PRESENTATION
AT THE
2012 ACCOUNTANTS’ CONFERENCE ON
“SME FINANCING OPTIONS FOR REGIONAL GROWTH”

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PRESENTATION OUTLINE

• Definition of SMEs
• Contributions of SMEs to Economic Growth
• The status of SME Financing in the Region
• General Challenge faced by SMEs
• Financing Challenges
  – The SMEs
  – The Financiers
• Financing Options for SMEs
  – Commercial Banks
  – Development Partners
  – Capital Market
  – Private Equity/Venture Capital
  – Lease Finance
• Necessary conditions for improving SME financing Options
• Conclusion
SMALL & MEDIUM ENTERPRISES (SMEs)

DEFINITION AND CHARACTERISTICS OF SMEs

- The term Small and Medium Enterprises (SMEs) encompass a broad spectrum of definitions. Different organizations and countries set their own guidelines for defining SMEs but generally all definitions boarder on number of employees, asset size and annual turnover.
- SMEs include a wide range of businesses, which differ in their dynamism, technical advancement and risk attitude.
- SMEs are crucial contributors to job creation and economic growth in both high and low-income countries.

<table>
<thead>
<tr>
<th>ORGANIZATION/COUNTRY</th>
<th>NO. OF EMPLOYEES</th>
<th>ASSET SIZE</th>
<th>ANNUAL TURNOVER</th>
</tr>
</thead>
<tbody>
<tr>
<td>WORLD BANK</td>
<td>≤ 300</td>
<td>US $15 MILLION</td>
<td>US $15 MILLION</td>
</tr>
<tr>
<td>EUROPEAN UNION</td>
<td>≤ 250</td>
<td>€43 MILLION</td>
<td>€50 MILLION</td>
</tr>
<tr>
<td>UNIDO:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Advanced countries</td>
<td>≤ 499</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>- Developing countries</td>
<td>≤ 99</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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IMPORTANCE OF SMEs IN AN ECONOMY -I

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>BUSINESSES</th>
<th>EMPLOYMENT</th>
<th>GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>GHANA</td>
<td>92%</td>
<td>85%</td>
<td>70%</td>
</tr>
<tr>
<td>SOUTH AFRICA</td>
<td>91%</td>
<td>61%</td>
<td>52-57%</td>
</tr>
<tr>
<td>AFRICA</td>
<td>90%</td>
<td>63%</td>
<td>50%</td>
</tr>
<tr>
<td>TAIWAN</td>
<td>96%</td>
<td>66%</td>
<td>-</td>
</tr>
<tr>
<td>USA</td>
<td>99%</td>
<td>-</td>
<td>52%</td>
</tr>
<tr>
<td>OECD</td>
<td>95%</td>
<td>60%</td>
<td>-</td>
</tr>
</tbody>
</table>


• The table above depicts similar trends regarding the important role played by SME in all economies irrespective of the country's level of development.

• It is clear that, on the average, over 90% of businesses the world over fall within the SME domain.

IMPORTANCE OF SMEs IN AN ECONOMY-II

• SMEs have been identified as the means through which economic growth and other developmental goals of countries like those mentioned above, can be realized.

• Indeed, in many emerging markets like China, India, Brazil etc, the SME sector is one of the principal driving forces for economic growth and job creation. Generally, SMEs play useful roles in:
  • Ensuring income stability
  • Enhanced economic growth
  • Increased employment
  • Promoting the equitable distribution of income
  • Contributing to even distribution of economic activity
  • Helps slow the flow of rural-urban migration

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RECENT ECONOMIC GROWTH TRENDS IN AFRICA

<table>
<thead>
<tr>
<th>Region</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa excluding North Africa</td>
<td>1.6</td>
<td>4.8</td>
<td>4.5</td>
</tr>
<tr>
<td>North Africa</td>
<td>3.2</td>
<td>4.2</td>
<td>0.0</td>
</tr>
<tr>
<td>West Africa</td>
<td>4.6</td>
<td>6.9</td>
<td>5.6</td>
</tr>
<tr>
<td>Central Africa</td>
<td>1.8</td>
<td>5.2</td>
<td>4.2</td>
</tr>
<tr>
<td>East Africa</td>
<td>3.8</td>
<td>5.8</td>
<td>5.8</td>
</tr>
<tr>
<td>Southern Africa</td>
<td>-0.8</td>
<td>3.2</td>
<td>3.5</td>
</tr>
</tbody>
</table>

- Despite some growth in Africa over the years, progress in social development remains slow.
- Growth has rarely translated into strong jobs growth and unemployment rates remain high, especially among the youth.
- Africa’s economic growth has not yet yielded commensurate dividends in poverty reduction.
- There is wide income inequality in Africa.

GENERAL CHALLENGES

- Lack of access to appropriate technology
- Lack of Management skills and Training
- Regulatory constraints eg high start-up costs
- Poor physical infrastructure, eg energy, poor roads
- Macroeconomic instability
- Lack of Access to Finance
THE STATUS OF SME FINANCING IN THE REGION

- However, inadequate access to financing continues to be one of the most significant impediments to the development, sustenance and growth of SMEs in Africa.

- The financial sector of most African economies is characterized by low levels of financial intermediation and infancy, undercapitalized and illiquid capital markets. This is evidenced in the following:

- Few firms have listed, and even fewer have utilized the opportunities on the capital market like the issuing corporate bonds.

- A World Bank study found that 90% of all small enterprises surveyed stated that credit was the major constraint to new investments. They also found limited access to capital as the most crucial.
SOURCES OF FINANCING

Many SMEs therefore rely on:
- retained earnings,
- funds from families and friends and
- informal savings and loan associations
- Non-bank financial intermediaries, such as microcredit institutions,

- These sources are not only inadequate but unreliable. Hence SMEs have serious challenges in the area of financing

- Financial intermediaries in Africa typically focus on a handful of large companies and government securities. This results in a preference for large borrowers and purchase of government bonds.

ACCESS TO CREDIT

- SME access to financing remains more limited in Africa than elsewhere in the world.

- The opposite table indicates that Sub-Saharan Africa is ranked unfavorably with respect access to credit compared with the rest of the world

- The average ranking is obtained by averaging the rankings of the countries belonging to the region (the most efficient country ranked No. 1)

<table>
<thead>
<tr>
<th>Region</th>
<th>Getting Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>114</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>64</td>
</tr>
<tr>
<td>Central Asia</td>
<td>107</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>65</td>
</tr>
<tr>
<td>South Asia</td>
<td>77</td>
</tr>
<tr>
<td>Eastern Europe and Central Asia</td>
<td>42</td>
</tr>
<tr>
<td>Middle-East and North Africa</td>
<td>113</td>
</tr>
<tr>
<td>OECD</td>
<td>37</td>
</tr>
</tbody>
</table>

Source: World Bank, 2009
ADEQUACY & EFFECTIVENESS

- In spite of the significant contributions made by SMEs to GDP, employment and livelihoods, SSA’s SMEs are faced with plethora of challenges.

- Access to and cost of finance remain two leading constraints. For instance, bank loans devoted to SMEs average 13.47% in other developing countries, while 9.14% of loans are allocated to such firms in Africa.

- Bank lending to SMEs in Africa is also more expensive than in other developing countries.

CHALLENGES FACED BY SMEs IN THE REGION
FINANCING CHALLENGES-THE SMEs

• The main challenges faced by SMEs are:
  – Poor corporate governance
  – Weak administrative infrastructure
  – Inefficient Management Skills
  – Inability to present bankable business proposals
  – Under-developed Financial and Internal Control Systems
  – Lack of transparency and poor record keeping

FINANCING CHALLENGES-THE FINANCIERS

• According to a research conducted by Beck, T. et al in 2008 and published in the World Bank Economic Review (Vol 22), about 9 percent of banks in non-African developing countries indicated that macroeconomic factors are the most significant obstacle to their involvement with SMEs, while about 40 percent of African banks point to this factor as constraint in dealing with SMEs.
• Other challenges Banks and other financial intermediaries face include;
  – High Credit Risk
  – Weak legal and regulatory framework
  – Lack of long term funds
  – Lack of tax incentives for both SMEs and Banks for expanding SME lending
  – Stringent regulatory requirements
FINANCING OPTIONS FOR SMEs

COMMERCIAL BANKS

- Although Commercial Banks dominate the financial system in Africa, their participation in long-term finance remains limited due mainly to structural asset-liability mismatch and underdeveloped corporate and government bond markets.

- Despite these constraints, Commercial Banks have committed funding to SMEs through these traditional credit facilities. These include:
  - Debt Finance
  - Overdrafts
  - Working Capital financing
  - Bridge Finance
  - Trade Finance
DEVELOPMENT FINANCE INSTITUTIONS (DFIs)

RISK MITIGATION

Guarantee schemes can be source of solutions in the area of risk mitigation, and supplementary in reducing cost of funds. Examples are:

- **Development Credit Authority (DCA) Loan Portfolio Guarantee** provided by USAID
- **Credit Risk Insurance Scheme** provided by the African Trade Insurance Agency.

**African Guarantee Fund:**
- Established by the African Development Bank to absolve the risk of SME funding on the continent.
- The Fund takes on 50 percent of the risk of commercial banks in lending to Small and Medium Enterprises (SMEs) in Africa.
- All formal African SMEs regardless of sector, industry, location, etc. may benefit from loans backed the Fund.
- The intermediate target group will be financial institutions that wish to engage in, or expand their lending to African SMEs.
- The Fund, headquartered in Nairobi, Kenya has a Pan-African mandate, and is expected to help financial institutions that are lending to SMEs to scale up their business.

- Currently, the only government-supported loan guarantee scheme in operation is operated by Eximguaranty Company which is majority-owned by the Bank of Ghana

- **Export Development and Investment Fund (EDIF):** Under this scheme, companies with export programs can borrow up to $500,000 over a five-year period at a subsidized cedi interest rate.

A number of lending programs are undertaken as partnerships between government and donors are listed such as:

- **Trade and Investment Program (TIP)** operated by USAID and the Ministry of Finance

- **Private Enterprise and Export Development Fund (PEED)** managed by Bank of Ghana but administered through banks.

Lending programs implemented onors have directly with financial institutions. Examples of such schemes are:

- **DANIDA SME Fund**
- **GTZ Fund for the Promotion of Micro and Small Enterprises**
- **SECO SME Financing Scheme**
- **FMO SME Financing Scheme**
CAPITAL MARKET

- There is still a lot to do for the capital market to take its rightful place in developing the economies especially in Africa.

- African capital markets have not created enough products to attract SMEs to the market.

- Stock markets can lower the cost of mobilizing capital and thereby facilitate investment in SMEs.

- The Ghana Stock Exchange facilitates the entry of SMEs to the exchange by creating the Provisional List, which allows companies to list provisionally for six months during which they are guided by the GSE, with the support of financial advisers, to meet the requirements for full listing.

PRIVATE EQUITY/VENTURE CAPITAL-I

- According to the World Bank, portfolio equity flows to Sub Saharan Africa rose by 10 percent in 2010, reaching $11 billion. The strong growth performance of Sub Saharan African countries over the last decade.

- This is evidenced in the recent establishment of a number of Africa-focused private equity funds e.g. Ebankese Venture Capital Fund in Ghana, Aureos African Fund, Ghana Venture Capital Trust Fund.

- South Africa receives the largest share of such inflows. Other economies, including Nigeria, Kenya, and Ghana are of particular interest with respect to private equity funds.
PRIVATE EQUITY/VENTURE CAPITAL-II

- According to data, published in the Private Equity Africa Journal of 2011, US$38BN worth of Private Equity deals were closed across all sectors were completed in Africa in 2011.
- Business services had US$1BN during the year representing 37%.
- Consumer and retail attracted US$586M worth of investments, making up to 20% of the total.

LEASE FINANCE

- There have been a general increase in leasing activities in Africa over the past year.
- The increased activities in the leasing industry has resulted in the increase in lease transactions (volume and value of leases) and generally in an increase in the size of the leasing market.
- This growth has been driven primarily by the increase in the number of lessors especially banks.
- Lease operators are financing more equipment.
SOVEREIGN WEALTH FUNDS

- Sovereign Wealth Funds (SWFs) is another source of long-term funding with strategic interest in Africa.

- These include funds in China, India and Middle East, which focus more in funding minerals, raw materials and transport infrastructure.

- According to the World Bank, African SWFs had US$114.3 billion in assets, which was much less than Middle East peers, which held assets amounting to US$1.4 trillion as of December 2009.

NECESSARY CONDITIONS FOR IMPROVING SME FINANCING - I

- Capacity support is needed in the following areas, among others:
  - Good Corporate Governance
  - Management Competence
  - Accounting and Transparency
  - Articulating and presenting bankable projects
NECESSARY CONDITIONS FOR IMPROVING SME FINANCING - II

• The Government can also take actions in the following:
  – Provide tax incentives to Banks lending to SMEs
  – Strengthen the existing Business Advisory Centres and NBSSI
  – Reduce capital gains taxes on equity exits.
  – Adjust the regulatory environment for Banks to SME lending.
  – Make the creation and registration of companies more easier.
  – Guarantee schemes to alleviate provisioning requirements.

CONCLUSION

• Economic Growth despite its limitations is still very important for developing countries in the African region and particularly in the ECOWAS sub-region.

• The use of financing options like Private Equity/Venture Capital Funds targeted at SMEs can be an important mechanism for accessing long-term development finance for SME development.

• Although there are several constraints plaguing the SME Sector they contribute significantly to the growth of economies and so cannot be ignored.

• New modes and options for financing SMEs by all stakeholders must be found, if the African region is to make any major stride in its development efforts.

• But more importantly, the SMEs themselves will have to put their houses in order to be able to attract adequate and reasonably cheap forms of financing.
THANK YOU FOR YOUR ATTENTION