Exploring the SME experience and potential of Triple Jump's investee network

Introduction

Small and medium enterprises (SMEs) generate up to 50 % of the jobs in developing economies. Despite the huge impact of SMEs on economic development, these enterprises have only limited access to financial services.[2]

Many of Triple Jump's investees offer SME loans in order to retain current graduating customers. Others have gradually enlarged their target market to include SME clients and hence increased the overall loan size of their portfolio. Yet, others are Greenfields that focus 100% on the SME market from the onset of their operations.

In order to understand the needs of the SME market and the role that Triple Jump could play, Triple Jump conducted a survey among its investees. Triple Jump distributed a questionnaire to more than 50 % of its investees (see table 1).

Table 1: Distributed questionnaires and response

	Total MFI	Sent	Interest	SME exp	SME pot
Total	175	90	56	41	15

Out of the 90 questionnaires, 56 (62 %) expressed explicit interest in the SME market - 41 of the 56 (73%) already having SME experience and/or interested in scaling its services into the SME market.

In addition to the surveys, we conducted a number of in-depth interviews with some of the investees and other stakeholders working on improving SME financing.

It is a pleasure to share the findings with you in this report and we thank all those who participated in the survey. In the last chapter we present the conclusions that we have cautiously drawn from the findings.

Findings

Working definition

Most commonly used variables to identify SME and distinguish SME from micro enterprise are – in order of importance: number of employees, loan size, volume of sales, assets and degree of formality.

Although the number of staff[3] is mentioned most frequently, only 28 (50%) out of the 56 respondents indicate that they are currently monitoring the number of staff of the enterprises.

The variable that is most widely available and most easily measured is the loan size. The declared minimum loan size used to define SME varies from USD 4,400 to USD 30,000.

For the purpose of this study we have set the threshold for "SME finance" at a minimum average loan size of USD 5,000, to focus on those investees that are more likely to be providing financial services to small businesses, rather than micro-businesses.

SME portfolio

Out of the 41 respondents who indicated having SME experience, 29, or 71%, have an average loan size in their SME portfolio above the USD 5,000 threshold (see table 2).

Table 2: Respondents per average loan size

	< 5.000	5.001 - 20.000	20.001 - 40.000	40.001 - 60.000	Grand Total
Grand Total	12	19	7	3	41

---

[2] According to the 2010 IFC study " Scaling Up SME Access to Financial Services in the Developing World,'' only 14% of small enterprises in low-income countries have a loan from a financial institution.

---

[3] IFC applies the following categories: micro (1-4 employees), very small (5-9 employees), small (10 - 49 employees) and medium (50 -250).

The investees that did not meet the SME threshold were reclassified as SME potential for the quantitative analysis of the survey results.

The total SME portfolio (with a range of average loan sizes from USD 5,000 to USD 60,000) is USD 707 million with the following breakdown per average loan size (figure 1):
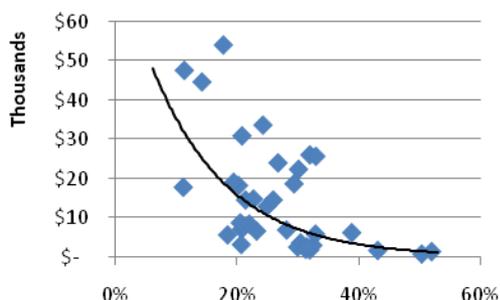
Figure 1: SME portfolio per average loan size
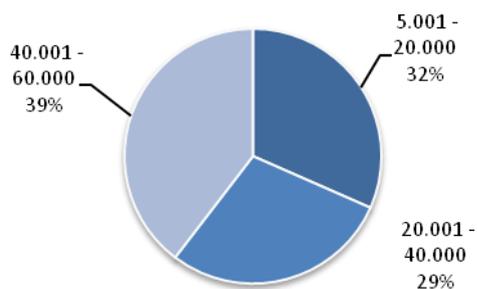
Products

The relationship between the average loan size and the costs of the product for the end customer (interest rate and additional fees) is displayed in the figure 2 (note that this includes the total sample size of 41).

Figure 2: Average loans size vs. effective interest rates

The relationship between loan size and costs is best modeled with an exponential curve (R^2 = 0.46). The dots above the line represent relatively expensive loan products, mostly in countries with instable local currency and imperfect markets (e.g. Honduras, Mongolia, Tajikistan). The dots under the line represent cheaper loan products, mostly in countries with stable local currencies (dollarized as in Ecuador) or well-performing markets (as in Bolivia).

The median and average of the average loan size and effective interest rates of the investees with SME experience are shown in the table 3:
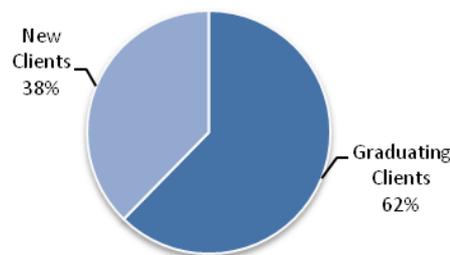
Table 3: Average loan size and effective interest rate

	Average loan size	EIR
Average	$ 19,928	24%
Median	$ 17,933	23%

Clients

A total of 41,147 clients are being served by the 29 institutions with SME experience. The majority of the SME clients consist of graduated microfinance clients (see figure 3).

*Figure 3: Graduating clients vs. new clients*

In some cases, however, the investees have made a strategic choice to offer services to a new client group. Reasons for this choice include a response to a market need, the desire to contribute to economic development through job creation and to improve sustainability. Other investees are specialists in the SME market and don't have a microfinance portfolio (or no longer have one).

Of the investees that offer both SME and microfinance services (n = 18; not all provided sufficient data for this calculation), the clients graduating from microfinance to SME form about 2.8 % of the total clients and their loans 11.6 % of the total portfolio. This may be an interesting proxy for the graduating potential of microfinance clients.

The portfolio of all respondents is well balanced in geographical terms: 41% of the clients are from the rural area and 59 % of the clients are from the urban area (see figure 4).

Figure 4: Urban vs. rural clients
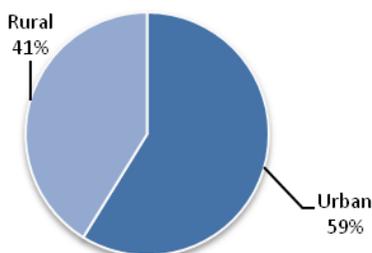
The majority of SME clients are engaged in trade and commerce (46 %), followed by activities such as industrial (food) processing, livestock and services (44 %) and agriculture (10 %). A substantial portion of client activity is related to the food production chain – directly or indirectly (see figure 5).

Figure 5: Economic Activity of the clients
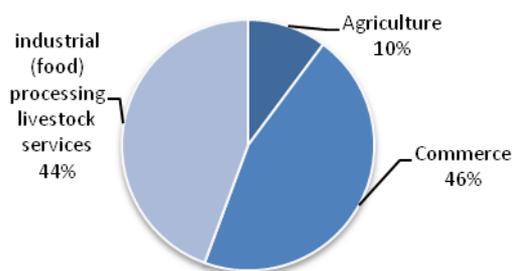
Competition

Only 26 % of all respondents and 34 % of respondents with SME experience perceive competition as a challenge or obstacle (table 4).

Table 4: Perceived competition

	Competition
SME experience	34%
SME potential	18%
Total	26%

In terms of sources of competition, commercial banks and other MFIs are listed as the most important competitors by the survey respondents (see figure 6). In Latin America, several respondents commented that commercial banks are increasingly entering the low-end SME market. In Peru, Kenya and Uganda, competition from regulated MFIs (that is, deposit-taking) is

encroaching on non-regulated MFIs. Only one respondent indicated that donor programs are competing with providing services to SMEs in its country.

Figure 6: Main sources of competition
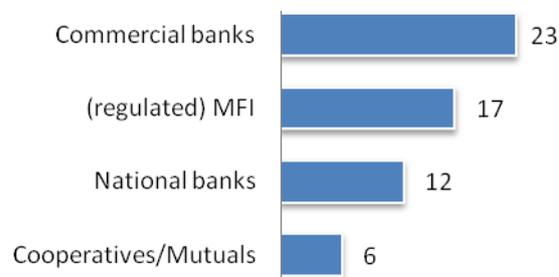
The in-depth interviews confirm that if there is competition, banks and other MFIs are the main source especially in the main urban markets, although banks tend to compete in the upper-end of the market for clients demanding higher loan sizes.

Competitive advantage

Survey correspondents indicate that their main advantages are better service delivery in terms of speed, more personalized products, more flexible conditions (in terms of collateral, notably) and client relations. One can deduce that this competitive advantage stems from the fact that most MFIs offer SME products to graduating clients, thereby partly basing their loan decisions on their historical relationship with their SME clients and capitalising on their relationship-based methodology. Not surprisingly, very few MFIs offer better interest rates than commercial banks because of generally higher financial costs.

The in-depth interviews also reveal that as a part of good client relations comes the capacity to continue developing products that respond to client needs. Such products can not only include larger loan sizes or longer terms, but developing mechanisms for existing SME clients to draw down money quickly when opportunity arises such as pre-approved lines of credit or flexible savings withdrawals.

Several MFIs also deliver higher end customer service to SME clients including dedicated call

center lines, 'VIP' spaces at branches and even SME dedicated branches.

Internal Changes

Engaging with the SME market requires some significant internal changes. The following graph (figure 7) lists the most important and impactful changes listed by the respondents.

Figure 7: Most impactful internal changes
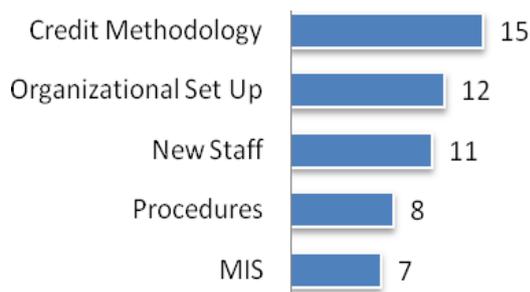
The first and foremost change is the credit methodology, followed by changes in organizational set up (separate business unit) and recruitment of new staff.

The in-depth interviews highlight the importance of hiring the right staff and training them on credit risk assessment, including the capacity to do client cash-flow analysis. This is especially important when considering that many countries do not have effective (or any) collateral registries so that collateral has little chance of being used to offset loan default. Also mentioned is the need for a well-functioning MIS to begin with and a competent internal audit department. Those institutions that were interviewed also have separate loan approval procedures (and in some cases, staff or committees) for their SME and microfinance portfolios.

Success factors

The top five success factors for servicing the SME market, reported by the questionnaire respondents, are displayed in the following graph (figure 8).

Figure 8: Success factors for servicing SME market
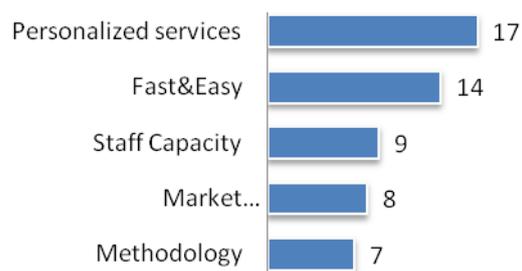
The number one success factor is the personalization of the services: listening and understanding customers, tuning products to their needs, tailoring repayment scheme to their projected cash-flow and offering a flexible guarantee structure. Easy access and speedy services are repeatedly mentioned as the number two success factor to compete with other financial institutions. The third success factor is finding, training and retaining the right staff. Number four is the positioning in the market, based on experience and knowledge of that market. The fifth factor is the quality of the methodology. As an investee from Central Asia states it is all about "good quality loan analysis and making the right lending decisions". Finding, training and retaining the right staff is a precondition for success.

Among the other factors that were mentioned are client retention (in terms of graduating customers), access to adequate funding (enough and long term) and specialization in rural/agricultural markets.

Obstacles & Challenges

The following graph (figure 9) shows the 6 most mentioned obstacles and challenges. The most often mentioned obstacle listed by 10 (34 %) of the respondents is competition.

Figure 9: Obstacles and challenges

The second obstacle – tied into the generic remark around competition – is the disadvantage that MFIs face vis-a-vis commercial banks in terms of high financial costs, relative short maturity of the MF loans and a more limited array of services.

The informality of the SME sector, which in general is considered to be one of the main entry barriers, is only in third place. It relates to the difficulty to get reliable information about customers and adequate guarantees. Funding is another obstacle – as one respondent puts it: "commercial banks have access to cheaper credits". The obstacles that are more related to internal challenges are the need to bring staff up to speed to work with SMEs, the adjustment of the MIS, the speed of delivery and the importance of focusing and not getting involved in too many things at the same time. Other obstacles that were mentioned are external factors such as weak court systems and corruption, mindset of the customers (not entrepreneurial yet) and over indebtedness.

Related challenges that emerge from the in-depth interviews are the need for continued vigilance with repeat loan clients and ensuring that the right credit staff incentives are in place. Indeed poorly designed staff incentives can lead to friction between microfinance credit officers and SME credit officers and also push the SME credit officers to take too much risk if rewards are only quantitative.

Funding and TA[4] needs

Out of the 56 respondents, 47 (84%) indicated interest in Finance and/or TA support (table 8).

Table 5: Funding and TA needs

	only F support	only TA support	both Finance/ TA support	Total
SME experience	6	5	12	**23**
SME potential	15	2	7	**24**
Total	**21**	**7**	**19**	**47**

[4] TA = technical assistance

Of the 47, 21 (45 %) are mainly seeking finance, 7 (15 %) only TA and 19 (40 %) are interested in both. The demand for only finance is stronger among investees with "SME potential", while investees with an SME portfolio are mostly inclined to request both types of services. In several cases the importance of getting access to loans that allow competition with banks in terms of maturity and costs are mentioned. Credit lines are the most popular product.

A categorization of the TA needs of all respondents yields figure 10.

Figure 10: Demand for Technical Assistance

Support for developing and testing an appropriate credit methodology for the SME market is number one, closely followed by marketing (in most cases referring to mapping out the real demand) and staff training. Staff training closely links to the credit methodology. Development of specific SME products is also high on the agenda. Number five is the possibility to share best practices with and visit SME champions. Other topics that were mentioned are rural finance, BDS support for clients, procedures and MIS.

It is interesting to see that investees with SME experience are more interested in strengthening their credit methodology than other investees. Experienced partners also express their interest in exchange visits with other investees to share best practices.

Similarly, for the number two area for TA needs – marketing – several respondents of the in-depth interviews highlighted the need to analyze and understand different SME market segments.

Conclusions

Triple Jump conducted this survey among its investees to:

1. To understand the demand for SME services,and explore the experience that our investees have with SME and

2. Study the potential for scaling SME services.

The experience of our investees with SME …

1. The SME market that is served through the investee network is the lowest segment of the SME spectrum – in terms of loan size up to a maximum of USD 60,000 and is mostly represented by graduating MF clients.

2. Using the arbitrary threshold of USD 5,000 loan size minimum to distinguish SME from microlending, the total volume of the current SME portfolio adds up to more than USD 700 million.

3. Competition is limited, only 34 % of the investees with SME experience competition as potential obstacle. The main competitors are downscaling commercial banks. The competitive advantages of our investees are better service delivery in terms of speed, more personalized products, more flexible conditions (in terms of collateral, notably) and client relations. They generally cannot compete with banks in terms of lower costs or a full range of financial services.

4. The most impactful internal changes that investees have had to put in place to serve SMEs successfully are in the areas of credit methodology (SME cash flow analysis, flexible guarantee structure), organizational setup (separate business unit, additional legal units) and human resources management (both recruitment of new staff and intensive training).

The potential for scaling SME services …

5. The respondents identify a substantial market at the lower end of the SME segment with a substantial rural component. **International studies confirm that this lowest segment of the SME spectrum is an underserved market**. Hence, from the perspective of market demand, there is clear potential for scaling the current SME services.

6. Personalized services, speed and accessibility are mentioned as key success factors. The latter may lead to an increase of the credit risk (too shallow credit analysis, adverse selection). Hence, it is recommended that MFIs only focus on underserved markets, as long as they understand that market well and put in place effective risk assessment strategies.

7. This recommendation is echoed by the investees, especially the ones with solid SME experience, who express the need to strengthen and/or consolidate their credit methodology, better understand the SME market and build the capacities of their staff.

8. In conclusion, the SME services provided by Triple Jump's investees do serve a relevant market and show great potential for scaling as long as:

- It is confirmed that there is a local market at the informal bottom of the SME market.

- The investees are supported in strengthening their credit methodology, understanding the market, and building the capacities of the staff.

- The investees are provided with additional financial means.