Benchmarking support to SMEs in three multilateral development banks

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In spite of the importance of SME development and growth, relatively little research exists on whether, why and how banks, in particular, development finance institutions (DFIs), finance SMEs around the world.

This article analyses and benchmarks the policies, strategies, and operations underlining SME support schemes in three multilateral development banks: the World Bank Group; the European Bank for Reconstruction and Development; and, the African Development Bank.

Introduction

This article analyzes and benchmarks the policies, strategies, and operations underlining SME support schemes in three Multilateral Development Banks (MDBs): the World Bank Group – as the biggest and most innovative player; the European Bank for Reconstruction and Development (EBRD) – as it contains specific reference to Small and Medium Enterprises (SMEs) in its mandate/charter; and the African Development Bank (AfDB) – for its recent focus on private sector development, notably on SMEs. The World Bank Group is included as opposed to singling out the International Finance Corporation (IFC) because it remains a significant provider of SME finance and support through the International Bank for Reconstruction and Development (IBRD), in a complementary fashion to the support provided by IFC.

The article reviews the role played by the three MDBs in supporting SME development and how this role has evolved over time. It also provides a benchmarking review of SME-targeted operations, that is, where SMEs are the primary focus of the intervention; and assesses, at the operational level, financing and non-financing instruments (technical assistance and at the policy, business climate level), including how new approaches and instruments have evolved over time.

The methodology involved a desk-review of documents (including policies, strategies, operational documents, and analysis of targets for SME development), and interviews with staff at their respective head offices, with subsequent interactions to obtain more detailed information.

Structure of the article

First, the article provides a brief operational overview of the AfDB, WBG (IFC & IBRD) and EBRD and compares the volumes of their financing and technical assistance operations to SMEs. Second, it compares the SME strategies and approaches of the three institutions as set out in strategy and policy documents, including how such strategies and policies have evolved over time, and reviews areas of interventions and instruments deployed, both financial and non-financial (technical assistance at the micro and at the policy and business climate levels). Third, it examines how SME activities are undertaken from an organizational/institutional perspective, in particular, the mix of operational/transactional units and strategy/policy units. Fourth, it provides an overview of the emerging trends in this area.

Operational overview

In spite of the importance of SME development and growth, relatively little research exists on whether, why and how banks, in particular development finance institutions (DFIs), finance SMEs around the world[6] and on impact assessment[7] in the sector. Efforts to collect comprehensive data on SME financing have been scaled up within the G-20 framework (Consultative Group to Assist the Poor, 2010).

International Finance Corporation (IFC) support to SMEs began in 1981, showing a continuing commitment to developing local financial markets focusing on micro, small and medium enterprises (MSME), although it has no dedicated SME strategy. It is part of the WBG that has the widest range of SME instruments and support mechanisms. Only IFC has an official definition of SMEs, although this is not always used in practice. Defining SMEs is essential for an appropriate strategy to serve them to be formulated. IFC identifies SME support as a strategic objective based on job creation potential. It has the largest number of SME specialists, with hundreds of staff – this probably explains why it is considered the most innovative IFI in SME financing and technical assistance. Regionally, Sub-Saharan Africa and the Middle East and North Africa (MENA) are two of the three priority regions for SME targeting.

The African Development Bank (AfDB) recognized the importance of SMEs as long ago as 1986 in its Industrial Sector Policy Guidelines. However, at present the AfDB does not have a dedicated SME strategy and SME-related interventions are guided by the institution's general and private sector development strategies and policy documents. The Bank's 2003 Financial Sector Operations Policies proposed the use of financial intermediaries for targeting SMEs, via Lines of Credit (LOCs). This use of LOCs was expanded further in the 2004 Private Sector Development Strategy, which strongly stressed the importance of SME support via financial intermediaries. The newly created Financial Sector Development Department in the AfDB is expected to take over responsibility for SME-related operations through financial intermediaries that were handled by the Private Sector Department of AfDB until 2014.

The documents establishing the EBRD in 1991 state that the Bank shall, in member countries, "[...] promote, through private and other interested investors, the establishment, improvement and expansion of productive, competitive and private sector activity, in particular, small and medium sized enterprises" (Bronstone, 1999, pag. 177). The EBRD is the only MDB that has a very high-level specific commitment to SMEs in the form of a dedicated

[6] Notable exceptions are Kwakkenbos and Romero (2013), Calice, Chando, and Sekioua (2012), Dalberg (2011), Perry (2011), and Beck, Demirguc-Kunt, and Peria (2008, 2010).

[7] With respect to impact evaluations of SME programs, notable exceptions are Giorgi and Rahman (2013), López-Acevedo and Tan (2011), Bah, Brada, and Yigit (2011), López-Acevedo and Tinajero (2010), Castillo, Maffioli, Monsalvo, Rojo, and Stucchi (2010), Tan (2009), Tan and Lopez-Acevedo (2005), World Bank (2010), and Oldsman and Hallerg (2004).

SME strategy. At the end of 2013, EBRD adopted a radical new approach to SME in its Small Business Initiative Review (SBI), which contains, inter alia, a more strategic approach, a wider range of instruments, and more efficient, faster processes and approval procedures. In 2012, EBRD expanded operations in North Africa following the Arab Spring.

SME strategies and approaches

The three institutions have a similar range of financial instruments to support SMEs through financial intermediaries, as well as technical assistance and policy dialogue (investment climate reform and support structures for SME etc.). While the AfDB provides only indirect forms of support, IFC and especially EBRD also have significant portfolios of direct investments in SMEs.

With respect to policy and strategic orientations, both EBRD and IFC have been innovators in private equity, sponsoring a number of SME-focused investment funds that are the first of their kind geographically or by target market, whereas AfDB has been investing alongside such funds and those sponsored by other development institutions. IFC has a major competitive advantage in sourcing investment projects as it can bundle investment operations and technical assistance together. It is noteworthy that while IFC is moving towards bringing even closer together its advisory (technical assistance) and investment services activities under the premise that combined projects have better development and financial outcomes, AfDB appears to be moving towards more stand-alone technical assistance activities.

IFC's relevance and potential contribution is greatest where the financial sector (or other service markets) is weakest in serving SMEs that is, addressing market failures. Geographically, relevance seems to be greater in projects in frontier markets.

SME activities from an organizational / institutional perspective

With respect to organizational aspects, technical assistance activities in all three financial institutions involve SME specialists. IFC has by far the largest number of staff working on SME transactions, with its MSME Finance and Access. IFC's organizational approach to SME operations changes approximately every four or five years, indicating that an optimal operating structure has not yet been identified. The World Bank Group as a whole also has a global vice presidency for financial and private sector department that is also, inter alia, involved in SME operations. EBRD also has a significant number of SME specialists. It has advanced further in bringing together the coordination of its SME activities with the recently announced establishment of its Small Business Initiative Department. Compared with IFC and EBRD, AfDB has a relatively small number of staff working on SME operations.

Emerging trends

With respect to emerging trends, the AfDB is planning to expand the scope and volume of its technical advisory services to SMEs several fold. It is also planning to be more innovative in the use of financial instruments. The recently launched Africa SME Program provides a possible model for reaching SMEs in a more efficient and appropriate manner. There is also a move towards the use of stand-alone technical assistance facilities that can be tailored to specific sectors and/or countries, alongside umbrella programs.

IFC is likely to lead the way in the innovation of new investment and advisory services products. However, it does in one way appear to have a more limited approach to SME projects in that it looks at development results primarily through the lens of job creation. IFC is likely to continue to undertake direct SME investments on a selective basis.

The 2013 World Bank Group Strategy stresses "Working as One World Bank Group", including an increase in the number of projects involving two or three WBG

member institutions. It notes that in poorer countries, small SMEs predominate as private clients, served primarily through financial intermediaries, and IFC and MIGA often support foreign investors for direct investment. Furthermore, the Strategy stresses the importance of projects with strong private sector demonstration effects.

The most important development in SME support at EBRD has been the 2013 Small Business Initiative that provided a more coordinated strategy and approach to its SME activities, which encompasses country by country SME Action Plans. The recently set up Small Business Initiative (SBI) unit has developed an enhanced "toolbox" of product services across five pillars. Key innovations/developments include significant increases in targeted SME credit lines, the use of risk sharing and guarantee instruments, especially the Medium-size Co-financing Facility, the use of local currency denominated instruments, and the use of TC for developing the SME capability of financial institutions.

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