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REPORT OF THE EXPERT MEETING ON IMPROVING THE COMPETITIVENESS OF SMEs IN DEVELOPING COUNTRIES: THE ROLE OF FINANCE, INCLUDING E-FINANCE TO ENHANCE ENTERPRISE DEVELOPMENT

Held at the Palais des Nations, Geneva
22-24 October 2001

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Chapter I

OUTCOME OF THE EXPERT MEETING

1. The Expert Meeting on Improving the Competitiveness of SMEs in Developing Countries: The Role of Finance, including E-Finance, to Enhance Enterprise Development examined a range of issues for consideration by the Commission on Enterprise, Business Facilitation and Development pursuant to paragraphs 119 and 156 of the Bangkok Plan of Action (TD/386). Experts made presentations and exchanged views on trends in financial innovation and best practices at the international and national levels.

2. The experts noted that sustainable economic growth is strongly related to the rate of enterprise creation and technical innovation. Vigorous enterprise creation depends on a nation's entrepreneurial culture and the ease with which businesses can be started and financed.

3. They recognized that many financial institutions in developed and developing countries find it difficult to serve small and medium-sized enterprises (SMEs) because of high perceived risk and high transaction costs and lack of experienced personnel and appropriate corporate structures, which bias them against SMEs, including those created by women entrepreneurs. The key to securing access for SMEs is to improve the ability of financial institutions to seriously expand and make more efficient the delivery of financial products, both offline and online, for different segments of SMEs. It is important for financial institutions to know their markets and customer needs and offer packages of tailor-made products, as well as automatic and standardized ones.

4. They equally stressed that the advent of the Internet, with the possibility of achieving enormous efficiency gains, including much lower transaction costs, faster communication and unparalled networking opportunities, has brought about new opportunities and challenges for SME access to finance and in particular to e-finance.

5. The experts reviewed a number of innovations used by international and national financial institutions to facilitate SME finance. Local financial institutions in developed countries, which have been particularly successful in serving the SME market, have found that it is highly profitable. Their strategy is to improve their core competencies by adopting sophisticated credit techniques such as credit scoring, strengthening management and information systems and developing highly efficient automatic processes, efficient marketing and distribution, and developing close ties to clients. The experts also discussed complements to finance such as insurance and guarantee schemes that could increase a bank's ability and interest in terms of servicing SMEs. They considered how such innovations could be widely applied to developing countries, where the conditions for SME development are often much less favourable.

6. They also observed that in developing countries equity funds and especially venture capital funds have greater difficulty in serving SMEs or even identifying fundable ones. Such

difficulties severely limit the amount of equity and venture capital funds available to SMEs in developing countries and particularly in LDCs. In the case of the LDCs, there is a special need for public-private investment funds devoted to the support and promotion of SMEs and information infrastructure development.

7. During the second part of the meeting, the experts stressed the revolutionary impact of open Internet technologies and platforms on financial services. In particular, they discussed the development of online payments with or without the use of cards, Internet banking, e-trade finance and e-credit insurance. The discussion centred on adapting these online financial services to the needs of SMEs and in particular SMEs from developing and transition economies.

8. The experts paid special attention to a number of innovations in the financial industry to reduce costs and risks, including modern Internet-based data mining technologies making it possible to build up huge credit information databases and apply modern credit analysis and related credit appraisal, scoring and rating techniques, permitting the appraisal of SME credit risks and the rapid processing of their credit applications. They considered how those innovations could be introduced or further developed in developing countries.

9. They agreed that the provision of medium and long-term finance should be closely linked to the delivery of business development services so as to improve both the viability of SMEs and their ability to repay loans. They urged that partnerships be struck between financial institutions, business associations, networks of entrepreneurs and business development service providers.

10. Lastly, they noted that the international financial system can influence the availability of domestic and external resources and in particular long-term finance for productive purposes in developing countries. They therefore requested that their recommendations on ways and means of increasing SME access to finance should be made available to the next preparatory meeting of the forthcoming UN conference on Financing for Development in Monterrey, Mexico, in March 2002.

11. The experts examined a number of best practices that can facilitate SME access to finance and recommended the following for consideration by:

Governments

Finance

(a) Maintaining prudential supervision of the financial sector, taking into account the specific requirements for medium and long-term investment finance for SMEs, and ensuring that commercial lending to SMEs is on a sustainable basis;

(b) Avoiding crowding out of the private sector by excessive borrowing from national financial institutions;

(c) Designing loan guarantee schemes that reach target beneficiaries, ensure balanced risk sharing and avoid moral hazard;

(d) Requiring commercial banks to disclose the composition of their loan portfolios, particularly the percentage of loans going to SMEs ;

(e) Encouraging banks to implement good corporate governance practices and transparent procedures and, within this framework, to appoint independent outside experts with a knowledge of SMEs to their boards of directors;

(f) Improving the reliability of financial information provided by SMEs by adopting user-friendly accounting and reporting requirements;

(g) Promoting an institutional framework for SME support services;

(h) Supporting public-private sector partnerships for SME venture capital funds and investment funds ensuring a level playing field for all market participants;

(i) Adopting regulatory and legal frameworks that allow for the establishment and best use of financial sector infrastructure such as credit bureaus and other information sharing solutions, while maintaining appropriate privacy laws;

(j) Creating conditions for promoting local capital markets;

Public and private sector

E-finance

(k) Creating a technology-neutral e-commerce and e-finance friendly regulatory environment and developing secure methods of electronic transmission of commercial messages, e-signatures and e-contracts, which should be considered as legally binding by contracting parties;

(l) Adopting flexible regulations and creating a supportive institutional environment to encourage the introduction of e-payments, Internet banking, online trade finance and credit information and other e-finance relevant to SMEs in developing and transition economies and ensure public–private cooperation in that respect;

(m) Developing a conceptual framework to allow systematic collection of data on e-finance;

(n) Encouraging a variety of partnerships and joint ventures between local and foreign e-finance service providers in order to ensure the possibility of rendering efficient services to customers at local, regional and global levels;

(o) Improving international coordination among national financial supervisory authorities to better manage systemic risks related to the borderless nature of e-finance;

(p) Developing online credit information, credit scoring and rating databases for SMEs from developing and transition economies to facilitate and shorten their credit appraisal process and hence improve their access to finance and e-finance both locally and internationally;

(q) Creating local, regional and global e-finance platforms with the active participation of financial service providers and other companies from developing countries and making them accessible to developing country SMEs;

(r) Developing online business development and information services and supporting capacity building for SMEs in respect of getting online access to business opportunities and facilitating online matching of best conditions for their financing requirements;

(s) Supporting SMEs in acquiring technologies and skills required to pay and be paid online, as well as entering into longer-term trade-related e-financing arrangements;

(t) Laying foundations to develop a strategy for online access to longer term e-finance for SMEs;

(u) Developing alternative bilateral and multilateral online payments and financing arrangements, such as online clearinghouses, and making it possible to expand productive and trading frontiers of SMEs from developing and transition countries;

Development agencies and international financial institutions

(v) Bringing the recommendations of the Expert Meeting to the attention of Governments and national development finance institutions;

(w) Bringing the outcome of the Expert Meeting to the attention of the forthcoming UN Conference on Financing for Development in Mexico;

(x) Supporting SME associations in setting up infrastructure to collate and update SME data;

Finance

(y) Developing, whenever appropriate, debt swaps within existing aid budgets as a means of strengthening local financial institutions by providing them with medium and long-term finance for SMEs, also taking into consideration finance and guarantee schemes in local currency. Debt swaps should also be used to provide business development services. This could be useful to complement the HIPC debt alleviation facility and for countries not benefiting from the facility. When dealing with capacity building, development agencies should be ready to enter into full partnerships with public and private stakeholders and share risks and responsibilities;

(z) Promoting user-friendly accounting and reporting systems for SMEs that would provide uniform (within the country) and useful financial information to managers, creditors and investors;

(aa) Disseminating information on financial innovations and assisting commercial banks in developing core competencies in credit policy making, risk management, credit information and management systems, and efficient marketing and distribution;

(bb) Developing/strengthening programmes that assist commercial banks in developing countries to train bank management and staff to better appraise SME credit risk, particularly in the case of women entrepreneurs;

(cc) Encouraging banks to develop contractual relations with business development service providers to better identify opportunities and to provide efficient follow-up services;

(dd) Joining with Governments and private partners in creating public-private venture capital funds and investment banks to assist SMEs;

(ee) Urging development banks to adopt a sectoral approach to:

(i) Policy dialogue with Governments and domestic national banks to create an enabling environment for SME support;

(ii) Long-term assistance through loans and equity to local institutions with a perspective of long-term sustainability;

(iii) Complementary capacity building for financial institutions and SMEs via business development service providers;

(ff) Developing common standards and systems to link commercial banks and micro-finance institutions to increase outreach and accelerate the mainstreaming of productive poor into the formal financial system;

E-finance

(gg) Facilitating, through policy dialogue, financing and technical cooperation, the introduction of a technology-neutral regulatory and institutional environment for e-finance;

(hh) Encouraging, through training, co-financing and various partnerships between local and international financial service providers, the introduction of e-finance and related financial innovation by banks and other financial service providers from developing and transition countries and thus demonstrating to them possibilities to tap into e-finance related efficiency gains;

(ii) Participating through co-financing and technical assistance in the creation of local and regional e-finance platforms of various types with a view to improving the quality of services rendered to SMEs and other customers;

(jj) Assisting the SME sector in developing and transition economies to acquire e-finance related technologies and skills as a part of improving their competitiveness and participation in the global economy;

(kk) Supporting Governments, public and private sector entities and NGOs in fulfilling the above-mentioned recommendations on e-finance;

(ll) Doing a more effective job of networking and creating clearing houses for information and experiences relating to types of infrastructure to support e-finance, in close consultation with private market participants;

(mm) Exploring a more structured approach to transfer of knowledge and training and associated cooperation between public agencies;

Commission on Enterprise, Business Facilitation and Development

(nn) Selecting a topic for the next two years which develops coherent approaches to SME finance, e-finance and non-financial business support services, taking into consideration the work of other agencies, in order to contribute to the effectiveness of UNCTAD's research, intergovernmental discussions and technical cooperation and ultimately to UNCTAD XI;

UNCTAD

(oo) Continuing its research on financing for SMEs particularly in the fields of new technology acquisition, export credit, e-finance and e-economy, which are critical for the competitiveness of SMEs and their participation in the global economy;

Finance

(pp) Completing its work on a user-friendly accounting framework for SMEs that will allow them to produce transparent, reliable and uniform financial and business information and reporting back to the Commission as soon as possible;

(qq) Ensuring, in its technical cooperation programmes for entrepreneurship, that business development services are linked to financial services and developing the necessary products and services within its programmes in order to facilitate this;

(rr) Developing, together with other relevant international agencies, programmes for women entrepreneurs to facilitate their access to finance, extrabudgetary funds permitting;

E-finance

(ss) Continuing systematic research into various online financial services and their impact on economic development and in particular on opportunities opened up for SMEs to improve their access to finance and e-finance;

(tt) Organizing regular fora, including regional seminars and group training, to sensitize governments, central banks, financial service providers and the corporate sector in developing and transition countries to the advantages of electronic finance at the local, regional and global levels;

(uu) Incorporating the aspects of e-finance that are more relevant to the needs of SMEs into UNCTAD technical cooperation activities in the area of e-commerce, and ensuring coordination and synergies with other international organizations active in this field;

(vv) Encouraging Governments, central banks and financial institutions to collect information on e-finance and using it for analysis, intergovernmental deliberations and technical cooperation.

Chapter II

CHAIRPERSON'S SUMMARY

12. The Deputy Secretary-General of UNCTAD noted that the theme of SMEs' access to finance was high on the international agenda of urgent issues. While major strides had been made to ease access to finance in developed countries, this was still not the case in developing countries. Much needed to be done to convince traditional creditors and investors that doing business with SMEs could be profitable.

13. Many financial innovations depended on advances in information technology. E-finance could offer many new opportunities if the appropriate regulatory framework was in place and capacity-building programmes for SMEs were available. He was confident that the experts would thoroughly review the questions of finance and e-finance and that the outcome of the Meeting would be directly relevant to the forthcoming international conference on Financing for Development to be held in Monterrey, Mexico, in March 2002.

A. Finance for SMEs

Innovative approaches in commercial banking

14. The experts began their consideration of financing for SMEs with a panel on innovative approaches and successful programmes in commercial banking. The lead panellist underlined the fact that sustainable economic growth was strongly related to the rate of enterprise creation and technical innovation. Vigorous enterprise creation depended on a nation's entrepreneurial culture and the ease with which businesses could be started and financed. There was an empirical relation between a slowdown in an economy and a lack of growth of new enterprises. Panellists from international and national institutions stressed the importance of a dynamic process of SME creation. They emphasized that lending to SMEs could be highly profitable if banks knew the market and customer needs. It was necessary for banks to segment the market and offer a package of products suited to the client. In order to do this, banks had to be close to their clients and have a well-developed branch network, as in the case of the German Savings Banks or Swedbank.

15. Surveys had shown that SMEs needed to know their local banker and valued a personalized service. The challenge for banks oriented to SMEs was therefore to blend the two approaches, i.e. using information technology (IT) to cut service costs and at the same time developing personalized services. The key to maintaining such a balance, according to the experts, was to segment the SME clients, reserving "high touch" service for the most profitable clients while encouraging the marginally profitable customers to use automated delivery channels.

16. In order to segment the market and offer the right package of products using the right approach (high touch vs. IT), national banks had to concentrate on certain core competences. These competences were developed by:

- Adopting sophisticated credit policies: using credit appraisal techniques such as credit scoring and risk-oriented pricing;
- Strengthening management and information systems;
- Developing highly efficient automatic processes, as well as efficient marketing and distribution;
- Developing close ties with clients.

17. Such an approach had helped commercial banks in developed countries to begin to service SMEs and at the same time to make a profit. However, to reach the SME sector effectively, training bank management and staff was essential because only experienced staff could provide good service and judge risks.

18. Examples were given of financial innovations in developing countries, particularly by the Small Industry Development Bank of India (SIDBI). SIDBI, in collaboration with the Indian Banks Association and the National Institute of Bank Management, had organized a number of bank manager sensitization programmes for financing of SMEs. SIDBI had also developed special programmes for financing technology upgrading and marketing. However, there was still a wide gap between the availability of working capital and long-term loans. In response, almost all Indian commercial banks had started giving composite loans (both term loans and working capital) under one roof. SIDBI also operated a National Equity Fund Scheme for projects of up to one million rupees with a 1% service charge. Along the same lines, SIDBI also ran Mahila Udyam Nidhi to assist women entrepreneurs. Numerous venture capital funds had been set up by public and private financial institutions. Apart from setting up 10 regional venture capital funds, one national fund and one overseas fund for IT industries, SIDBI was now setting up a special venture capital fund dedicated to biotechnology. To meet the problem of delayed payment of bills, commercial banks discounted them under the Bills Marketing Scheme with a rediscounting facility from SIDBI.

19. The most successful local banks had found it necessary to combine business development services with their financial services. Depending on their size and capabilities, they either provided these business development services in-house or entered into a partnership with business development service providers to serve their SME clients. It was often possible to outsource credit appraisal and monitoring, as well as the provision of business services such as business plans, accounting, marketing, etc. Business services made SMEs more creditworthy or attractive to investors, but the experts noted that someone must pay for these services.

20. International and regional financial institutions were also rethinking their approach in order to encourage their affiliates and partners to service SMEs. In developing countries, there was competition among financial institutions for traditional corporate clients. Many financial institutions therefore recognized the need to move down-market to SMEs, but the question was how to do it profitably. International financial institutions were concentrating on providing the financial infrastructure to selected national financial institutions and

encouraging them to leverage financial, information and communication technologies to reduce transaction costs and improve portfolio risk management.

21. It was acknowledged by a number of experts that commercial banks had little incentive to lend to SMEs and that they preferred to keep their funds in treasury bills. Until the public sector stopped crowding out the private sector, it would be very difficult to start a widespread movement among commercial banks to lend to SMEs. It was also noted that international prudential requirements would cause local banks to tighten their credit rating systems, thus increasing their costs and thereby reducing their ability to lend to SMEs. The proposed new Basel accord on the amount of capital that banks must hold threatened to choke off finance for small and medium-size enterprises.

22. Regional development banks such as the Asian Development Bank were offering credit lines of up to 15 years to local financial institutions, which were then able to provide long-term finance to SMEs, rather than merely short-term finance. However, these loans were in foreign currency, thus obligating the national banks to restrict lending to those SMEs earning foreign currency. The experts agreed it was preferable that the international financial institutions should provide local currency loans so that the risk of devaluation was borne by the international financial institution rather than by the receiving financial institution. Most SMEs did not earn foreign exchange and thus would otherwise be exposed to currency risk. One difficulty in servicing the SME sector was the lack of reliable and transparent financial information and the need to develop a user-friendly accounting system for SMEs that could generate information for creditors, investors and SME managers.

Equity and venture capital

23. The second session dealt with equity and venture capital for SMEs and complements to finance, such as credit insurance, which could help SMEs to enhance their access to finance, especially long-term funds. Among the issues discussed by experts in this session were: (i) elements of successful venture capital funds in reaching SMEs; (ii) advantages and disadvantages and latest trends in SME venture capital; and (iii) contribution of export credit insurance and guarantee schemes to increasing bank lending to SMEs.

24. Two experts provided accounts of the Small Enterprise Assistance Funds (SEAF) operating in developing countries and economies in transition and those of the Chinese Development Bank.

25. The primary mission of SEAF was to provide private equity financing for SMEs in underserved markets, generating commercial returns. It was underlined that, without commercial returns, the venture capital industry would not be able to attract private capital and would not be sustainable over the long term. An ultimate goal of SEAF was to promote the creation of capital markets for SMEs, which in developing countries remained underdeveloped. SEAF managed 14 funds for multilateral and private investors. The average investment in a company was US$ 300,000.

26. In China, the Government had implemented a number of measures to encourage venture capital funds and SME development since 1999. Such measures were part of the new emphasis on helping SMEs at the start-up and grow-up stages. The measures included encouraging technology innovation; increasing fiscal and taxation support; setting up a credit guarantee system; and improving social service organizations (e.g. pension funds). In the last two years, China's venture capital funds had increased significantly in terms of both the number of companies involved and the volume of funds. However, the venture capital industry remained quite limited in China, as most venture capital financing still came from the Government. The Chinese Development Bank (CDB) had been providing supplementary funding (long-term loans) and financial advice to help venture capital companies to attract more funds.

27. Special emphasis was put on the key elements of a successful SME venture capital fund:

- Experienced fund managers;
- Significant and high-quality deal flow;
- Professional business managers in enterprises;
- Adequate deal size in order to pay back completely the equity investment made by the shareholders;
- Some form of additional training, market opening, technology, etc., along with equity capital;
- Collaboration with technical assistance providers.

28. The advantages of SME venture capital funds were the following: they could provide extremely profitable returns if run properly; they provided growth capital for SMEs that normally did not have access to stock markets and, frequently, were over-leveraged companies; and they provided managerial and technical assistance to talented entrepreneurs. Nevertheless, SME venture capital funds also had disadvantages. They were not appropriate for all SMEs, particularly for smaller ones. Unless a company could generate cash flows to pay for technical and managerial assistance, venture capital funds were not a cost-effective method. In addition, venture capital required significant involvement of fund managers in mentoring and supporting SMEs.

29. Experts observed that, in developing countries, equity funds and especially venture capital funds had greater difficulties in servicing SMEs and even identifying fundable ones. The required rates of return for investments in developing countries were very high, thus disqualifying most potential investments.

30. It was also noted that, since developing countries had illiquid markets, exit strategies were a difficult issue for SME venture capital funds. In the case of SEAF, the fund actively

searched for prospective exit opportunities such as a strategic purchase by a competing firm even before making the initial investment.

31. The experts focused on mechanisms that could be used to bridge the gap between the lack of business competence of SMEs in developing countries and the requirements of commercial banks or private equity funds. They emphasized the importance of a competent and motivated management team for the success of an SME. They agreed that SMEs needed handholding in the pre- and post-finance stages. In such cases, donor agencies and business development service providers could play a key role through programmes dedicated to strengthening SMEs in order to improve their creditworthiness. They agreed that there is a need for public-private investment funds devoted to the support and promotion of SMEs and information infrastructure development, especially in the LDCs.

32. The latest trends in private equity investment showed that there was a need to bring in private pension funds, insurers and investors who were looking for high returns in order to provide equity capital for SMEs. Governments had recognized the dynamic nature of the SME sector, which meant that there were more government funds for equity capital investment in SMEs. In addition, public and private sectors were entering partnerships to promote the investment of private funds.

Complements to finance: insurance

33. SMEs engaged in exporting must also have access to export credit insurance in order to cover both commercial and political risks.

34. COTUNACE, a Tunisian company, provided export insurance and bank guarantees to SMEs. Examples of services it had developed to serve SME clients included business advisory services and follow-up, and easier access to bank financing through guarantee conventions signed by COTUNACE with banks.

35. In 2000 the company had launched a new product: a Pre-Financing Export Guarantee. Through this instrument, COTUNACE guaranteed SME activities vis-à-vis banks. The role of this guarantee was to replace the traditional collateral demanded by banks with a pre-financing credit guarantee. The main objectives were to facilitate the access of SMEs to bank pre-financing with guarantees up to 80% of export orders and to facilitate exporting instead of subcontracting by SMEs.

36. COTUNACE had overcome the reluctance of banks to accept guarantees instead of collateral in three ways. Firstly, banks were allowed to come forward with their own SME customers (persuasion efforts). Secondly, COTUNACE rendered the system credible by paying quickly when there was a default problem. Thirdly, banks were under increasing pressure from COTUNACE and the Government to provide finance to SMEs. Furthermore, SMEs were aware that such a system existed and that guarantees could be financed by COTUNACE. Thus, persuasion had been combined with a credible guarantee system.

37. The experts discussed the use of guarantee schemes to increase bank lending to SMEs. Such schemes could reduce the risk perceived by banks when lending to SMEs and they could also have a positive impact on the prudential regulations imposed on banks. For example, in the case of defaults, rapid compensation from a guarantee scheme enabled banks to restore liquidity without waiting for the outcome of legal procedures.

38. However, many guarantee funds had failed in the past because of moral hazard problems, inadequate procedures that involved high administrative costs, inexperienced staff dealing with SME loan portfolios, and delays in paying claims to banks. In Africa, guarantee schemes had a political aspect whereby banks were often compelled to finance risky projects and sectors.

39. To avoid repeating past failures, guarantee schemes should be constructed on solid principles, such as:

- Additionality: the introduction of the guarantee had a significant role to play in the decision making process of banks in granting credit to those SMEs which had previously been rejected;
- Viability: ability to cover running costs as well as any losses;
- Credibility: the guarantee must be obtained easily in case of a default, and the fund should be run professionally;
- Trust: the guarantee scheme should inspire trust in all financial institutions and should foster long-term relationships between banks and borrowers.

40. It was underlined that export credit insurance and guarantee schemes could increase banks' appetite for servicing SMEs in developing countries, but they had to be combined with financial innovation and training at the bank and the guarantor levels and with business services at the SME level. Experts also emphasized that loan guarantee schemes should be designed so as to ensure that the target beneficiaries were reached, balanced risk sharing was ensured and moral hazard problems were avoided.

Combining business services with finance

41. The experts then considered the need to combine non-financial services (or business development services) with actual finance in order to ensure long-term and sustainable results in strengthening the SME sector.

42. They noted that in many cases the main obstacle for SMEs to access finance was not the shortage of finance, but the lack of well-formulated and sound business proposals that banks and investors would find creditworthy.

43. Critical skills needed to run a successful enterprise were described by one expert as a tripod: (1) product or service know-how; (2) marketing and sales ability; (3) finance and accounting skills. Business development services (BDS) aimed at strengthening the capacities of SME entrepreneurs in these areas had the potential to improve the attractiveness of SMEs. More professional management of SMEs improved their survival rate, thus reducing loan losses for banks. Well-formulated business plans, high-quality financial information, knowledge of available financial instruments and properly prepared loan applications all reduced the costs for banks of servicing SME clients.

44. Experts brought up the need for third party business appraisals for SMEs before they entered a bank and sought finance. This would involve a confidential assessment of the SME's business idea and options, covering the basic business idea, market potential, management ability, financial needs, security and repayment. SMEs would have a realistic picture of options available to them, and for banks the potential clients would already have been pre-screened.

45. The experts considered a number of business support services offered to SMEs. They noted that schemes involving business mentors had been particularly useful for SMEs. A mentor was someone who was experienced in the business of the SME concerned, trustworthy, professional and able to give up-to-date advice.

46. For a BDS provider to be useful, the services it provided needed to be of high quality. This was especially true in cases were partnerships between banks and BDS were promoted. If banks were to outsource some of their operations to BDS providers, they needed to have great confidence in the partner. These partnerships had the potential of improving SMEs' access to credit significantly by reducing the costs of lending for banks through the outsourcing of activities such as credit appraisal and monitoring of loans to BDS providers.

47. BDS services should not only focus on SMEs. Commercial banks also needed to develop their skills in working with SMEs. Experts noted that in many cases commercial banks lacked entrepreneurial spirit and tended to choose the easy and low risk option rather than to work with more challenging SME clients. BDS providers should therefore also aim to develop the entrepreneurial skills of bankers (intrapreneurship) and to promote their sensitivity towards SME clients.

48. Experts considered the need to subsidize the provision of business development services. It was noted that SMEs were often very reluctant customers of these services, since the advantages were not always directly apparent. It was noted that especially the initial contact between an SME and a service provider should be either free or inexpensive. However, at later stages SMEs should feel that the services they were receiving were worth their time and money (demand driven) and would thus be willing to pay for the services.

49. The experts also noted the need to promote an institutional framework for SME support services.

Governments and international organizations

50. On the role of Governments and international organizations in promoting SMEs' access to credit and the special difficulties faced by women entrepreneurs in accessing credit, a panel was chaired by the Minister for SMEs and Commerce of Senegal. In her opening statement the Minister outlined the financial environment that SMEs faced in Senegal and emphasized the need to actively support SMEs' access to credit and the importance of providing technical assistance to them. In Senegal, the Fund for Economic Promotion used instruments such as refinancing, guarantees and credit lines to improve SMEs access to credit, and in recent years a number of measures had been taken to improve the efficiency of the Fund. These included a communication strategy to strengthen partnerships with banks and SMEs, placing emphasis on hiring finance and banking experts, establishing systems to ensure managerial rigour, and improving the visibility of the fund and its products, especially among SMEs.

51. Experts further discussed the experiences of the Ugandan Government with programmes for improving SMEs' access to credit. Their success had depended on whether the final credit decisions were made on a commercial basis. Programmes in which the Government had provided funds for banks to on-lend to SMEs had resulted in mismanagement of the funds and had usually failed to reach the target groups. Schemes that had worked better were ones in which Governments had channelled funds (especially long-term resources) through the central bank, with commercial banks taking the full risk. The problem with this approach was that the credits were generally expensive by the time they reached SMEs, it did not solve the problem that SMEs faced with respect to lack of collateral, it depended on existing infrastructure and it did not promote innovations. Credit guarantee schemes in Uganda had worked relatively well. They brought in burden sharing and forced commercial banks to consider SME clients that otherwise would not have been eligible for credit. Equity financing had so far been limited, but represented a very promising initiative.

52. Experts emphasized the role of the Government in strengthening the financial system by adopting regulatory and legal frameworks that allowed for the establishment of financial sector infrastructure such as credit bureaus and other information sharing solutions, encouraged banks to implement good corporate governance practices and transparent management procedures, and created conditions for promoting local capital markets.

53. Experts noted a number ways to encourage commercial banks to lend to SMEs. These included requiring banks to disclose the composition of their loan portfolios, particularly the percentage of loans to SMEs, and encouraging banks to appoint outside experts with knowledge of SMEs to their board of directors.

54. Experts discussed the use of debt-swaps for international organizations as a means of strengthening local financial institutions by providing them with medium and long-term finance for SMEs and also using them to provide business development services. Experts noted that this could be a useful complement to the HIPC debt alleviation facility.

55. Experts discussed the need to develop common standards and systems to link commercial banks and micro-finance institutions to increase outreach and accelerate the mainstreaming of productive poor into the formal financial sector.

56. Experts also noted the need for reliable SME data for reliable policy analysis.

Women entrepreneurs' access to credit

57. The experts considered the problems faced by women entrepreneurs in obtaining access to credit. Despite the active role of women as entrepreneurs and their good track record in repayment of loans, their share of loans remained marginal. Experts noted that women entrepreneurs faced hurdles in accessing credit that male entrepreneurs did not face. For example, women entrepreneurs were frequently asked questions regarding their marriage status and family plans that their male counterparts were not asked.

58. The experts examined successful programmes to improve women's access to credit. These included the Women's World Bank (WWB) that operated through 43 affiliates in 35 countries. WWB had improved women's access to credit through partnerships with local savings banks and group lending models to substitute for collateral, through guarantee schemes for emigrant women and by working with bankers to make them aware of discrimination that women faced in obtaining access to credit.

59. Experts also considered it necessary to increase the number of women as advisers and staff in bank to improve banks' awareness of and capability to work with women entrepreneurs.

60. The experts discussed the special problems women entrepreneurs in developing countries faced in obtaining formal credit. For example, in Honduras women were usually restricted to obtaining credit from informal sources at very high rates of interest. The congress of Honduras was considering the creation of a Women's Popular Bank to improve women entrepreneurs' access to medium and long-term credit in both rural and urban areas.

B. E-finance for SMEs

61. Part two of the Expert Meeting was opened by the Director of the Division of Services Infrastructure for Development and Trade Efficiency (SITE). He briefly overviewed the importance of e-finance for the SMEs in developing and transition economies and stressed that the promised efficiencies of electronic commerce in developing countries would not materialize without investment in ICT infrastructure and in human resources, as well as adequate external debt relief. He also indicated that the papers of the e-finance for SMEs part of expert meeting were posted on the website of UNCTAD's e-commerce programme: www.unctad.org/ecommerce

62. The discussion on e-finance concentrated mainly on: the state of e-finance globally and in developing regions; the possibilities of global and regional e-finance platforms;

national experiences; and the prospects for improving SMEs’ access to e-finance in developing and transition economies

The state of e-finance

63. Two leading experts and UNCTAD consultants on e-finance maintained that financial services were among those sectors most transformed by the advent of the Internet. They discussed progress in online payments, Internet banking, digital cash, e-trade finance, e-credit information systems, and others. They agreed that the banking system alone would not be able to provide comprehensive solutions for cyberfinance. Solutions were emerging as a result of competitive pressures from the pure technology companies or dot.com newcomers and as a result of aggressive Internet e-finance development strategies of traditional service providers. Adopting e-commerce in the financial sector was a complex process with many hidden costs, including the need for new levels of intermediation.

64. Even today, in developed countries 80 per cent of all small payments were still in cash. On-line retailing or business-to-consumer e-commerce (B2C) relied predominantly on the credit card as a means of e-payment. Credit cards were convenient as they provided for international cross-currency payments, the main credit card brands were generally recognized and deemed trustworthy, and bankers already had experience with credit-card-holder-not-present payments in mail/telephone order retail before the advent of Internet based e-commerce. No dominant mode had yet emerged for online payments in business-to-business e-commerce (B2B). The development of online modes of automated clearing house payment systems (ACH) was important for online transfer of large funds. In order for these to take off, legal changes accommodating e-commerce practice needed to be in place and a public key infrastructure (PKI) system was necessary.

65. Developing countries were still disadvantaged in terms of participating in this process because of their underdeveloped banking systems and low credit card penetration. However, the possibilities for leapfrogging were substantial, as Internet-based technology was still less expensive than traditional technology. Although e-finance was at an early stage, especially in developing and transition economies, it had the potential to dominate global finance in the coming years, hence the far-reaching implications for developing countries’ SMEs and their financial institutions.

Global and regional e-finance solutions

66. According to the representatives of two major credit insurers, Coface and Gerling Namur, third party online credit risk management, particularly through credit insurance, was becoming an important constituent part of e-finance. Even in traditional finance, poor credit information resulted in the perceived risk of doing business with SMEs in developing countries being greater than the real risk. Traders in developed countries found it difficult to extend trade credit to traders from developing countries if there was no credit information on the latter. The Internet had great potential in terms of improving the situation by making credit information, and therefore credit ratings, accessible to developing country SMEs. As a

result of improved transparency, SMEs might be listed in online credit information and rating databases and improve their access to trade finance. The Coface @rating system was one of the biggest private sector initiatives to monitor online millions of SMEs, including those from emerging economies, and provide them with credit limits.

67. From the perspective of the representative of Citibank, e-finance would not bring any new finance for SMEs if their credit risk remained the same. SMEs had to face a number of challenges, including high trade barriers, lack of technological know-how, and inadequate access to financing and information. While credit rating was an important area, other issues, such as management quality, were also significant when extending finance to SMEs. E-commerce and e-finance were parts of many SMEs' future, as their larger trading partners in developed countries were adopting these practices and would exclude partners that failed to comply with the new technological standards.

68. Paradoxically, microfinance, including lending to individuals or very small SMEs, was better organized at the regional and global levels than traditional SME finance, in spite of the fact that this lending was frequently offered without collateral. The representative of Virtual Micro-finance Market and Pride Africa explored new approaches needed to embrace this economic segment and extend finance, in particular the active use of Internet-based platforms. The Virtual Microfinance Market resided on a website developed in UNCTAD. This particular e-finance application provided various types of information about Micro-finance institutions (MFIs), including information related to their reliability, thus permitting internationally known financial institutions to fund MFIs more frequently and more quickly than in the past.

69. As the practice of microfinance had shown, the traditional development finance approach did not give the desired results. In Africa, half of all economic activity was in the informal sector, which was out of reach of formal financing and its institutions. A more promising approach would be to establish a network of MFIs based on a replicable and successful model. This network could develop linkages with the formal financial sector and among individual MFIs. Existing and new technologies could be tested for their appropriateness and banks spared from having to deal with thousands of small clients.

70. The expert on regional e-commerce from the Philippines stressed the importance of SMEs developing electronic back-offices. In order to participate in e-commerce in the framework of global and regional supply chains, SMEs had to face the challenge of meeting standards applied by TNCs. Otherwise they risked being technologically excluded. While, so far, all e-commerce failures had had their roots essentially in technology deployment issues, future success would depend on implementation of legal and public key infrastructure. Legally enforceable digital signatures were key to enforcing global standards. At present global standards were lacking, and this was creating a problem of redundant costs caused by the need to have proprietary solutions. The availability of real-time financial risk information called for consequential adaptation of financial risk management products. Thus many trade credit and credit information institutions were willing to expand their activities and become B2B clearing houses or markets.

71. The experts also expressed their concern that, although many schemes were in place, little if any additional financial flows were generated. Leveling the playing field for businesses worldwide was an easily assumed characteristic of the Internet. However, given concerns about the growing global digital divide and the marginalization of LDCs in global trade, it was not clear if a unitary approach could be taken to suggesting policy options or best practices for LDCs and their SMEs.

72. The accountability of rating agencies for the quality of their ratings, as well as their ability to continuously update the ratings of the millions of businesses in their databases, was also questioned. While e-commerce was not a panacea, its full-fledged adoption by the main global trading partners was going forward. Developing countries therefore needed to reassess their technical assistance focus. They had to require more e-commerce and e-development-centred assistance to be able to adopt e-commerce-compatible legislation and re-engineer government administration currently bogged down in paperwork and red tape. Equally SMEs needed to adopt e-commerce practices, invest in IT and retrain their personnel to benefit from the efficiency of e-commerce. Experts also stressed the potential of mobile e-commerce, as mobile telephony provided secure hardware and a billing system that could be utilized for commercial transactions other than telecommunications.

National e-finance experiences

73. An expert representing a leading Indian banking institution active in e-finance pointed out that in India lending to SMEs was a risky proposition due to SMEs' lack of collateral, their inability to provide quality data, and the low company survival rate. Traditional banking could not adequately serve this market. E-banking, in contrast, could capitalize on the linkages that SMEs had with parent corporations as supply chain partners. A corporation could create a B2B platform involving an e-finance network, permitting SME participation in e-banking and making SMEs more creditworthy. Furthermore, e-banking led to significant cost reductions through lower cost of delivery, speed and wider reach, while online credit information tools facilitated transaction analysis and risk mitigation. Savings could then be transferred to SMEs in the form of lower interest rates.

74. The representative of a leading Brazilian bank explained that the payment system in Brazil was very efficient and comparable to those in developed countries thanks to the heavy investments in IT made by leading Brazilian commercial banks in the high inflation years. An efficient payment system was the basis for e-finance and e-commerce. Brazil also had a relatively high Internet and e-banking penetration rate, with greater focus on transactions and payments than on credit and loans. In particular, e-banking allowed current account management, payment of salaries, collection of receivables, payment of suppliers, credit-related services and expense account management. Crucial issues for the development of e-finance were the adoption of compatible regulations for e-finance in Mercosur countries and the adoption of laws and regulations for digital signatures for loans and other financial transactions.

75. The "Coalition" project presented by an expert from Mexico represented a concrete way to solve SME financing problems by leveraging on the special relationship that they had with large well-established enterprises. Upon delivery of materials, services or products, SMEs obtained documents from buyers, normally large corporations, which were regarded as a sort of guarantee by a bank ready to cash them in advance of the due date. This system benefited all participants, because guarantor corporations did not have to worry that SMEs might go bankrupt because of a cash-flow problem, while banks attracted new customers or helped existing customers make more business.

76. An expert from Bangladesh pointed out that over 50 per cent of SMEs from Bangladesh had no access to any form of formal finance. ICT could play an important role in helping remove this major obstacle to SME growth. A first concrete project was the introduction of innovative e-finance services specially designed for SMEs through the use of smart cards and the development of a point-of-sale network. A second important initiative was being taken to address the most important barrier in getting access to finance in Bangladesh: lack of collateral. In this respect, Bangladesh was planning to create a countrywide, inexpensive, electronic public records system that would allow individuals to retrieve information about all movable property claims. A new law would then strengthen the enforcement system for creditors. Finally, in order to overcome the lack of reliable and validated business-related information, a new electronic business information system – accessible from anywhere in the country – would be implemented in stages from 2002 to 2008.

The prospects for e-finance

77. Experts from the World Bank and Amsterdam University maintained that e-finance was not limited to industrial countries and advanced emerging markets, but instead offered opportunities to leapfrog to countries with underdeveloped financial systems. In Africa electronic cash and other smart cards offered savings and payment services to low-income customers—including those in remote areas—who often did not even have formal bank accounts. However, realizing the gains would require changing public policies toward financial services. The most pressing policy issues related to an enabling regulatory environment for e-finance. Adjustments were needed in approaches to telecommunications, security and related infrastructure for electronic transactions, information and privacy, and contract enforcement. In addition, steps had to be taken to minimize risks for consumers and investors, adjust prudential regulation, and improve the performance of markets.

78. The representative of the Bank for International Settlements presented the possible implications of e-finance for banks and other financial institutions, as well as for financial markets. Exactly how these developments would take place and at what speed they would unfold was quite uncertain. These uncertainties could have potentially destabilizing effects on the financial systems and thus posed challenges to central banks and financial supervisors, among other things in respect of the level of their international cooperation. Responding to these challenges required a technology-neutral regulatory and institutional framework that would make it possible to reap the full benefit of e-finance without stifling innovation. One

obstacle in developing this new framework was the lack of reliable data on e-finance itself. But before new data collection systems were considered, a clearer conceptual framework was needed to pose relevant questions, and the help of the private sector and the academic community was needed in this endeavour. In this context, it was all the more important to have regular and in-depth exchanges of information between central banks, supervisors and private market players.

79. Finally, in assessing the future of e-finance, a practitioner from India stressed lack of finance as the premier constraint on SME growth. The main problems in this connection were lack of collateral and lack of reliable information on SMEs, which, compounded with smaller fund requirements per deal, made the transaction costs of funding SMEs excessively high. Fortunately, Internet technologies provided a feasible solution to these problems. The solution lay in leveraging Internet technologies and involving SME associations in the collation of basic data. This initiative could be complemented by policy initiatives such as mandating public sector units and public listed companies to collate basic information on all SMEs associated with them and requiring that industrial parks have a database on SMEs operating under their aegis to qualify for preferential fiscal treatment. Once reliable information on SME business was captured, a basic identity for SMEs could be established, and credible transaction histories could be generated, paving the way for e-finance.

80. Some experts also noted that the banking industry thrived on operational inefficiencies (floats and intermediation fees) that existed due to information asymmetry in the vendor-client relationship. It was estimated that e-finance could reduce the margins of the financial services industry by almost 50% in several developing countries. Hence, the banking sector had inherent reservations about encouraging digital efficiencies. In the short term, therefore, trade entities should come up with major initiatives in the area of e-finance to create competitive pressures on banks.

81. Finally, while one expert emphasized the importance for developing countries of knowing which changes they should introduce in their financial regulations before launching e-banking, another did not agree that the regulatory environment was of fundamental importance to start e-banking, citing as an example the case of Mexico where, in spite of a public sector guarantee on savings deposited with any type of bank, customers were still reluctant to put savings in pure Internet banks “because they did not trust a non-physical entity”. In that respect experts also touched on security issues and in particular PKI, including the quality of certification authorities and the possible role of Governments in that process.

Chapter III

ORGANIZATIONAL MATTERS

A. Convening of the Expert Meeting

82. The Expert Meeting on Improving the Competitiveness of SMEs in Developing Countries: The Role of Finance, including E-finance, to Enhance Enterprise Development, was held at the Palais des Nations, Geneva, from 22 to 24 October 2001.

B. Election of officers

(Agenda item 1)

83. At its opening meeting, the Expert Meeting elected the following officers to serve on its bureau:

Chairperson: Mr. Paul Frix (Belgium)

Vice-Chairperson-cum- Rapporteur: Mr. Edsel Custodio (Philippines)

C. Adoption of the agenda and organization of work

(Agenda item 2)

84. At the same meeting, the Expert Meeting adopted the provisional agenda circulated in document TD/B/COM.3/EM.13/1. The agenda for the Meeting was thus as follows:

1. Election of officers
2. Adoption of the agenda and organization of work
3. Improving the competitiveness of SMEs in developing countries: The role of finance, including e-finance, to enhance enterprise development
4. Adoption of the outcome of the Meeting

D. Documentation

85. For its consideration of the substantive agenda item, the Expert Meeting had before it an issues paper prepared by the UNCTAD secretariat entitled: “Finance and e-finance for SMEs as a means to enhance their operations and competitiveness” (TD/B/COM.3/EM.13/2),

E. Adoption of the outcome of the Meeting

(Agenda item 4)

86. At its closing meeting, the Expert Meeting authorized the Rapporteur to prepare the final report of the Meeting under the authority of the Chairperson.

Annex

ATTENDANCE [*]

1. Experts from the following States representatives of UNCTAD attended the Meeting:

Belarus
Belgium
Benin
Brazil
Chad
China
Costa Rica
Cuba
Denmark
Egypt
France
Germany
Ghana
Guinea-Bissau
Honduras
India
Ireland
Italy
Jordan
Kenya
Madagascar
Mexico
Morocco
Mozambique
Nigeria
Oman
Panama
Philippines
Qatar
Russian Federation
Saudi Arabia
Senegal
Spain
Sudan
Sweden
Switzerland
Syrian Arab Republic
Thailand
Togo
Trinidad and Tobago
Tunisia
Uganda
United Republic of Tanzania
United States of America
Venezuela

2. Palestine attended the Meeting as an observer.

3. The following intergovernmental organizations were represented at the Meeting:

European Community
Arab Labour Organization
Organization of the Islamic Conference

[*] For the list of participants, see TD/B/COM.3/EM.13/INF.1.

4. The following specialized agencies and related organizations were represented at the Meeting:

International Labour Organisation
International Monetary Fund
World Intellectual Property Organization
United Nations Industrial Development Organization

5. The Economic Commission for Europe, the Economic Commission for Latin America and the Caribbean, and the Department of Economic and Social Affairs were represented at the Meeting. The International Trade Centre was also represented at the Meeting.

6. The following non-governmental organizations were represented at the Meeting:

General Category

Exchange and Cooperation Centre for Latin America

Special Category

International Federation of University Women

7. The following panelists and special invitees attended the Meeting

Ms. Aïchatou Agne Pouye, Minister for SIYEs and Trade, Senegal
Mr. John C. Bays, Regional Director, Small Enterprise Assistance Funds (SEAF), Bolivia
Mr. Håkan Berg, Executive Vice-President, Swedbank, Sweden
Ms. Inger Berggren Garnacho, President, Women’s World Banking, Spain
Mr. Jérôme Cazes, Managing Director, COFACE, France
Mr. Stijn Claessens, Professor of International Finance, University of Amsterdam, Netherlands
Mr. Brian Dunsby, Senior Vice-President, International Council for Small Business, United Kingdom
Mr. Thomas Glaessner, Lead Financial Economist, World Bank, Washington, United States of America
Mr. Charles Goldfinger, Managing Director, Global Electronics Finance, Belgium
Mr. Sanjay Guglani, Managing Director, Saksham Financial Services Ltd., India
Mr. Cuno Güttler, Director, German Savings Bank Organization
Mr. Tom Harrison, British Executive Service Overseas (BESO), United Kingdom
Mr. Louis Kasakende, PhD., Deputy Governor, Bank of Uganda
Ms. Renate Kloeppinger-Todd, Global Finance Marketing Group, International Finance Cooperation
Mr. Sankar Krishnan, Vice-President and Regional Head, E-Business for Middle East,

South Asia and Africa, Citibank, Dubai, United Arab Emirates
Mr. Sushant Kumar, Head-SME, ICICI Bank, India
Mr. Sailendra Narain, Principal Advisor, World Association for Small and Medium Enterprises (WASME), India
Mr. R. Narasimham, Senior Project Officer, Asian Development Bank, Manila, Philippines
Mr. Antonio C.B. Oliveira, Executive Director, Banco Itaú, Brazil
Mr. Donald O'Mahony, Director, Networks and Telecommunications Research Group, Trinity College, Ireland
Mr. Mauricio de la Orta Pardo, Westbridge University and Banco Santander, Mexico
Mr. Pancho Otero, Member of the Advisory Board, Virtual Microfinance Market, Bolivia
Mr. François Perrin, Manager, Global Electronics Finance, France
Mr. Ananya Raihan, Research Fellow, Centre for Policy Dialogue, Bangladesh
Mr. Philippe Régnier, Director, Modern Research Center, University Development Studies Institute, Switzerland
Mr. Philippe Rennotte, Member of the Executive Board, Gerling Namur
Mr. Setsuya Sato, Senior Advisor, Bank for International Settlements, Basel, Switzerland
Mr. Jean Marie Vianney Nyirimihigo, Director-General, African Solidarity Fund, Rwanda
Ms. Rina de Villeda Bermudez, Inter-American Commission of Women, Honduras
Mr. Andrew Warner, Professor, Centre for International Development, Harvard University, United States of America
Mr. Moncef Zouari, CEO, Compagnie Tunisienne pour l'Assurance du Commerce Extérieur (COTUNACE), Tunisie

Specially invited

Mr. Ernest Ngome Ajang, Senior Accounts and Finance Officer, Cameroon TPO
Mr. Jean Bastin, President, Fondation Scientifique Jean Bastin a.s.b.l.
Mr. Robert Bedrikow, SERASA, Brazil
Mr. Jeremy Bullock, Financial Consultant, United Kingdom
Mr. Jaime Echegoyen, General Manager, Spain
Mr. Michael Firth, Chair Professor, Hong Kong
Mr. José Gabriel Hernandez Figueroa, Internet Division, Banco Santander Mexicano, Mexico
Ms. Tulay Gungen, Executive Vice-President, Yapi Credit Bank of Istanbul, Turkey
Mr. Ahmad M. Jachi, Chairman and Chief Executive, Al-Buhous Institute, Lebanon
Mr. Konstantin Karabanov, Consultant, Netherlands Economic Institute, Moscow Office, Russian Federation
Mr. Bruno Masier, President, World Trade Point Federation, Geneva

Mr. Pascal O'Dogherty, Director, Financial Analysis, Banco de Mexico

Ms. Maria Otero, President and CEO, ACCION International, United States of America

Mr. Pierre Paris, Consultant, Ministry of Foreign Affairs, France

Mr. Robert Parson, Head, Legal Team, CCEWeb Corporation, United Kingdom

Ms. Colette Schreiber, Vice-President, Les Femmes Chefs d'Entreprise (FCEM), France

Ms. Claudine Seynave, Fondation Scientifique Jean Bastin a.s.b.l.

Mr. Raymond W. So, Assistant Professor, Hong Kong

Mr. Kumar Sushant, Head SME, ICICI Bank, India

Mr. Jean-François Tarel, President, COFACE, Switzerland

Mr. Daniel Wyss, Director, Credit Suisse Banking, Switzerland