



FMO & SME Finance

Henk Nijland

Manager Europe & Central Asia
Financial Institutions Department

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FMO

Finance for Development

FMO: The Entrepreneurial Development Bank

Facts

- Unique Public-Private Partnership - 51% / 49%
- Standard & Poor's AAA rating & Bank Status
- One office in The Hague – The Netherlands & 303 staff members

Investment Criteria FMO

- Solely private sector
- Additional to commercial investors
- Preferably catalyzing commercial funding
- ESG requirements
- CAAML/Know Your Customer



FMO Strategy: “Moving Frontiers”

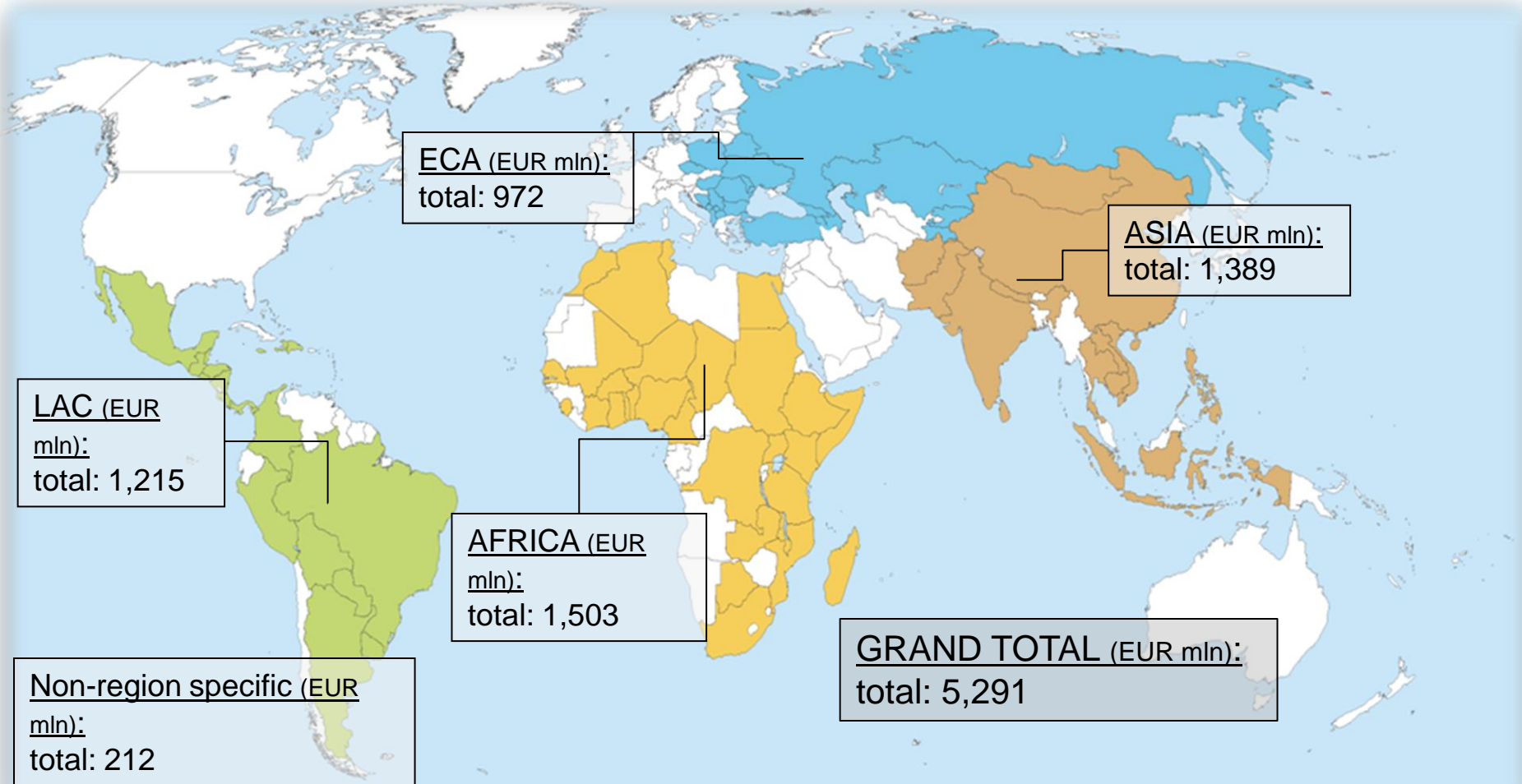
Focus on low and lower-middle income countries (World Bank list January 2008)

Four focus sectors:

- ✓ Financial sector: cornerstone to a viable economy. Access to finance for micro, small and medium sized enterprises means people can grow sound and sustainable companies.
- ✓ Energy sector: provision of a basic need. With high pressure on resources, sustainable energy has become very important.
- ✓ Housing sector: a strong affordable housing sector serves as an engine for economic growth and employment, with spin offs to related industries.
- ✓ (New!) Agribusiness, Food & Water: with nearly one billion people that are unable to satisfy their food needs, providing better access to food has an enormous development impact.

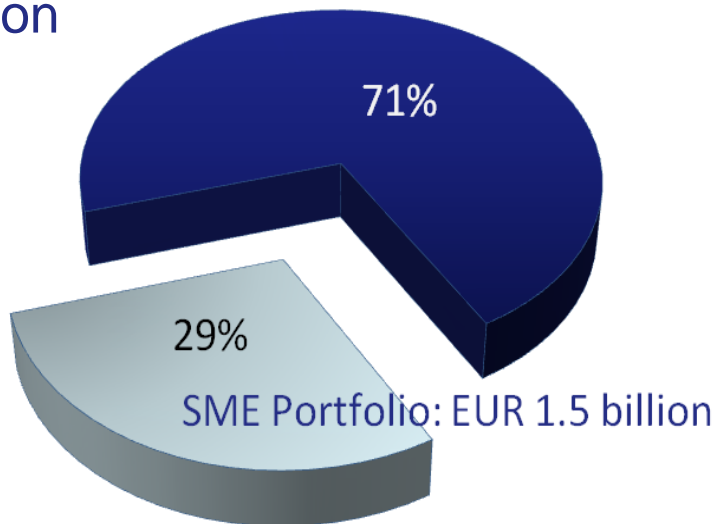


Total Committed Portfolio FMO (YE 2010)

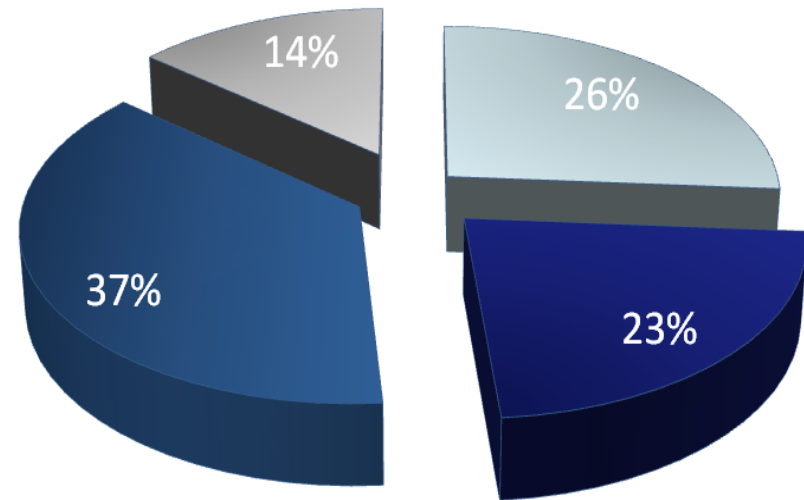


FMO & Small and Medium-sized Enterprises (SMEs)

Total Portfolio: EUR 5.2 billion



Regional Distribution of SME Portfolio



■ Africa
 ■ LAC
 ■ ECA
 ■ Asia



FMO & Small and Medium-sized Enterprises (SMEs)

- Total FMO SME Portfolio: EUR 1.5 billion
- SMEs are served via more than 150 financial institution clients
- Investments in SMEs create sustainable growth in emerging markets and developing countries: the engine for employment generation
- Focus on Low Income Countries

Development Reach by FMO's clients:

- Number of SME loans provided:
700,000
- Amount of SME loans provided:
EUR 26.5 billion



Facts on SMEs around the world:

- i. On average, SMEs account for 60% of all manufacturing employment
- ii. SMEs and start-ups are important drivers of employment growth
- iii. SMEs face more growth barriers than large firms
- iv. SMEs benefit more from institutional development than large firms
- v. Access to finance is the biggest growth constraint for SMEs



i. On average, SMEs account for 60% of all manufacturing employment

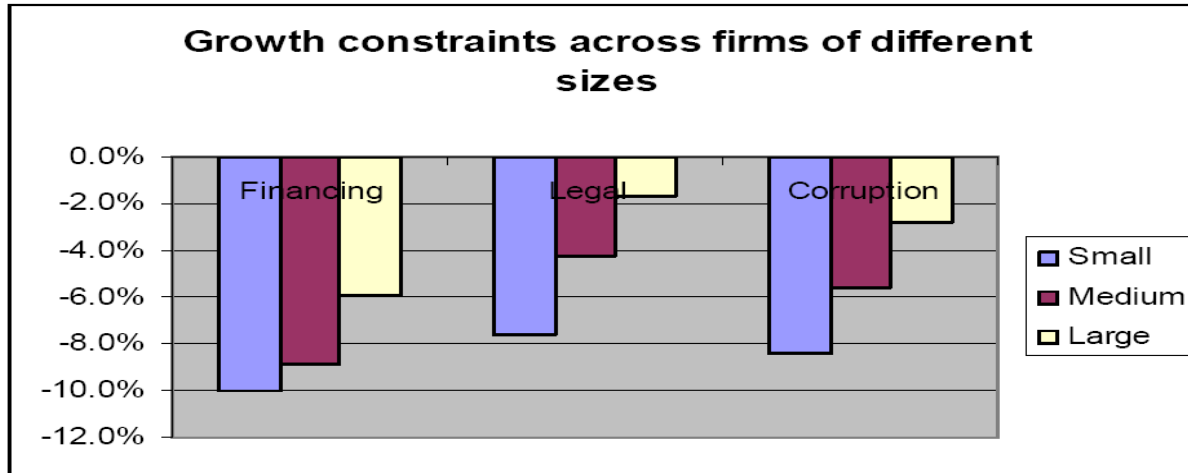
- Countries with higher GDP levels have larger SME sectors
- The importance of the informal SME sector is bigger in low income countries

ii. SMEs and start-ups are important drivers of employment growth

- Business startups contribute substantially to both gross and net job creation
- Small firms contribute to employment disproportionate to their share in the economy



iii. SME face more growth barriers than large firms



Source: Beck, Demirguc-Kunt and Maksimovic (2005)

iv. SMEs benefit more from institutional development than large firms

- Firms in countries with more effective and more adaptable legal systems report lower financing obstacles
- The effect of financial and legal obstacles on growth is lower in countries with better developed legal systems, especially for small firms
- Financial and institutional development helps alleviate SMEs' growth constraints



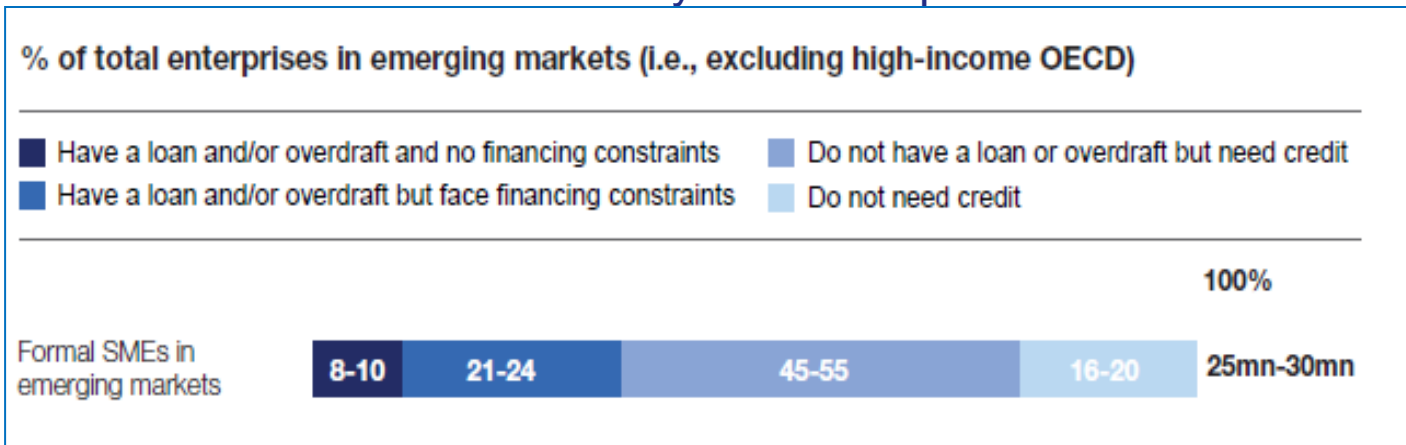
v. Access to finance is the biggest growth constraint for SMEs

- Small firms consistently report higher financing obstacles than medium and large enterprises
- Smaller, younger and domestic- (as opposed to foreign-owned) enterprises report higher financing obstacles
- 35% of SMEs rate the cost of finance as a major growth constraint
- 30% of SMEs rate access to finance as a major growth constraint
- Small firms are less likely to use bank finance: 30% of large firms use bank finance to finance new investment, only 12% of small firms do.



Market Potential

- Approximately 20 million or 70% of formal SMEs in emerging markets are unserved or underserved
- This results in a financing gap of \$-0.7-\$0.9 trillion
- Most formal SMEs in emerging markets have a bank account (70-76%)
- 80-88% of the value of the formal SME's credit gap in emerging markets comes from SMEs that already have a deposit account



Source: IFC & McKinsey (2010)



FMO & SME Financing next steps

About 30% of FMO's total portfolio concerns SME Financing: loans to financial institutions to be on lent to SMEs.

Focus appraisal of Financial Institutions: track record in terms of quality portfolio, profitability, cost-to-income, etc; but.....

*One of the main risks: how does the client conduct his business?
Does the client really know what he is doing?*

In other words: which lending methodologies and techniques are used for SMEs and do they work?

Increasing SME Financing knowledge within FMO: better position ourselves to give advice to clients on increasing their SME business in a commercially viable way.

FMO started research among FMO clients on best lending practices to serve SME. Supervised by renowned professor Thorsten Beck, former senior economist at the World Bank.



Lending techniques

- Cash flow based lending: common in microfinance/individual lending, cash flow guarantees repayment, grip on cash flow important
- Asset backed lending: assets (fixed and current) used as collateral
- Relationship lending: soft information on client gathered over long period of time; qualitative assessment risk profile client, rather subjective approach
- Credit scoring: quantitative approach based on past performance/track record (groups) of clients; modeling; more objective approach
- Financial statements lending: based on analysis of financial statements; quality statements often questionable, specifically in case of small enterprises
- A combination of the above



Research on best lending practices to serve SMEs

- Survey among FMO's bank clients to find:
 - Most commonly used lending practices
 - Possible relationship between certain lending practices and portfolio quality
- Hypothesis 1: *Financial statement lending is the most commonly used lending practice to serve SMEs*
 - Recent research in Japan has shown that most SMEs are served through financial statement lending. Even though SMEs in developing countries are more opaque we expect to find similar results
- Hypothesis 2: *Banks who use a combination of different lending practices will have a higher portfolio quality*
 - Previous research has shown that different lending practices can be complementary to each other. Therefore, we expect to find that banks who use more than one lending methodology will have a higher portfolio quality
- Expected completion date: September/October 2011



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Thank you for your attention.

www.fmo.nl

