

ITC's response to the Financial and Economic Crisis

Over the past few months, much has been said and written about the mechanisms that have prompted the global financial and economic crisis and their impact on global trade and exports.

It is now however becoming urgent to realise and measure the concrete impact of the crisis on the millions of SMEs worldwide, and its longer consequences on the productivity and competitiveness of enterprises. It is also urgent to develop and implement short and medium-term solutions specifically designed to restore confidence, trust and dialogue between SMEs and financial institutions.

In the particular context of the global financial crisis **why increasing access to finance to Small-and-Medium Enterprises (SMEs) is so important?**

The answer lies on the premise that SMEs are the engine of economic development, they constitute the majority of business enterprises, and they are vital for employment generation and poverty alleviation.

As we all know, SMEs comprise the great majority and even up to 95% of registered companies in developing (and even developed) countries. They play an important role in the economy by generating employment and income, and contributing significantly to export earnings. But financial institutions tend to lend more to large companies, even in normal times, because of higher risks and the high transaction and monitoring costs of SME lending activities.

Nevertheless, higher operating costs and lack of access to finance – constrain SME growth. Indeed, these problems rank top among other perceived obstacles by SMEs. Without sufficient capital, SMEs are unable to develop and young and women entrepreneurs remain risk averse, unable to take advantage of business opportunities.

Among the crucial elements of business environment that are fundamental for SME survival and growth, is access to finance. SMEs consider financial constraint as a top barrier to growth. Studies also show that younger and smaller firms face higher financing obstacles than older and bigger enterprises. Furthermore, these financing obstacles have greater effect on annual growth of small firms - twice the effect of the same obstacle on the annual growth of larger firms.

In this situation, caution would suggest allocating the few precious funds to borrowers that have a lower risk profile because of their size, the quality of their collateral, as well as the openness and stability of their lender-borrower relationship over the years.

There are however, banks that have succeeded in maintaining and increasing SME portfolios, by differentiating their approaches in banking for different creditors

without necessarily deviating from the principles of good credit. We believe that in many cases, access to capital for SMEs **must also be accompanied by capacity building** through management training, financial management skills, business and strategic planning, marketing, accounting, and technology upgrading.

With its mandate to assist developing and emerging countries exporters, the **International Trade Centre (ITC)** is recognizing the plight confronting SMEs and has initiated a number of practical initiatives designed to bridge the knowledge gap often present between SMEs and the financial institutions, and constituting a major impediment to restoring confidence, trust and mitigating risks.

In that regard, ITC has developed a strategy bringing short and medium term solutions aiming at improving SME's access to affordable finance, based on the following:

- ❑ **Strengthening financial management capacities of SME managers to develop bankable proposals to access to financial resources,**
- ❑ **Facilitating financial institutions' risk assessment of exporting SMEs, through an interactive screening tool that rapidly assesses the real SME's export potential and management of associated risk,**
- ❑ **Negotiating and mobilising from regional development banks, medium and long-term credit and guaranty lines for SMEs,** hosted within identified commercial banks, using screening tools based on ITC's certification methodology.
- ❑ **Broadening the range of financial services made available to SMEs,** to improve their international competitiveness.

1. Strengthening the financial and overall management capacities of SME leaders:

To maximize its outreach to SMEs and ensure sustainability, ITC partners with local Institutions, to set up local teams of counsellors capable of providing business and financial management training, diagnostic and advisory services to SME managers. In this programme, selected staff from partner Institutions and SME managers receive training aimed at enhancing SMEs' business management skills, as well as their ability to adopt sound financial management practices and develop bankable proposals. Financial topics include How to assess SME's financial needs, Alternative sources of finance for SMEs, Methods of payment and risk mitigation techniques in international trade, Bookkeeping and cash flow management, Analyzing financial statements, budgeting and forecasting. The program includes practical work with existing SMEs, during which participants receive coaching from ITC. Upon successful completion of the program, participants are certified by ITC and the partner Institution, and are equipped to provide their services to SMEs.

This multiplier approach is currently being used in Laos, where local counsellors have received training from ITC in financial management and are now

conducting their fieldwork. It is expected that the network of counsellors, set-up under the auspices of the Lao Chamber of Commerce and Industry, will in turn provide support to SME managers in three provinces, in the sectors of Garment, Tourism industry, Handicrafts and Services.

2. Facilitating the financial institutions understanding of SME needs and risks:

This is achieved by developing a tailored version of ITC's innovative risk assessment / risk management software (Loan Com), that was developed in close partnership with Exim-Bank of India. Besides looking into traditional financial parameters such as financial ratios, credit history and collateral, this software thoroughly assesses the SME's non-financial performance and potential. More precisely, the software looks into the SME's capacity to define sound and sustainable strategies, reach its business objectives through an efficient management of its production, marketing, distribution and transaction functions, and its ability to manage its resources efficiently. It quantifies the SME's performance along these categories, displays a visual representation of the SME's strengths and weaknesses, and provides recommendations to the financial institution on how to proceed. (green, yellow or red light is provided for the banker's final decision).

The software is adapted to each financial institution requirements and is made available online on its intranet. It is easily customizable to specific sectors (Tourism, Agribusiness etc) and to different banking contexts (e.g: microfinance, Islamic banking).

3. Building better links between international organisations, regional development banks and commercial banks

This is a core component of ITC's response to the financial crisis. It allows more coordination amongst key actors at the country level, ensuring that financing is indeed made available to SMEs, while assisting partnering commercial banks in mitigating risks associated to SME lending.

Through this programme, a regional development bank provides a line of credit as part of a technical assistance package to a local commercial bank. ITC conducts some of the technical assistance, specifically the development and adaptation of its risk assessment / risk management software, and the capacity building of a local Institution to support exporting SMEs. By screening loan requests using ITC software and providing successful candidates with coaching from local Institutions, the chances of success of loan beneficiaries is considerably enhanced. Moreover, to further encourage SME lending by the partner commercial bank, the regional development bank provides a credit guarantee of at least 50% for every loan request.

This cooperation structure is being used as a framework of ITC's work with the African Development Bank in Zambia and is part of an initiative with some Commercial banks for West and Central Africa.

4. Broadening the range of financial services targeting SMEs to improve their international competitiveness:

In the present context of credit crunch, SMEs need to be fully aware of alternative sources of finance. Moreover, specific solutions for SMEs located outside of major urban centres of developing countries and countries in transition have to be found. Indeed, the impact of the crisis is particularly acute in rural areas as financial institutions are curtailing their limited presence outside of major development poles. In view of these concerns, ITC is currently finalizing two publications on Islamic Finance, one targeting SME managers, the other reaching out to a broader readership. Additionally, ITC is considering a number of solutions such as postal banking and e banking to enhance SMEs' access to a wider range of financial services, at a more affordable cost.

These four components are the foundations of ITC's Trade Finance offering. The innovative partnership under consideration between ITC, the Association of Development Financing Institutions of Asia Pacific (ADFIAP), provides a good illustration of how they can be put in action. Under the existing partnership, ITC and ADFIAP focus at consolidating their outreach in the Asia Pacific region by developing an **SME Finance Centre of Excellence**, aimed at bridging the gap between SMEs and Financial Institutions in the region.

With the above short-term measures, ITC hopes that SMEs in developing countries and in transition economies will be better equipped to go through the financial crisis and recover from it, while retaining their competitiveness and positioning on global markets.

April 2009