

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

Presentation by: Philip J. Pierre

All SME's surveys worldwide always identify access to finance as an overwhelming need yet most funding sources are generally unable to meet their portfolio expectations.

My discussion will basically involve the situation in St. Lucia.

The St. Lucia Micro and Small-scale Business Enterprises Act of 1998 defines a Micro Business Enterprise as an enterprise with the following characteristics:

- Not more than 5 persons are employed whose annual sales does not exceed EC \$100,000C;
- The net assets do not exceed EC \$75,000 and is locally owned.

The Act defines a Small-scale Business Enterprise as follows:

- Not more than 50 persons are employed, the annual sales or turnover does not exceed EC \$1million whose net assets do not exceed half a million EC and is locally owned.

Traditionally, financing for SME's came from the resources of the owner, or from Government-owned development banks established by statutes.

The St. Lucia Development Bank was established in 1981 with the Government of St. Lucia the sole shareholder, contributing EC \$1.25 million to the share capital annually for four years based on an agreement with the CDB. The bank upon its formation replaced the Agricultural and Industrial Bank, (the AIB), the Housing Development Bank (the HDB) and the Further Education Loan Scheme effectively abolishing these institutions by taking over the assets and liabilities. The SLDB also took over the lending activities and loan portfolios of the Student and Industrial Credit Loans of the St. Lucia National Development Corporation.

The St. Lucia Development Bank's balance sheet at its opening dates showed a net liability position of EC \$2.2 million and a loan portfolio of EC \$11 million. It is clear that from the beginning the SLDB was undercapitalized, and was generally slow in performing its function as a development banking institution.

Professor Wayne Sandiford in his paper "A Development Banking in Eastern Caribbean - the case of St. Lucia and Grenada" commenting on the portfolio of the SLB notes that from 1983 to 2001 the dominant sector was the housing sector accounting for an average of 47.1% of total outstanding loans. The second sector of importance was that of education which accounted for an average of 21.5%, followed by tourism in which there was an average of 17.6%.

That clearly shows that the productive sectors were not the priority sectors for on-lending in the case of St. Lucia. Funding sources may be underutilized because institutions like the SLDB use for on-lending to SME's are not adequately structured to suit the diverse requirements of SME's.

Reviewing the definition of SME's used earlier, it is reasonable to assume that many of these businesses lack both the structure and capacity to cope with growth and expansion. It is a fact that most SME's complain of a lack of financial resources. On the other hand, as our field states possible sources of financing are complaining that they are unable to disburse these funds. Is the problem with the original funding source, the intermediary or the SME?

Using the experience of the SLDB we see from its inception, the bank was not structured to act as a lender to SME's. SME's are peculiar institutions that require not only finance but support in several areas of their operations. If SME's are to fully use the available financial resources, the institutions that make their resources available must ensure that at the firm level the SME has the capacity to beneficially absorb and utilise the financial resources. Since many SME's are unable to source funds from the traditional banking sector the criteria used to evaluate them must be subject to constant review and analysis. I want to suggest that financial institutions consider funding of programmes of projects for SME's on a specific item basis.

Funding should not only be restricted to the acquisition of assets like machinery, equipment and buildings, but to build capacity, example: marketing, research, information technology, standardization, human resource development, product development, diversification, governance, vertical integration, strategic retooling, smart partnering and other similar activities. Disbursements must be flexible and timely and this would mean a re-engineering of the relationship between the financial institution and the SME.

The traditional procedures for borrowing would have to be redefined. Usually the institutions require a comprehensive business plan and some form of security whether assets or pledges of income. In the new arrangement, the financial institution would have to fund an activity at all stages - at initiation, implementation, then monitor and evaluate it. This means there will be a hands-on relationship between the SME and the finance house. Such an approach would have a number of advantages for the SME and the financial institution. By its direct involvement the financial institution would establish an intimate knowledge not only of the requirements but the use to which the funds are used. The SME would be forced to follow procedures agreed and utilize the funds for the purpose requested, the ability to adjust plans and programmes according to the prevailing environment. Due to its direct involvement the institutions would in a timely fashion be able to review the terms and conditions of the loan to the benefit of the SME and the institution. Financial institutions would be in regular contact with management of the SME and be in a position to make recommendations.

What I am suggesting is that development banks are not only involved at the consultancy and advisory processes of this level. They should be asked to

broaden their involvement by direct intervention in financing and management and other capacity building requirements of the SME. This calls for a shift in the paradigm. The traditional role of institutions that finance SME's must change. This requires not only a re-position of development banks but a complete reorientation of the functions. These new functions must impact at the direct firm level. These interventions are not meant to supplement or change present arrangements, but to compliment and redefine their roles to a more functional at the ground level of the SME.

In the new dispensation, the development and other financial institutions would play an integral part of the SME at firm level and not only provide finance but assist the SME in figuring out its requirements and finance projects that will enhance their productivity and competitiveness.

Returning to the St. Lucian experience we found that in order to improve their bottom line, the bank finance other areas like education and housing so as to reduce the exposure to risk and bad debts from failed SME's.

SME's may be unable to access finance because they may have reached a point where they cannot expand or be competitive under present conditions and a paradigm shift would mean a complete reorientation of their business. Such a reorientation may call for a partnering of the business in a vertically integrated arrangement. The SME may have to engage in the production of semi-finished products instead of a finished product or produce a completely different product.

What I am suggesting is that financial institutions whether at the level of funding source or intermediary, may have to find innovative ways of encouraging these partnerships. They may have to seek out SME's where the possibility exists for changes and herald that new paradigm. An emerging opportunity for the use of available funds may be found in the area of food production. There is a good example in China, where a hybrid variety of rice is used and which has increased the availability of the product and that variety is not genetically modified.

Consideration could be given to the funding of research and development at the commercial level. It may be possible for researchers, food production experts and agriculturists to form a commercial research facility from borrowed funds instead of waiting for grant funds. Some thought could be given to financing a strategic alliance between farmers and researchers. A new cadre of business persons could be created.

I am suggesting that the role of funding institutions may have to change and a more proactive posture assumed, finding opportunity for existing firms and in other cases, creating new areas of business. It appears that SME's may have reached the point of saturation and the persons involved may not be able to effectively make use of finances in a manner that benefit them and limit the risk to the financial institutions. Instead of awaiting a proposal for financing, institutions may have to fund the preparation of these proposals and then seek and fund the business at the implementation stages.

In conclusion I suggest consideration for the following:

- A revised approach by both funding source and intermediary to provision of loans to SME's;
- Direct intervention of the intermediary at the firm level;
- Flexibility in the provision of funds;
- Possibility of funding both tangible and intangible needs of SME's;
- Consideration of funding for research and development of new business ventures;
- A more aggressive approach to possible areas of food processing and research;
- Access to financing may be problem because even when available SME's may not have the capacity, ability or ideas to use these funds.

Thank you.