

SME HIGH-LEVEL SYMPOSIUM: Entrepreneurship & the SME business environment in the Caribbean – June 5th 2008, Port of Spain, Trinidad

Is access to finance a problem for SME's in the Caribbean?

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What are the characteristics of SME's, specifically SME's in the Caribbean. Why are they important? What their financing needs are. What are some of the more significant challenges they face in terms of accessing finance. Therefore is it a problem? How do they overcome these problems? Philip puts a different perspective on the issue.

In terms of their characteristics, obviously, entrepreneurial, small number of employees, very informal, both in terms of its organization and information, very flexible, owner-manager or family-owned business.

That's about 75-85% of the enterprises in the Caribbean. We believe about 70-75% of all businesses fall within that SME category and that is backed up by a source from the ILO. Typically they are sole proprietorships in terms of ownership. A large majority of them use their own funds in terms of start up. About 40-50% of them are in the distributive trade and again that is a survey done both in Jamaica and Trinidad. And a significant number have actually not applied for loans from financial institutions just because they did not know how to proceed, afraid of refusal, could not afford the collateral typically that is required or when I say afford, - afford to lose it anyway, or do not have confidence in the F.I.'s or the interest rates were too high. Again that was a survey that was done on this. But as we saw they are a big part of our businesses. They are a distinct sector in our economies. Through SME's a lot of opportunity is created, in terms of employment opportunities. It does develop the entrepreneurial skills of the nation or people, utilizes local raw materials and obviously enhances market opportunities. Also, it is estimated that about 35-50% of this sector is actually made up of women and we see the demand for loans in this sector is actually growing, fuelled essentially by the growth as occurring in our local economies and therefore the greater opportunities for entrepreneurship and business.

What are the needs of SME's. Like everything else, it is not just the traditional bank loan that is required by an SME. They go through the full spectrum from needing seed capital, to venture capital probably not the public market, but obviously then they become more formalized in terms of their funding needs. The traditional bank funding really comes in at the last end of the stage in terms of business growth, when they actually stabilize, they have steady cash flows, they have a proven record that they can take to the bank to actually then access funding, but in their first three years of operations obviously is going to

be a challenge. But these SME's both in their early stages and throughout need access to finance.

Essentially for this sector to thrive innovative ideas by unknown creditors need to be accommodated. These small enterprises obviously as we said face substantial difficulties in their first 3 years of operation and need financing that can fill that need in those early stages. But SME's perceive access to finance and the cost of credit as one of their biggest obstacles in terms of setting up. The SME owners are unlikely to have the significant level of collateral and cash that is often required to access financing via the traditional methods through the bank funding. And, finance is really one of the biggest constraints more so than larger more established firms, it is one of the biggest constraints to SME performance.

Very often we see small business owners coming to us, they have landed a large contract, great opportunity, their overdraft facility and existing facilities with their bank just does not allow them the where-with-all to pursue. They may traditionally get a big contract typically with the Government; Government takes more than six months to pay, they need funding to carry this contract, the bank is not willing to expand their facilities to do so, they end up in cash flow problems - typical scenario, it is not uncommon. One of the most significant barriers to SME's access credit, and this is again per a survey placed to financial institutions.

The SME's have difficulty in proving themselves capable of repaying the debt in terms of their loan applications. They are very informal in general and in the way they present themselves and their case. That informality obviously pervades the way they manage the business and typically they are already indebted to some other financial institution and it does not bode well in terms of putting confidence forward. So, is it a problem? We know the answer.

We believe commercial banks in the Caribbean view SME as a segment that is an attractive one. Most have some sort of unit that deals with it - be it commercial banking or small business banking. As to if it is right, the full spectrum from micro to SME, well that's another issue. But most of the banks have a unit, which is the corporate banking unit that is targeted to dealing with that. However, we believe that understanding the business of the SME as well as understanding lending and managing risk of an SME is an issue for the traditional commercial bank. And it is not helped by the fact that the SME's themselves do not have the capabilities to present their case in a strong way to demonstrate that here is a great idea to execute, here is how we are going to generate the cash flows and pay back, here is management and capability we have to make this happen. Again, the commercial banking sector would not necessarily have someone who will go out there and invest the time to define that and help them along. So that is an issue. Obviously, we are very weak in terms of and the contractual environment.

We are not a region where there is a lot of information available, yes there are the credit bureaus etc but again there is not a lot of information out there that can help in terms of assessment and we have a smaller market and economies.

As a result of that, there is a higher level of secured lending. A higher percentage of our loans do require collateral and a higher amount of collateral as well as interest rates generally are higher. Those characteristics are things that are not unique to us, but I guess to most developing nations versus developed nations.

So there is a great emphasis on credit history with the bank in terms of any applications that come forward. There is a great emphasis on obviously the owner's characteristics and the collateral that they present as opposed to the business idea itself and if it can work, which is important as well, I think there is more emphasis on that.

So the full spectrum of financing needs of the SME's cannot be accommodated comfortably by the commercial banking sector. So, that leads to our discussion now - how do we overcome these issues. Well obviously there is a need for providers geared towards addressing these financing needs and the technical assistance that these SME's require in order for this to become a reality. Is there need for Government programmes? Is there need for soft financing or more innovative forms of financing that address the early stages requirements as well as at the later stages? So I will leave it to Phillip now to make his presentation.