SME financing:
Key points

Expanding the range of SME financing instruments under risk constraints

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For more information contact:
eibtawestandcentralafrica@ipcgmbh.com
www.msmefinanceta.eu

I - Opportunities and challenges of SME financing

An unmet market for SMEs

- There are an estimated 44 million MSMEs in the market in sub-Saharan Africa
- **The financing gap is estimated at $245 billion for formal SMEs**
- **40% of SMEs in Sub-Saharan Africa consider access to finance as a major constraint to the development of their activities**
- The financing offer is considered inadequate both in terms of conditions (maturity, rate, guarantee) and procedures

Sources: MSME Finance Gap, IFC, 2017; Promoting SME Competitiveness in Africa, ITC, 2018; Report of Recommendations: The challenges and opportunities of SME financing in Africa, LSEG Africa Advisory Group

A real opportunity for a financial institution

An institution may find interest in financing SMEs to :

- **Increase and diversify its loan portfolio** (increased client base, increase in loan size, especially for MFIs, diversification of risks into more varied sectors)
- **Promote other financial services** (cross-selling, clientele of the SME's employees, personal needs of the owner)
- **Contribute to economic and social development** (support to the creation of value by SMEs and job creation, support for the large companies of tomorrow**)**

Challenges for SME financing

A financial institution may face certain challenges when it comes to financing SMEs:

- **Information asymmetry and profitability** (availability of reliable financial information, level of SME involvement in other FIs, profitability of SME loans)
- **Level of risks and collaterals** (financial and organizational fragility, limited management skills, higher risk of non-performing loans, availability of sufficient collaterals in value and quality)
- **Regulatory constraints** (KYC/AML/CFT compliance undermined by informality, capitalization standards for SME/SMI financing, adequacy of funding maturity to offer MLT loans)

Serving SMEs better by limiting risks implies designing a financing offer that meets their needs, adopting specific risk management methods, and seeking to strengthen the capacities of entrepreneurs.

II- Understanding the SME clientele

The five stages of SME growth

While not all small businesses are the same or develop in the same way, there are similarities and trends depending on the stage the business is in.

Found market

Profitable market

Sustainable market

Controlled growth

- **Stage 1: Existence.** Start-ups or small businesses with minimal business systems. Objective: Validate the existence of a market for their product.
- **Stage 2: Survival.** Small businesses with minimal business systems, identified market. Objectives: Break even and stabilize business model. Many companies never get beyond this stage.
- **Stage 3: Success.** Businesses making profits used for growth or funding other business or personal projects. Objectives: Sustainability through the implementation of proper business systems, higher growth.
- **Stage 4: Take-off.** Exponentially growing companies. More complex and decentralized organization. Objective: Fuel growth in a sustainable manner.
- **Stage 5: Maturity.** Companies with slowing growth, well-developped business systems, adequate human and financial resources. Objectives: Ensure stability, remain agile to adapt to market changes, continue to innovate

Source: Scott Turner, 5 Stages of Small Business Growth: How to Fuel Your Success, January 28, 2020

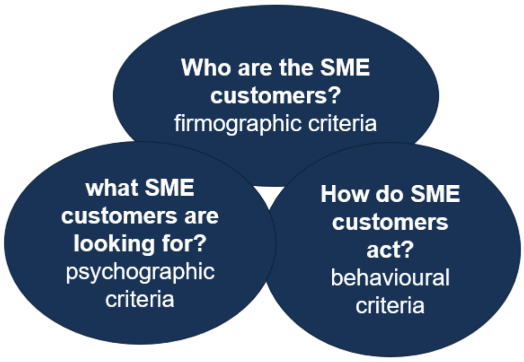
Segment your SME market

Customer segmentation consists of dividing a market into subsets of individuals (segments or profiles) who share one or more common characteristics.

Several types of criteria are crossed to segment the clientele:

- Firmographic: objective characteristics such as sector, turnover, seniority, etc.
- Psychographic: needs and priorities of the company such as the manager's aspirations, credit needs, difficulties, etc.
- Behavioural: buying habits and behaviour such as characteristics of the loans usually taken out, interaction channels with financial partners

Qualitative and quantitative surveys, as well as the exploitation of existing customer data, allow to collect the necessary information on the SME market.



To better serve SMEs, it is first necessary to understand their specificities and needs, and to identify the SME customer profiles in the market in which the financial institution operates. Segmenting the SME clientele makes it possible to make informed choices in order to position oneself in the market.

III - Choosing your SME target

Choosing a target consists of defining which of the various segments identified the institution will seek to satisfy as a priority, according to the opportunities and risks they present for it.

The analysis of the different segments can be based on :

- Potential: credit needs, industry outlook, weight in the institution's revenue, etc.
- The effort required to acquire this target: exposure to the competition, ease of contact, etc.
- Risk profile: stage of development, income stability, level of formalization, etc.

The choice of target client segments is a strategic decision that must correspond to the institution's overall objectives. The products and services to be developed, the commercial strategies to be implemented, and the methods of client management will follow.

IV - Adapting the range of financial instruments

Possible financial instruments

A wide range of financial instruments can be offered to SMEs depending on their profile and stage of development.

Type of financial instruments		Company profile and position in the life cycle
Low risk/return	Assets-based lending	Start-ups
	Factoring	Companies with limited credit history and no collateral
	Bank discount	Fast-growing, cash-strapped companies
	Financing of purchase order	Companies with a good consumer base but significant investment in intangible assets
	Storage credit	High-risk and non-transparent companies
	Stock financing (non-agricultural)	Companies that frequently change their financial assets
	Leasing	Commodity producers and traders
	Long-term rental (LTR)	Growing or mature companies

Type of financial instruments		Company profile and position in the life cycle
Low/medium risk/return	Medium and long term credit	• Small, medium and large businesses with stable revenues and relatively stable cash flows • Companies making investments or taking advantage of growth opportunities • Young companies facing tight cash flow and working capital financing problems • Growing or mature companies • Companies with an exporting activity
	Line of credit	
	Spot loans	
	Overdraft	
	Cash facility	
	Pre-financing of contracts	
	Advance on settlement	
	Documentary credit	

Adapting products to the chosen targets

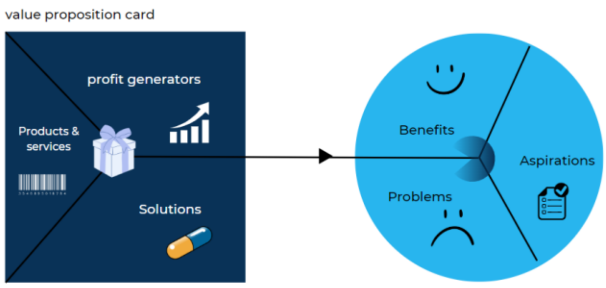
Among all the possible financial instruments, the financial institution will have to develop the ones that meet the needs of the targeted SME segments, as part of the design of its value proposition.
A value proposition describes how the institution addresses the needs and concerns of clients through its product and service offerings. It highlights the benefits to the client of subscribing to the institution's offering.

The following value proposition framework describes the elements to consider when designing a value proposition. The starting point is the customers' needs/difficulties/expectations (identified during the segmentation and targeting phases) to define the value that we want to bring them before developing products whose characteristics will allow us to generate this value**.**

- **Solutions**
How the product will solve problems and frustrations.

- **Profit creators**
How the product will generate the expected benefits.

- **Products and services**
Product that meets the customer's aspirations around which the value proposition is built.



Source : Strategyser

- **Aspirations/jobs/tasks**
What the client does or tries to do professionally or personally.

- **Problems**
The obstacles, constraints, reasons for dissatisfaction or risks encountered by the client in the accomplishment of his tasks

- **Benefits**
The expected results, the added value sought, that bring satisfaction to the client.

The process of defining the value proposition makes it possible to adapt the SME product offering to the target client profiles. The objectives and constraints of the institution and the conditions offered by the competition must also be taken into account when specifying products.

V - Adapting credit processes

Quality of service management

SME customers are generally sensitive to service quality. **The customer journey, before, during and after subscribing to the financing offer, must be adapted to take into account the expectations of the target profiles in this respect**. The following elements should be considered:

- Interaction/communication with customers (reception, information, etc.)
- Distribution channels (proximity, availability, digital solutions, etc.)
- Credit process (deadlines, transparency, etc.)

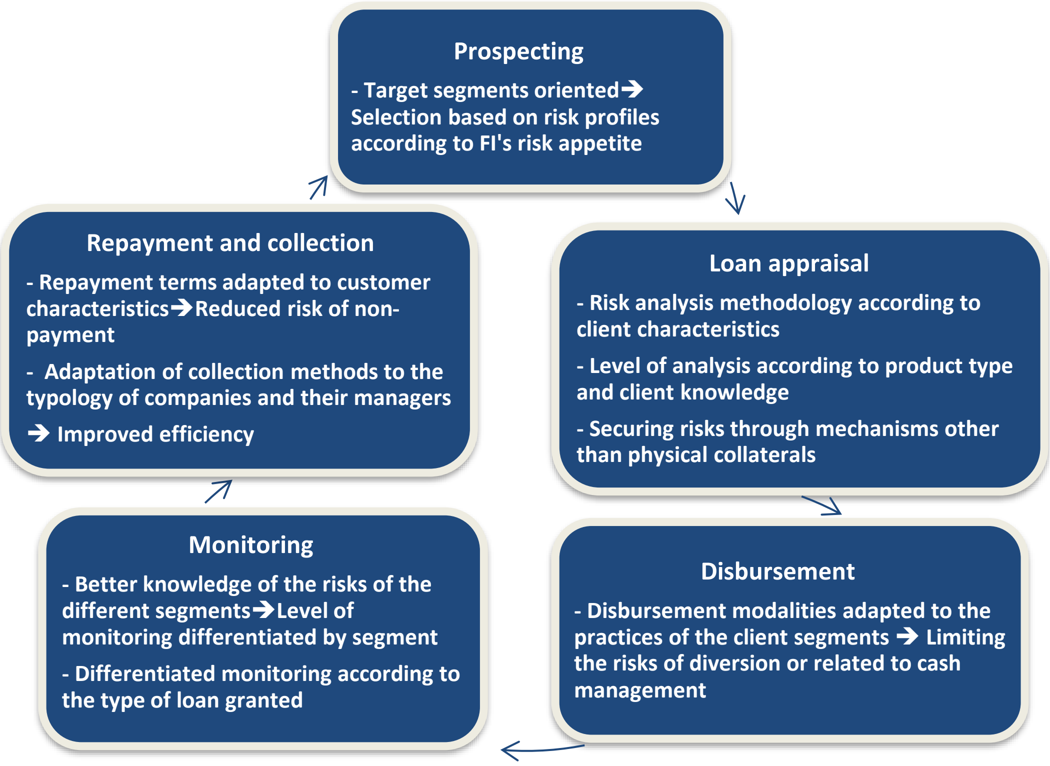
Risk management

A differentiated risk management must be implemented according to the segmentation of SME customers.

A good knowledge of the characteristics of the target profiles allows to choose appropriate strategies and methods for handling SME customers throughout the credit cycle.

For example, for credit analysis:

- Cash-flow based analysis methodology for segments where clients are poorly structured
- Financial statement-based analysis methodology for the more structured, medium-sized segments
- Introduction of scoring on the customer segments best known by the institution
- etc.



In addition to the products offered, it is also necessary to adapt the credit path of the SME clientele both from the perspective of service quality and the risk approach in order to meet the expectations and solve the challenges of financing the segments targeted by the financial institution.