

FIRM UP PERFORMANCE

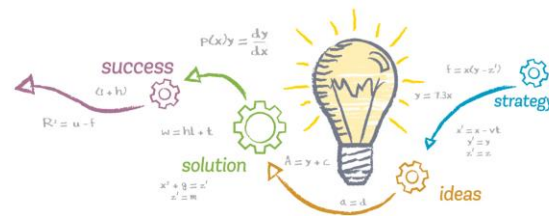
ATHENS, GREECE

SEPTEMBER 9-12, 2019



WORLD BANK GROUP





Improving Access to SME Finance

Bilal Zia
September 10, 2019





PLUMBER

PAINTER

BUILDER
PLASTER
RHINO LITE

WELDER

ELECTRICIAN

WELDER
PLASTER

Performance of Emerging Market Firms Matters



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Self employment rates 40%, as high as 75% (7% in the US)



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(Gollin et al, 2014)

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distributors





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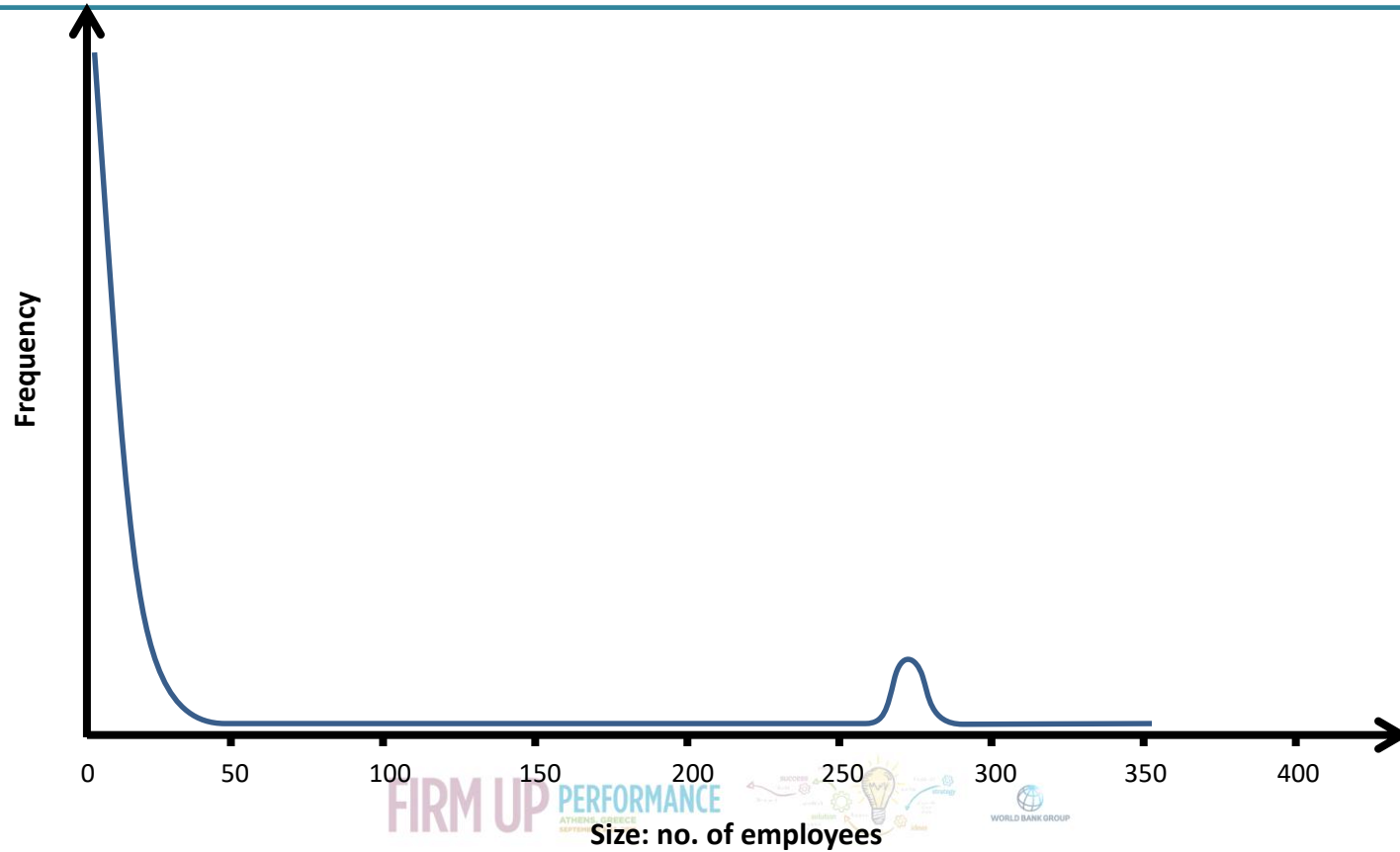
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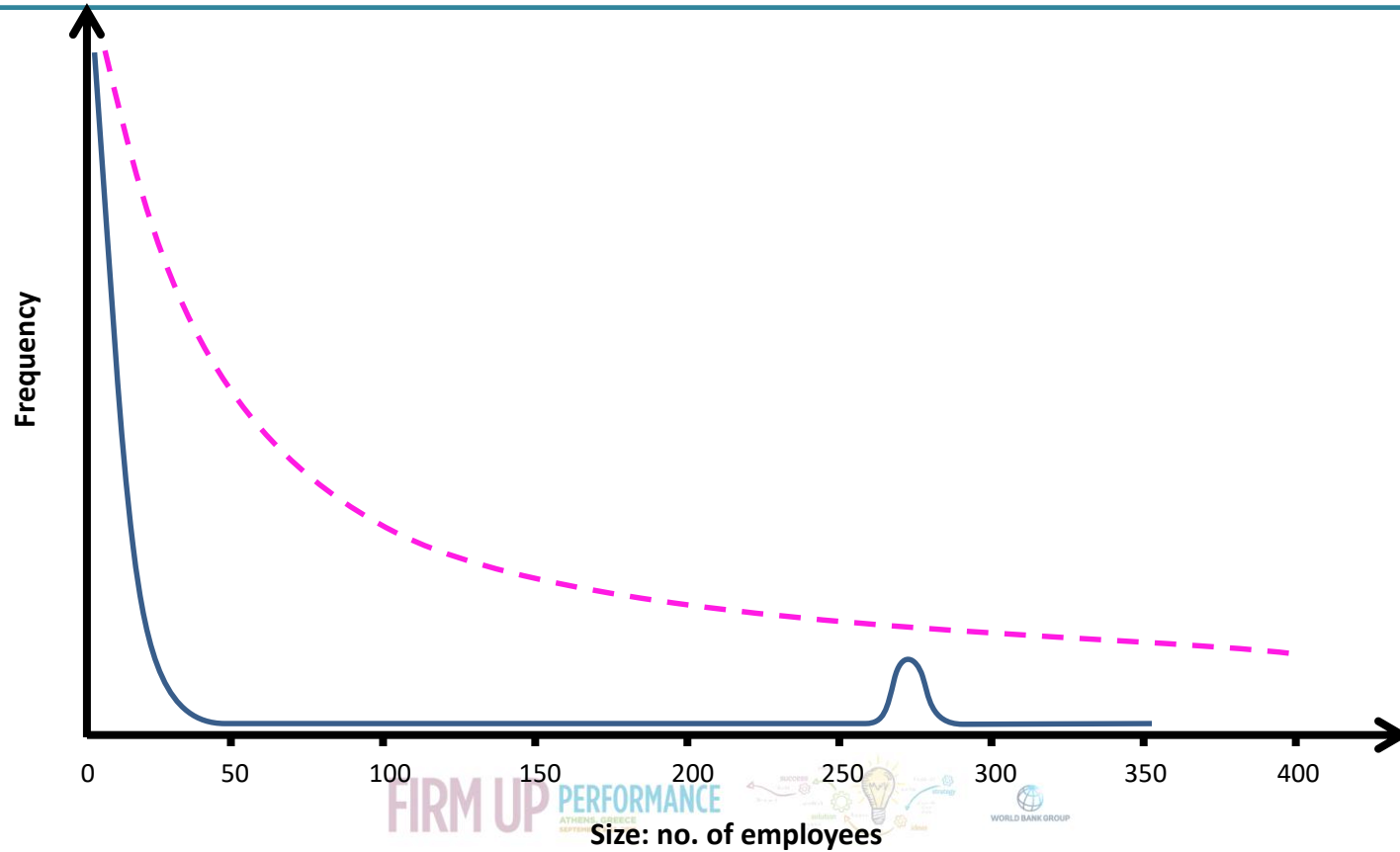
Question: How to help small firms grow?



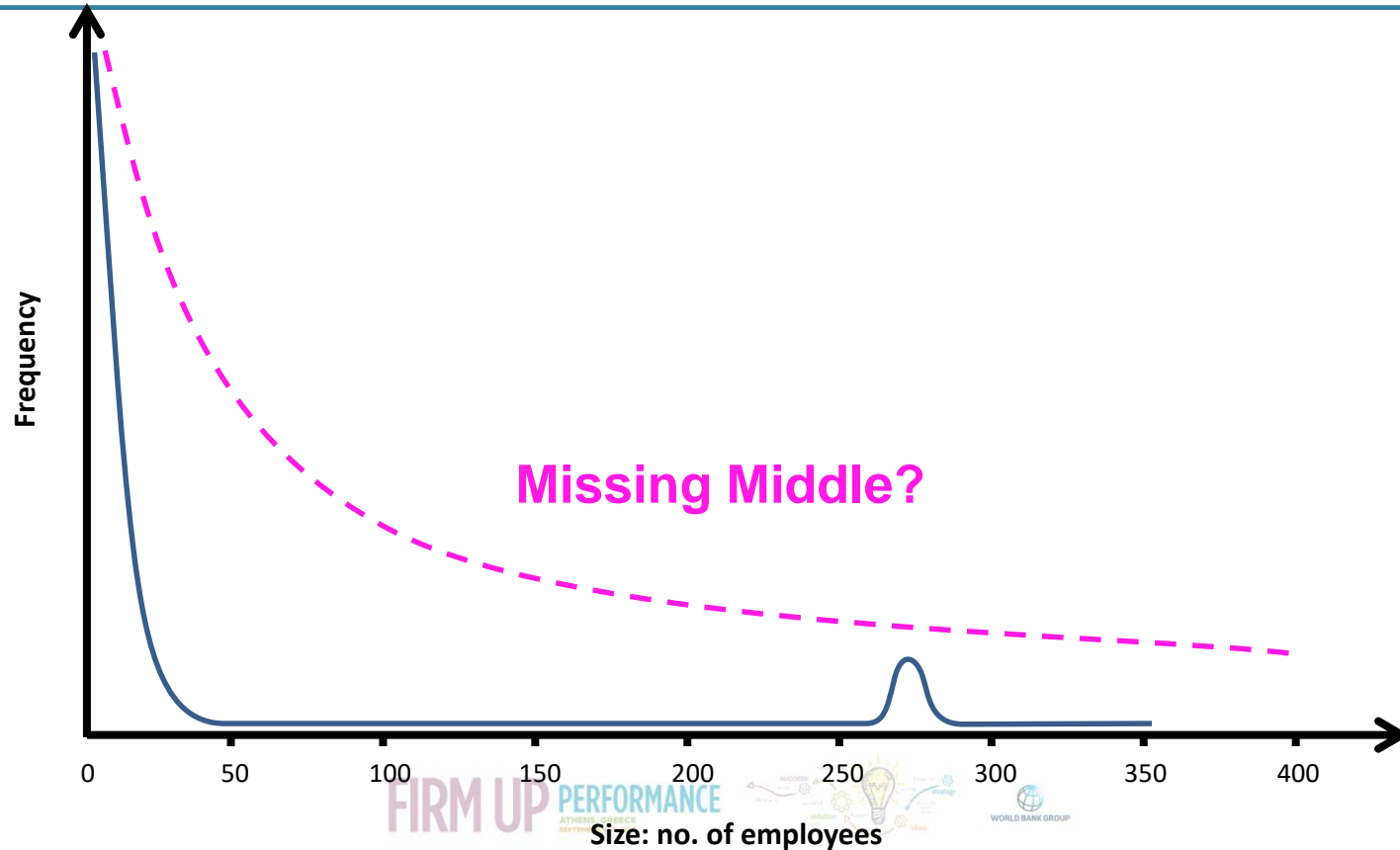
Empirical Puzzle



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Possible Solutions?

- **Institutions** (e.g. property rights)
- **Formalization** (e.g. registration)
- **Managerial Capital** (e.g. business skills)
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Access to Finance Challenge

- 55-68 % of formal SMEs underserved by financial institutions:
 - Credit gap of US\$ 0.9-1.1 trillion (World Bank, 2014)
- Impact evaluations of grants to microenterprises show severe credit constraints (e.g. McKenzie and Woodruff, 2008):
 - Estimated returns to capital 3-5 times higher than market interest rates
- Why credit constrained?
 - Opaque
 - Risky
 - Lack of collateral

Solutions?

- What has been tried:
 - Cash Grants
 - Microcredit
- Promising new/under-researched avenues:
 - Credit Guarantee Schemes
 - Collateral Registries
 - Trade Finance
 - Psychometrics
 - Digital Credit
 - Alternative Credit Scoring



Cash Grants

- Strong effects for male-owned enterprises, but not for female-owned enterprises in both short- and long-run (de Mel, McKenzie, and Woodruff, 2008 and 2012)
- Why?
 - Sector selection
 - Women are less entrepreneurial (?!)
 - Spousal capture
 - → Worth exploring household rather than enterprise-level outcomes (Bernhardt et al, 2019)

Microcredit: Theory of Change

Need	Input	Output	Outcome	Impact	LT Impact



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Microcredit: Theory of Change

Need	Input	Output	Outcome	Impact	LT Impact
Small firms are credit constrained	Microcredit	Business Investment (start/improve business)	Increased sales/profits	Improved HH income	Improved HH welfare (e.g. health, education, satisfaction)

Microcredit – Audacious to Humble

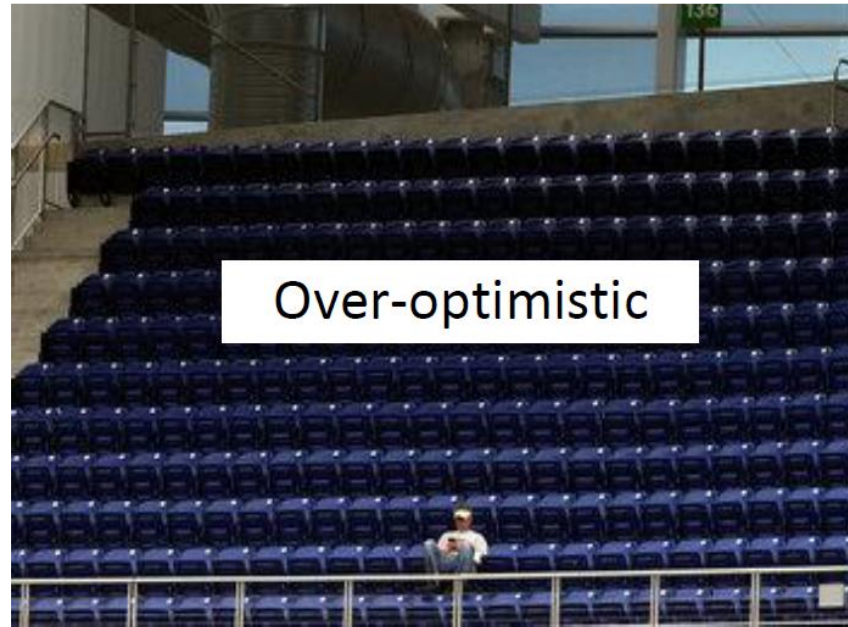
- Magic bullet against poverty
- Lifts millions out of poverty
- Raises income and consumption of the poor
- Helps poor cope with poverty
- Not about income or consumption, but rather about freedom and empowerment

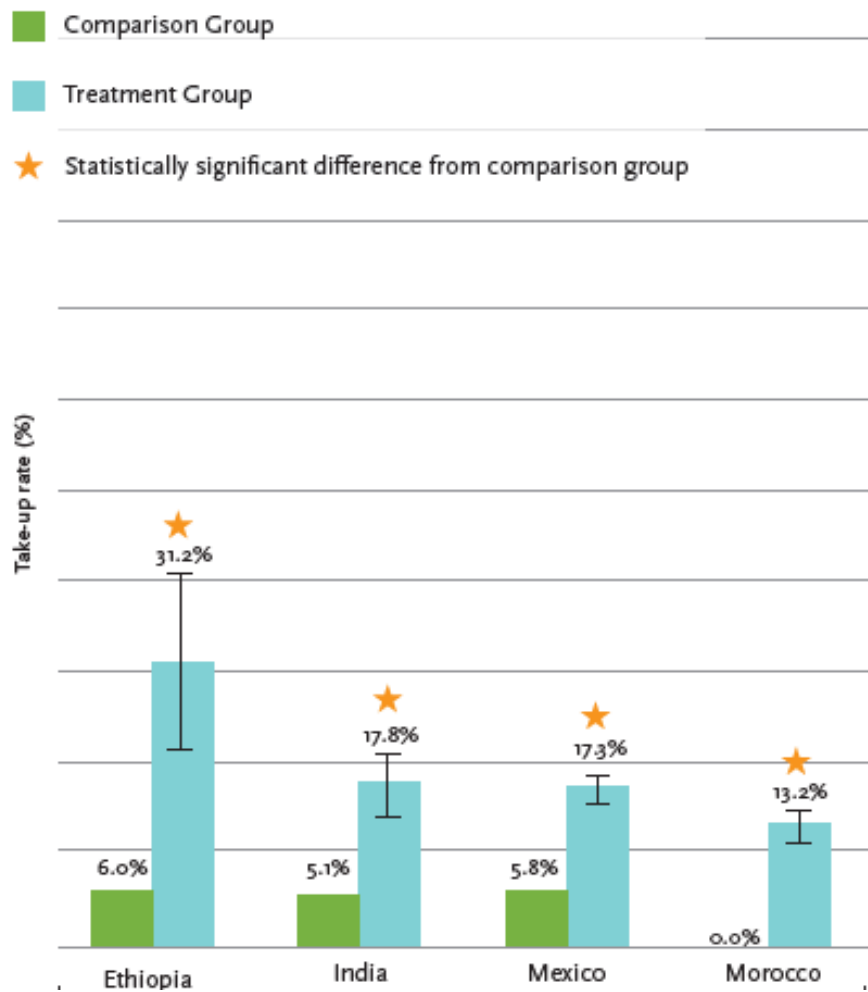


First Order Question: Take-up?



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Source: JPAL Policy Bulletin (2015)

JPAL Policy Bulletin (2015) Summary

Outcome	Bosnia & Herzegovina	Ethiopia	India	Mexico	Mongolia	Morocco	Philippines
Business ownership	↑	-	-	-	↑	-	-
Revenue	-	-	-	↑	-	↑	-
Inventory/assets	↑	No data	↑	No data	↑	↑	-
Investment/costs	-	-	↑	↑	No data	↑	↓
Profit	-	-	-	-	-	↑	-
Household income	-	-	-	↓	-	-	-
Household spending/consumption	-	↓	-	↑	↑	-	-
Social well-being	-	-	-	-	-	-	↓

Contract Structure

- MFI loans require repayment to begin immediately
- Contract structure not conducive for investment
- Possible explanation why money is spent elsewhere
- Rigol, Field, and Pande (2013) experimentally allow for a longer term loan with a 2-month initial grace period



Contract Structure

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- Possible explanation why money is spent elsewhere
- Rigol, Field, and Pande (2013) experimentally allow for a longer term loan with a 2-month initial grace period
- They find:
 - Business investment goes up
 - Profitability and variance also go up (borrowers are making risky investments)

Dynamic Incentives

- Dynamic incentives allow lenders to reward good borrowers while punishing defaulters.
- But without a national ID system, dynamic incentives cannot be used
 - Loan defaulters can avoid sanctions by using different identities
 - Easier when multiple lenders operate in same area
 - Lenders respond by limiting the supply of credit

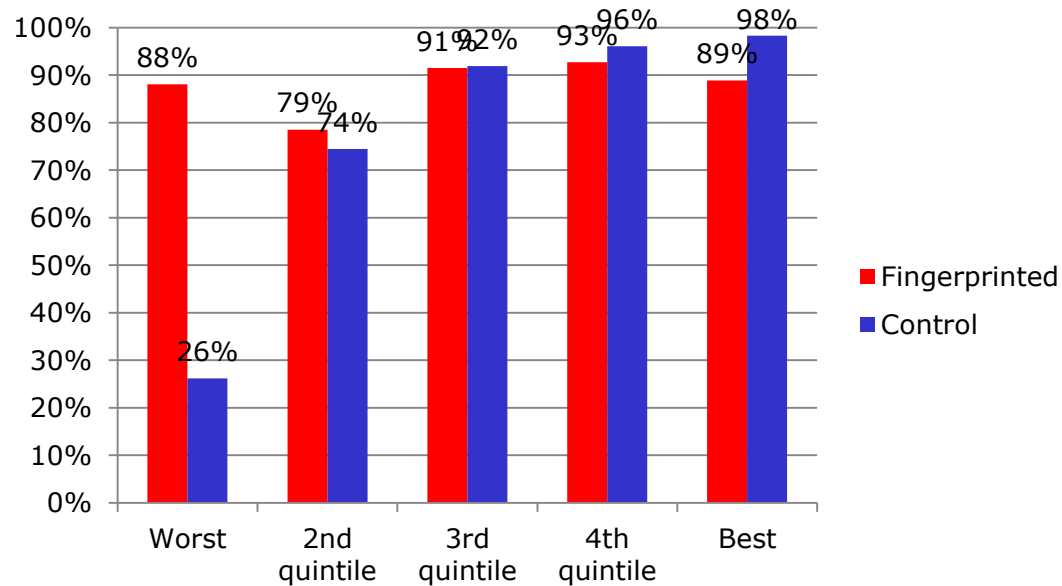
Biometrics for Borrowing

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Group Liability Structure

- Can increase tension among members
 - Leads to voluntary dropouts
 - Can harm social capital among members
- More costly for clients who are good risks, because they are more likely to pay off loans of their peers
 - Bad clients can “free ride” off good ones
 - Makes it more difficult to attract and retain good clients
- As groups mature, loan sizes typically diverge
 - Smaller clients may not want to guarantee larger loans of other group members

Group Liability Structure

- Carpena, et al (2011) look at shift from individual to group liability in an Indian MFI:
 - Group liability induces lower missed payments, greater mandatory savings deposits
- Gine and Karlan (2014) conduct an RCT to study shift from group to individual liability in the Phillipines
 - No differences in repayment rates
 - Greater # of borrowers

Credit Guarantee Schemes

- Governments pledge to repay loan amount in case of SME default.
- This reduces the lender's expected credit losses, acting as a form of insurance against default.
- CGSs can help improve information available on SME borrowers in coordination with credit registries and bureaus.
- Can help build the credit origination and risk management capacity of participating lenders.
- Important countercyclical role, providing support to small businesses during a downward economic cycle.

CGSs: Principles and Research

- Potential downsides: distortions and capture.
- In 2015 the World Bank Group and FIRST (Financial Sector Reform and Strengthening) Initiative convened a global task force to develop “Principles for the Design, Implementation, and Evaluation of Public Partial Credit Guarantee Schemes for SMEs”:
 - (i) legal and regulatory framework
 - (ii) corporate governance and risk management
 - (iii) operational framework
 - (iv) monitoring and evaluation
- Research on impact of CGS is limited to immediate outputs rather than economic additionality. WBG Toolkit offers menu of options for rigorous evaluation.

Collateral Registries and Trade Finance

- Collateral Registries:
 - Easier to pledge and collect collateral → improved access to finance
 - Relatively new tool and rigorous research is lacking
- Trade Finance:
 - Suppliers act as financial intermediaries
 - More research needed on impacts (e.g. Jaza Duka in Kenya)

Digital Credit and Alternative Scoring

- Digital savings, credit, payments, and education platforms are widespread (e.g. M-Pesa, Arifu)
- Large number of studies are ongoing to study impact of digital credit on firms and HH outcomes (stay tuned!)
- Alternative Scoring:
 - Psychometrics (stay tuned!)
 - Using mobile call records to generate scores
 - Using digital education platform engagement to predict credit worthiness

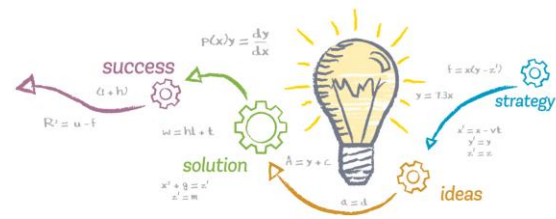
Conclusion

- Access to finance for firms is an important avenue for alleviating credit constraints and improving SME growth.
- Recent advances and innovations have made products and services widely available.
- Research is fast catching up to industry in terms of identifying key impacts of various new credit tools and products.



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Thank you!