial sector environment rather good in most cases
- **Impacts on partner banks:**
 - **Improved financial sustainability;** contribution of SME business line to partner banks' overall result unknown in most cases (MIS)
 - Most banks studied had not significantly increased their **capacity to serve SMEs** since the start of the projects; conservative approaches to SME banking in majority of cases
 - Outreach: in most cases limited increases in the **sizes of SME credit portfolios** (in absolute and relative terms)
 - Outreach: increased share of **MT and LT loans** in the banks' SME portfolios
 - No evidence **downscaling** evidence (FCY loans → allocation to FCY-earning enterprises). Downscaling was not a project objective

3. Downscaling in the narrow sense

○ Determining factors:

- Banks that had invested in their SME banking lines were more likely to have continued to do so
- But: no clear link seen between increased capacity in SME banking and increased outreach → **other factors** must have a strong influence on the banks' decisions (environment)
- Link observed between "business environment" and "increased capacity in SME banking"
- Link observed between "quality of the banking sector" (competition, credit bureau, registry for collateral securities) and "outreach"
- When macro-economic environment deteriorated, banks have tended to shift from small enterprises towards medium-sized enterprises

5. Some lessons

Approach

Downscaling in the narrow sense:
“do it yourself” approach

Advantages

- + Integrated; “SME banking” approach easier
- + Simple (?)
- + Cost efficient compared to “greenfielding” (?)

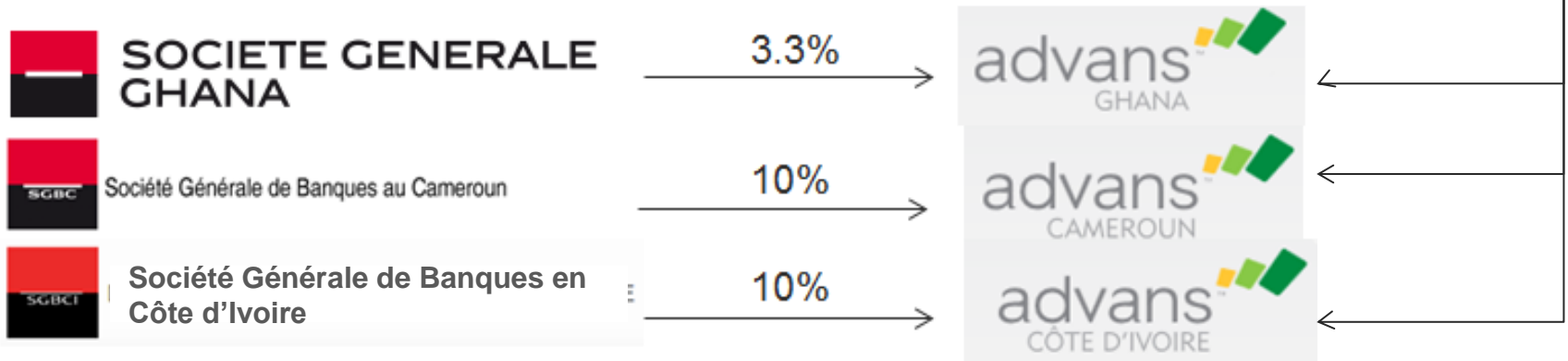
Disadvan-
tages and
risks

- * Corporate culture
- * HRM; MIS
- * Sustainability (environment!)



4. Indirect downscaling via equity link

- Example: A privileged partnership in Western Africa:



4. Indirect downscaling via equity link

- Determining factors:
 - Shared business vision: MF = retail; specialization; financial inclusion; not only PSE and communication
 - Regulatory framework (e.g. capped interest rates, reg. on unsecured lending, ...) → “do it yourself strategy” difficult or impossible

4. Indirect downscaling via equity link

■ Impacts

○ Local knowledge

- particularly important at the start of the MFI / the MF bank

○ Professional inputs and external view

- effective participation at board level; in audit committee

○ Shared infrastructure (ATM, co-branded cards,...)

- cost savings and mutual benefits

○ Access to local finance

- facilitated but at market conditions

■ Prospects: integration (?)

5. Some lessons

Approach

Downscaling via equity link

Advantages

- + Local knowledge
- + Professionalism
- + Mix social and commercial objectives
- + Shared infrastructure
- + MFI has easier access to local sources of finance
- + Bank gets revenues from financial services to MFI

Disadvan-
tages and
risks

- * Vision shift
- * Relationship-based

5. Some lessons

Approach	Downscaling in the narrow sense: “do it yourself” approach	Downscaling via equity link
Lessons	<ul style="list-style-type: none"> ■ Conducive <u>environment</u> required ■ Chose <u>preferably small or medium-sized banks</u> that have already developed a strategy for their SME business ■ Clear definition of <u>targeted enterprises</u> ■ <u>Baseline study</u> (partner banks strategy; targeted segments; investments and achievements in SME banking) ■ <u>Monitoring</u> of progress in accessibility and operational and financial performances ■ Provide TA where needed 	<ul style="list-style-type: none"> ■ Shared LT/MT <u>vision</u> ■ Business approach ■ <u>Active participation</u> at board level
SME finance	Yes	Yes (if MFI is “upscaling”)
Microfinance	Depends on definitions; rather small enterprises than micro-enterprises	Yes