Digitisation in Africa: Channelling Funding to SMEs

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Could innovation emerge from near destruction? Would the digitisation that led to the global financial crisis preclude SMEs from obtaining the finance they needed to continue playing the crucial role that they play on the African continent and elsewhere? Matthew Gamser recalls the launch of Private Sector & Development magazine over ten years ago and recounts the route leading up to the digital information superhighways that are connecting SMEs in Africa to worldwide solutions, especially for funding.

FOCUS
SME FINANCE FORUM
The SME Finance Forum works to expand access to finance for small and medium businesses. The Forum operates a global membership network that brings together financial institutions, technology companies, and development finance institutions to share knowledge, spur innovation, and promote the growth of SMEs. The SME Finance Forum is managed by the International Finance Corporation (IFC), the private sector arm of the World Bank Group. The SME Finance Forum has over 150 banks, fintech companies and development banks from more than 66 countries as its members and industry partners.

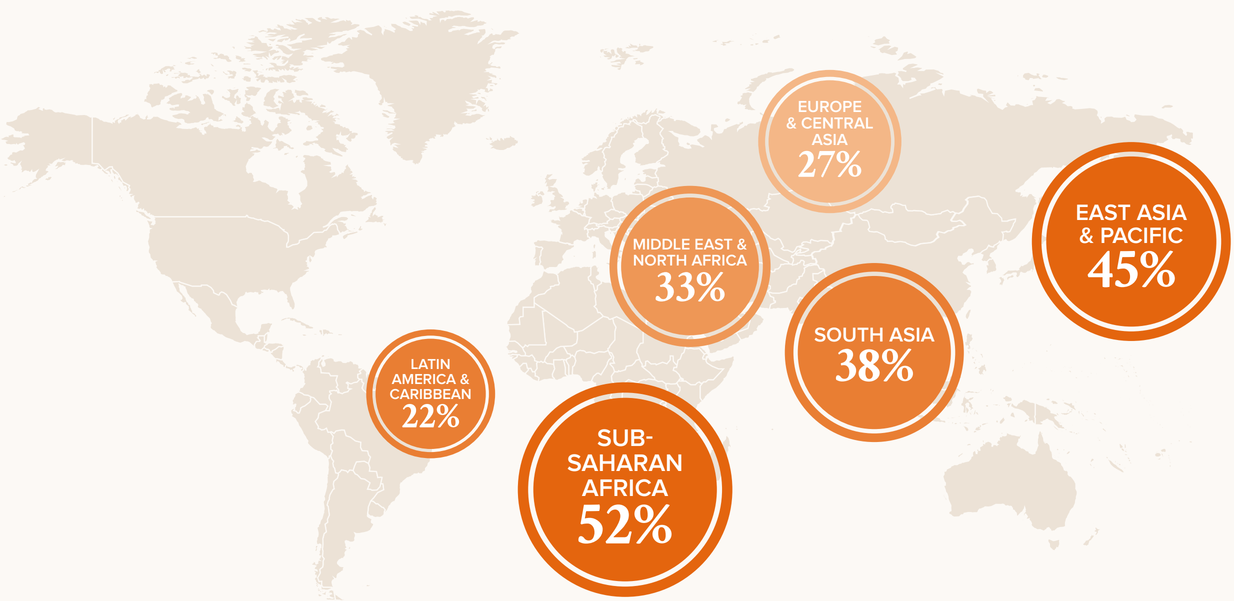
It was fascinating reading again the first edition of Proparco's magazine *Private Sector & Development*, published just over 10 years ago. It kicked off with Paul Collier noting that *"African banks had just started to show interest in SMEs when the global crisis reversed the tide"*. The risk was that SMEs might be prevented from accessing much-needed long-term financing. The situation would improve, he said, only if there was better dissemination of information on Sub-Saharan Africa's markets, which would make it easier for investors to identify high-quality SMEs. He concluded that the *"appropriate use of new information technologies should provide the solution"*.

Paul's words were prescient. We had watched digitalisation transform sub-prime housing loans in the US into toxic securities, nearly collapsing the global financial system. We had no idea that the same digitalisation could be a game changer for Africa's SMEs. Today we are starting to see the potential for digitalisation in Africa: in other markets, particularly China, we have seen how rapidly this can close financing gaps.

The importance of SMEs to economic growth on the continent was well known. But there was disagreement about why SMEs weren't being financed. Julien Lefilleur, then an investment officer with Proparco, recommended that securitisations and loan guarantees could do much to compensate for information asymmetries and to expand bank financing for SMEs. Paul Derreumaux of Bank of Africa seconded this, additionally advocating specialised SME departments, alternative products such as leasing, and even group mutual guarantee loans to firms. Patrice Hoppenot of IPD urged greater attention to equity and technical assistance, to complement long-term finance.

Only Collier talked about IT, though. The others focused on human measures – specialisation and product innovations – reflecting the thinking at the time of the institutions pushing to close the SME financing gap in emerging markets.

Figure 1 – Share of financially constrained MSMEs in total MSMEs by region



Source: MSME Finance Gap database (updated in October 2018)

PEDDLING NEW PRODUCTS

We believed that if we could change the way bankers worked – getting them into markets to personally check out firms, providing performance-based incentives, and removing fears through guarantees and securitisations – that SMEs would become the darlings of the banks.

In some cases in Africa, this worked – often without guarantees or securitisations. A number of banks and microfinance institutions scaled up their small business lending profitably. In other cases, largely due to a lack of buy-in from top management to the changes required, results were less impressive. Overall, though, we started to realise that this approach was not going to close the financing gap.

The latest World Bank Enterprise Survey data shows that over 50% of African formal microenterprises and SMEs report being credit constrained[1]. Sub-Saharan Africa has the highest proportion of under-financed MSMEs in the world (52%), followed by East Asia and the Pacific at 45% (Figure 1 above). The total financing gap for formal micro, small and medium enterprises in Sub-Saharan Africa exceeds $328 billion (Figure 2 p. 23), with formal women-owned enterprises making up 15% of this; 52% of women-owned MSMEs are credit constrained, again the highest share among the world's emerging market regions[2]. Adding the considerable informal sector to these totals would significantly increase them, and the gender gap.

1 These and other data come from the databases which can be found at www.smefinanceforum.org, in this case from the MSME Finance Gap database (Updated Oct. 2018).
2 MSME Finance Gap Database (Updated Oct. 2018)

OBSERVATION AND SYNTHESIS EQUAL INNOVATION

We development bankers were so engaged in the technical assistance necessary for transformation that it took our African clients to show us that a different course should be taken. It was the bold and visionary leaders of these banks – the Equity Banks, CBAs and KCBs, in the East, and the Ecobanks, Diamond Banks and Afrilands, in the West – who decided to disrupt their own models, by focusing on an IT- and data-centered course to achieve and sustain growth. They did this after observing the mobile phone companies in their own markets and the alternative financiers in Europe, North America and, in particular, China.

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They watched many of their specialised staff being poached with attractive offers. They saw the mobile phone industry in their countries growing, and network operators venturing ever deeper into their space. They also saw non-bank operators – such as vendors of decentralised solar power systems and large buyers of agricultural products – introducing financing through cellphones.

They responded – and rapid change is underway. Human-centric processes are being replaced by digital ones, and human delivery channels are being replaced by mobile phone-based channels. Several new brands, such as Jumo, Zoona, Kopo Kopo, Pula, Copia, Branch, and Tala have entered the market, starting with a digital approach and growing at a rate never witnessed before.

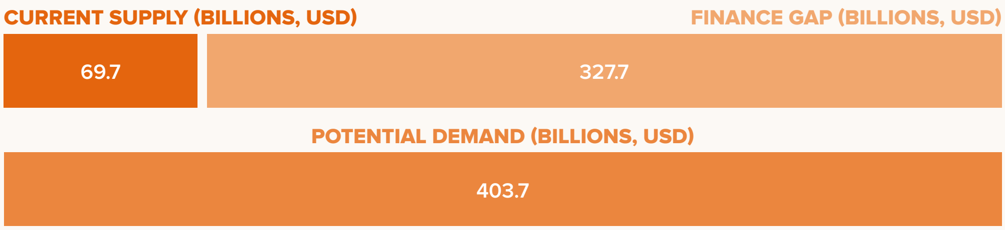
NEW NEEDS NECESSITATE NEW SOLUTIONS

They demand different things from development bankers too. They need us less to train up their people than to ensure that they're connected to the best and the brightest ideas – and not just from Africa. They need support in building an open API and a flexible core structure so that they can interact with new technologies and partnerships, enabling them to keep on top not only of SME banking, but also of all types of retail services.

The globalisation of capital markets and investing, and improvements in the business environments in Africa are giving our clients more and more options for financing. Our funding may no longer be the number one priority for these institutions: it will remain attractive only as long as it's “smart financing”, coupled with other ways of bringing value.

Our clients' stronger data infrastructure and approach may also finally enable instruments like guarantees and securitisations to realise their potential in the region. Just as they are finding it easier and cheaper to assess and manage their SME customers at scale through digital

Figure 2 – MSME finance gap in Sub-Saharan Africa



Source: MSME Finance Gap Database (Updated Oct. 2018)

data connections and analytics, so we can more easily assess their digital portfolios and thus efficiently manage these structured-finance and risk-sharing operations. This may mean that we can start making significant reductions in the financing gap, just as millions of Africans have been given access to formal financial services in just a few years through new digital payment services. This represents hope for Africa's SMEs – provided policymakers don't counter this with (often well-meaning) measures such as interest rate caps, overly rigid interpretations of the Basel capital requirements, and restrictions on partnerships and agency relationships.

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Ten years on, SMEs are the backbone of Africa's private sector, providing employment and essential goods and services – yet they remain a challenge for Africa's financial sector. Could the digitalisation that nearly broke the world's financial system ironically facilitate the provision of retail services, including SME financing, so that the majority of SMEs in Africa can report that they are receiving the financing they need, when they need it, at affordable rates. ■