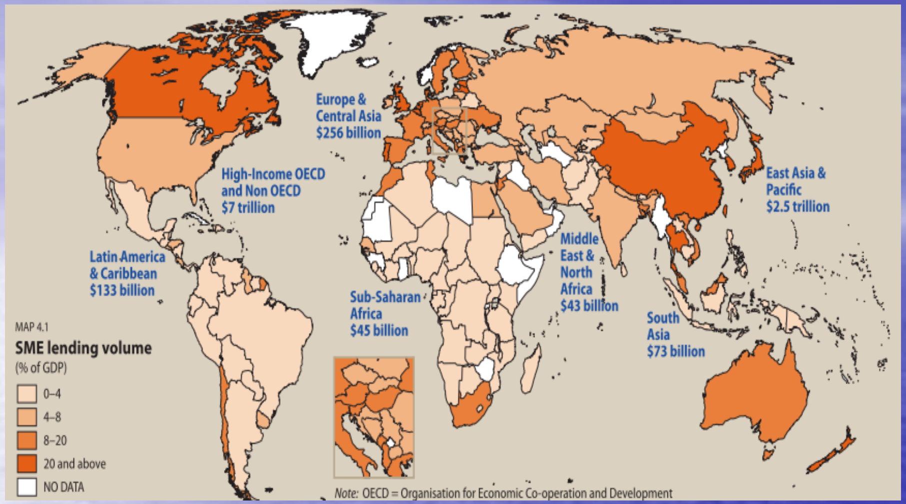

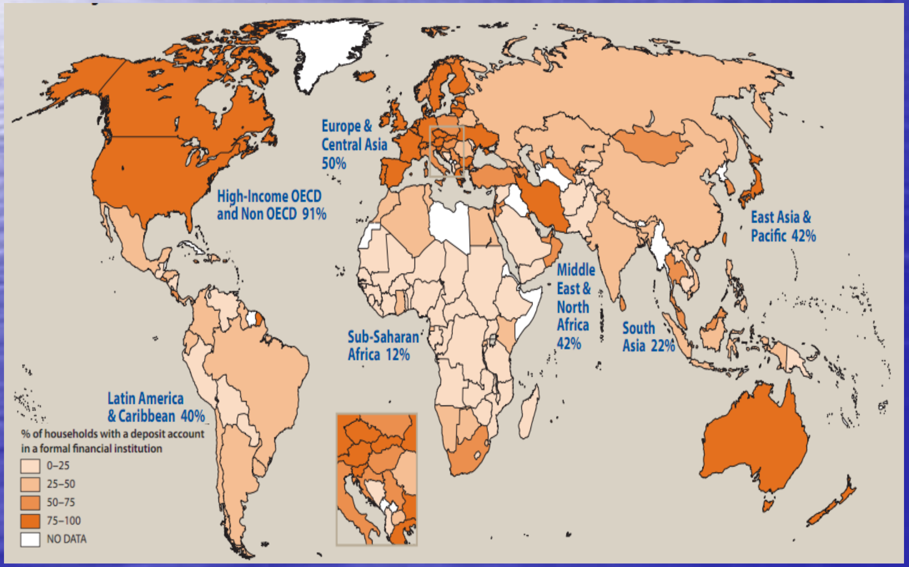

Challenges in Empowering Underserviced Groups in Accessing Finance

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Background

- Access to Finance is a key constraint for MSMEs.

- Correlation between Financial Access & Depth, Poverty & Inequality

-Lack of access to finance impacts smaller firms (-10%) more then larger ones (-6%).

- It is important to distinguish 'Access' from 'Use' but its not easy to measure the two independently.

- Bank finance is the biggest source of Finance, but it does not mean non-bank finance is less important.

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Background

Preference of bankers for Collateral rather than 'Cash Flow' based lending

- Less than 25% of small firms use external finance as opposed Bigger Firms have better access to Finance

Serving the MSME involves higher transaction costs

Lenders give preference to 'Priority Sectors'

Key role of efficient Financial Intermediaries

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Empowering Underserviced Groups in Accessing Finance involves Understanding the :

Social Context	Market Context	Economic Context	Political Context	Regulatory Context	Enforcement Context

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Cultural / Religious Issues
(Sharia Laws, Islamic Banking, Lack of Banking habits and Credit culture, Cultural bias towards some activities etc.)

Trust Deficit
(Trust in Banking, MFIs, Cooperatives, Government, etc.)

Absorptive Capacity
(MSME have Weak Documentation skills, Lack of awareness of available schemes, or Financial products)

- Reason for Taking Loans
(Consumption Expenditure, Investment)

Law and Order Situation
(Organized crime, Threat of Violence, Enforcement)

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-Existence of Capital Markets
(Debt and Equity Market option, etc.)

Distance
(Spread, Communication challenge, High transaction costs etc.)

Sectoral Issues
(Typical requirements of each industry, sector, seasonality etc.)

Size of the Market and Talent Pool

Loan Guarantees, Banking competition, CIB & CAR

Incentives within Financial Organizations

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- Financial Inclusion and Inefficiency Gap, Insufficiency Gap and Feasibility Gap

-Exchange Rate controls & Volatility, De/Regulated Interest Rates and Inflation

-Import / Export potential

Availability of Micro-Financing, Capital Markets, Informal Lenders

Investor Rights protection, E-Commerce Laws, Taxation

- Macroeconomic stability and Potential for Regional Cooperation
  (Regional stock exchanges, Cross border trade, etc.)

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Polarization
(Existence of completely divergent viewpoints)

Incentives for Politicians
(Does good economics makes good politics?)

Need for ‘Selling’ reforms

Access to Information

Strength of Democratic Institutions

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Empowering Underserviced Groups in Accessing Finance involves Understanding the :

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- Laws and legal framework
(Consumer Protection Laws, Banking Laws, Insurance Laws, CIB / CAR Laws , Bankruptcy Laws etc.)

- Institutional Capacity for Regulatory & Judicial Supervision
(Functioning of Judiciary and Legal System, Statutory functions, Mandate, Powers, etc.)

Knowledge and Skills
(Competent Regulators, Judges)

Adverse selection / Moral hazard / Sovereign Risk

Need to monitor the Borrower

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- Judicial Enforcement Mechanisms
(Civil Procedure Court, Consumer Court, etc.)

Titles to Business and Land, Labor Regulation

Qualified and Competent Judges
(Intellectual property Taxation, Banking, Insurance, Company liquidation)

Systems
(Case Management System, Criminal database, Judgment Debt database)

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Corruption

- About 42% SMEs in middle-income countries and 34% in low-income countries perceive corruption to be a major obstacle.
- Corruption contributes to inequality.
- Corruption is negatively correlated with the income level.
- Corruption is negatively correlated with growth.
- Corruption erodes trust in banking and financial system.
- Raises cost of capital.
- Increases the impact of risks.
- Discretionary powers given to government officials tends to prove counter productive to fight corruption.
- Powerful supervisory agencies are prone to capture and manipulation by politicians, regulators, or both and hence, tend to lower the integrity of bank lending.
- Private Monitoring works better for maintaining the integrity of bank lending in countries with sound legal and bureaucratic institutions.

Thank You

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