

SURVEY REPORT ON ALTERNATIVE FINANCE FOR MSMEs



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Authors:

Group members: Peter Owira (Subgroup Leader) SASRA, Kenya, Jason Barrantes (SUGEF, Costa Rica), Gul Badshah (Da Afghanistan Bank, Afghanistan), Olga Ilyukevich (National Bank of the Republic of Belarus, Belarus), Ugyen Choden (Royal Monetary Authority of Bhutan, Bhutan), Marie Thérèse (Banque de la République du Burundi, Burundi), Ismail Adam (Bank of Ghana, Ghana), Elijah Osha/Sale Lukman A. (Central Bank of Nigeria, Nigeria), Kalubi Kayembe/Kikata Kiowe Cynthia (Banque Centrale du Congo, Democratic Republic of the Congo).

Contributors:

Peter Owira (Subgroup Leader, SASRA, Kenya) and Jason Barrantes (SUGEF, Costa Rica). From the AFI Management Unit: Nik Kamarun (Senior Policy Manager, SME Finance) and Taty Azman (Policy Analyst). Roelof Goosen (Independent Consultant).

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EXECUTIVE SUMMARY

The objective of this report is twofold:

- > To share the insights from an AFI SME Finance Working Group survey undertaken in 2019 on the state of alternative MSME finance in the AFI network.
- > To provide guidelines and country examples to regulators and other authorities on the issues to consider when developing alternative MSME finance.

The report reflects on the economic and social importance of the MSME sector in emerging economies. It explores the significance of available research on the MSME finance gap, i.e. the difference between what access to finance is available to MSMEs and the level of financing that they actually require. The report analyzes the reasons for this and the growing role that alternative MSME finance mechanisms play to overcome the problem and to increase efficiencies in the market.

The survey results are summarized, largely reflecting the research insights. The survey identified three primary challenges experienced in the AFI network with MSME alternative financing, namely the lack of market awareness, lack of trust and the consequent low take-up of these mechanisms. Leasing, factoring and grants are identified as the three most commonly available and used alternative financing mechanisms.

The insights from the research and from the survey are then combined to identify principles that regulators and other authorities should consider and to guide them when planning to strengthen and develop alternative MSME finance market. These principles address regulatory and legal frameworks, market protection and the supporting environment that is necessary to take alternative financing forward.

The report concludes with examples from a few countries to further illustrate what can be achieved and provides a high-level roadmap of the steps necessary for countries to use alternative financing to improve the growth prospects of MSMEs.

INTRODUCTION

Micro, small and medium enterprises (MSMEs) play a major role in most economies, particularly in the developing world. The sector is rightly viewed as the engine of economic growth in many countries. It provides, particularly at the micro enterprise level, an on-ramp to economic participation that is often the only pathway out of poverty available to disadvantaged households.

MSMEs constitute 90 percent of all businesses and more than 50 percent of employment globally.¹ In emerging economies formal MSMEs contribute up to 40 percent of national income (GDP). In these countries, informal MSMEs form a sizable portion of enterprises, for a variety of reasons. If the contribution of such enterprises is also taken into account, then the MSME sector's contribution to GDP is significantly higher than 40 percent. In the next few decades, a large number of new jobs will be required to absorb the growing workforce - an estimated 600 million new jobs are required by 2030, with most of these in the emerging world. As MSMEs have been creating most of the formal jobs (7 out of 10) in emerging markets, the burden to provide additional employment will fall heavily on this sector. Consequently, MSME development has become a high priority for many governments, with a variety of supporting structures in place. However, MSME development is still hampered by a relatively constrained access to finance, which inhibits growth and job creation in the sector. It is the second most cited obstacle in growing an MSME business. Although traditional sources of access to finance, typically banks and similar institutions, have been growing over the last decade, this growth has been insufficient to meet the increase in demand from the sector in emerging economies.

MSMEs are not only an engine that drives economic growth, it is also a major conduit for **reducing gender inequality**. Women entrepreneurs play a critical role in the MSME sector, contributing to economic growth and job creation.² Women-owned businesses constitute 23 percent of MSMEs and account for 32 percent of the SME finance gap (see below). Women own about one-third of micro and small enterprises (less than 50 employees) and one-fifth of medium-size enterprises in

emerging countries (50-250 employees). Women-owned enterprises are more likely to be informal than male-owned enterprises. The majority of the women-owned MSME finance gap is in the low-income and lower-middle income countries, where it represents more than 50 percent of the total finance gap on average. Based on the World Bank studies, the higher the access to bank accounts and lending to women, the higher the share of female-led businesses.³ These market realities point to the fact that women-led MSMEs are more credit-constrained than male-owned enterprises, although women are able to directly convert access to finance into sustainable enterprises.

Women-owned MSMEs and MSMEs from vulnerable and underserved groups also face **significant non-financial barriers** that exacerbate the challenge to obtain credit and other financial services. Such MSMEs tend to have disproportionately lower access to collateral and they are often overlooked as viable businesses by financial service professionals. Non-financial barriers include social and cultural norms manifesting in gender biases, where women are traditionally not associated with running an enterprise. Other barriers include gaps in legal frameworks and property rights that may constrain women from entering into contracts. Limited access to business education opportunities and limited networks that enable access to business opportunities are frequently experienced by women. Biases and discrimination can also affect other underserved groups and can be a factor in the financial exclusion of small businesses.⁴

70% Some 70 percent of formal women-owned MSMEs in emerging economies are either excluded by financial institutions or are unable to receive financial services to adequately meet their needs.

This results in a growing credit deficit for women-owned MSMEs. The challenge requires a holistic public and private sector approach, which should aim to provide sustainable and beneficial support that will result in tailored financial services, and financial infrastructures that will directly and uniquely benefit women-owned MSMEs and MSMEs owned by vulnerable and underserved groups.

1 <https://www.worldbank.org/en/topic/sme/finance>

2 WBG (2017), Women's Entrepreneurship Facility

3 GPMI (2020), Promoting Digital And Innovative SME Financing

4 GPMI (2020), Promoting Digital And Innovative SME Financing

TABLE 1. DISTRIBUTION OF MSMEs BY FINANCIAL CONSTRAINT LEVEL, %

**MIDDLE EAST
 AND NORTH AFRICA**

Unconstrained	66,1
Partly Constrained	14,3
Fully constrained	19,6

**EUROPE AND
 CENTRAL ASIA**

Unconstrained	72,6
Partly Constrained	12,9
Fully constrained	14,5

SOUTH ASIA

Unconstrained	46,4
Partly Constrained	17,9
Fully constrained	35,7



**LATIN AMERICA AND
 THE CARIBBEAN**

Unconstrained	78,6
Partly Constrained	11,6
Fully constrained	9,8

**SUB-SAHARAN
 AFRICA**

Unconstrained	47,9
Partly Constrained	39,3
Fully constrained	12,9

**EAST ASIA
 AND THE PACIFIC**

Unconstrained	58,3
Partly Constrained	7,8
Fully constrained	33,9

TOTAL

Unconstrained	59,7
Partly Constrained	18,2
Fully constrained	22,2

The difference between the estimated demand or access to finance and the extent to which this demand has been met is termed the **MSME finance gap**. The International Finance Corporation undertook a number of studies to determine this gap, with the latest study done in 2017.⁵ This study is based on multiple data sources and covers 128 countries. According to the study, the potential demand for MSME finance in the emerging economies is estimated at US \$8.9 trillion, compared to the credit supply of \$3.7 trillion. The MSME formal finance gap from formal MSMEs in these emerging economies is therefore estimated at \$5.2 trillion. The gap is equivalent to 19 percent of the gross domestic product (GDP) of the countries covered in the study. This is 1.4 times the current level of MSME lending in these economies, or more than double the current lending total. In addition, there is an estimated \$2.9 trillion potential demand for finance from informal enterprises in these countries, equivalent to 10 percent of the GDP.

40%

The study estimates that 40 percent of all enterprises in the 128 reviewed countries face significant constraints in obtaining finance.

The percentage of enterprises with fully-met financing needs (unconstrained), with financing needs only partially met (partially constrained) and with financing needs not met at all (fully constrained) are shown in Table 1 above.

There are many **reasons for the large gap in MSME financing**.^{6,7} The cost to reach and serve MSMEs relative to the revenue potential that banks can achieve from them as customers; information asymmetries or the absence of traditional data used by banks to assess creditworthiness; lack of collateral; onerous documentation and application requirements and weak creditor protection. These factors may make it more difficult for financial institutions to assess the credit risk of MSMEs, to monitor MSMEs and to enforce repayment. Information asymmetry stems from the reality that MSMEs often have less available information, such as regular and complete financial statements, as compared to larger enterprises. This makes it difficult for banks to appropriately evaluate and monitor the credit risk posed by MSMEs. A related issue is the lack of available (shared) credit information for MSMEs in many emerging markets. From a MSME perspective, the high cost and limited availability of suitable financial products make it difficult for these enterprises to obtain financing. The lack of acceptable collateral is also a major barrier to access finance;

in emerging markets, many banks would only lend to MSMEs that have available collateral. In most emerging markets, informality represents a major barrier to financial access for MSMEs in general and particularly for access to finance.

Further evidence is available in many of the research studies that have been undertaken in the MSME finance space. The European Investment Bank's survey of the banking industry in Africa provides a perspective on how banks perceive the issues around MSME access to finance.⁸ The 2019 survey amongst African banks revealed that banks are planning to expand their loan books, with particular emphasis on MSMEs, as that is perceived as a growth area. However, banks also identify some specific constraints to MSME lending: a shortage of bankable projects, a lack of effective collateral, a lack of managerial capacity, informality and a high default rate amongst MSMEs. The results of the survey response are shown in Graph 1 below. Banks identify credit guarantee schemes as an important mechanism to mitigate some of the risk but are of the opinion that the available schemes typically do not meet their requirements.

The **COVID-19 pandemic** has and will continue to have a negative effect on MSMEs in the developing world. In some countries, the severity of the pandemic led to lockdowns and a severe dampening of economic activity in countries. This puts additional strain on already challenged MSMEs to cope in a situation of decreased or no revenue, resulting in a weakening of the sector financially. Even in countries where the local impact of the pandemic was less severe, the reduction in international trade is having a disproportionate effect on MSMEs. This reality is highlighted in the findings in the SME Competitiveness Outlook.⁹ This study finds that the lockdowns in China, the European Union and the United States that have had the greatest impact on trade. Together, these three economies account for 63 percent of the world's supply-chain imports and 64 percent of supply-chain exports.

The report estimates that the disruption of these manufacturing hubs will amount to a reduction of \$126 billion in global trade volume in 2020. This disruption is having a negative knock-on effect on emerging

5 IFC (2017), MSME Finance Gap

6 GPFI (2020), Promoting Digital And Innovative SME Financing

7 European Investment Bank (2020), Banking in Africa - financing transformation amid uncertainty

8 European Investment Bank (2020), Banking in Africa - financing transformation amid uncertainty

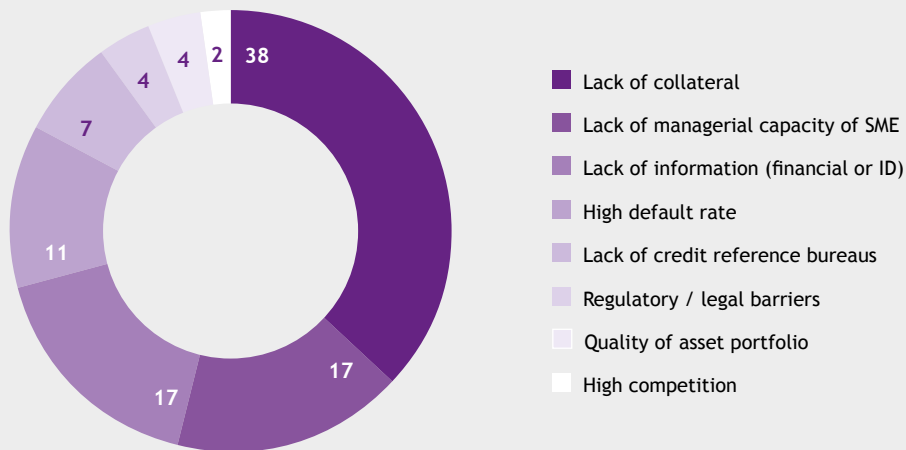
9 International Trade Centre (2020), SME Competitiveness Outlook 2020 - The Great Lockdown And its Impact on Small Business

economies. For example, the study predicts that African exporters are set to lose more than \$2.4 billion in global industrial supply-chain exports as a result of the global disruption in manufacturing and related industries. The survey supporting the study was carried out in the first few months of the pandemic. More than 55 percent of businesses globally had been significantly affected by the pandemic and the responses to the pandemic in that period. However, the effects were more severe for smaller businesses. Two-thirds of micro and small firms said that the crisis had affected their business operations, compared with 40 percent of larger companies. One-fifth of SMEs said that they were at risk of shutting down permanently within three months at the time of the survey.

The current situation regarding MSME access to finance requires the addition of different approaches to meet the growing demand for MSME finance. Traditional

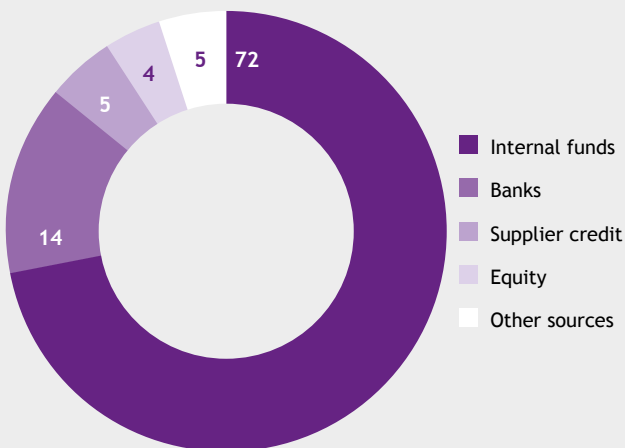
finance (from banks and similar sources) has been growing steadily but have been unable to reduce the MSME finance gap, have not adequately addressed the access to finance problems faced by women and other vulnerable groups, and is unlikely to deal with the anticipated increased demand from MSMEs as a result of the COVID-19 pandemic. Authorities in many countries have established a variety of measures to support the economy, including direct support to MSMEs, but this is generally insufficient to deal with the impact of the pandemic and will not deal with the structural shortcomings in the market with regards to MSMEs' need for finance. This will leave MSMEs in the current situation where the bulk of required funding has to come from own resources. This is illustrated in Graphs 2 and 3, showing the sources of funding used by MSMEs globally, split by investment or initial funding and working capital or operational funding.

GRAPH 1: MAIN OBSTACLE TO SME LENDING, %



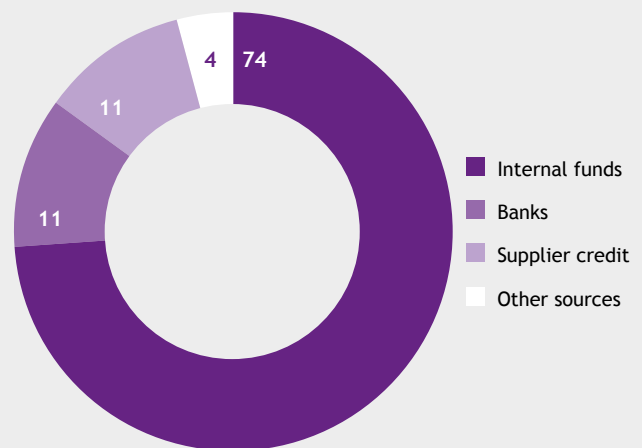
Source: EIB (2019), Banking in Africa financing transformation amid uncertainty

GRAPH 2: FINANCING OF INVESTMENTS, %



Source: World Bank Ghana Office (2016), Access to Finance for SMEs

GRAPH 3: FINANCING OF WORKING CAPITAL, %



The relatively low level of external funding indicates that there is a need to **strengthen and expand alternative finance mechanisms for MSMEs**. Given the expectations from the sector in terms of economic growth and job creation, improving access to finance for MSMEs is crucial for countries in emerging economies. As traditional finance has not been able to reduce the finance gap to a meaningful extent, alternative finance mechanisms are required. This approach is necessary to address some of the constraints that currently exists in the MSME finance ecosystem. Some of the alternative mechanisms can be used to reduce the impact of those constraints, thereby improving the levels of finance that are accessible to MSMEs.

The types of alternative finance mechanisms considered in this guideline note are the following:

- > **Digital finance**
 - Equity-base crowdfunding, debt-based crowdfunding, rewards-based crowdfunding
 - P2P lending
- > **The use of the capital market**
 - Equity finance
 - Angel capital
 - Venture capital
 - Mezzanine capital
 - Initial coin offering (ICO)

> **Finance mechanisms from banks and finance houses other than secured loans**

- Leasing & Factoring (asset-based financing)
- Non-secured loans, supply-chain financing

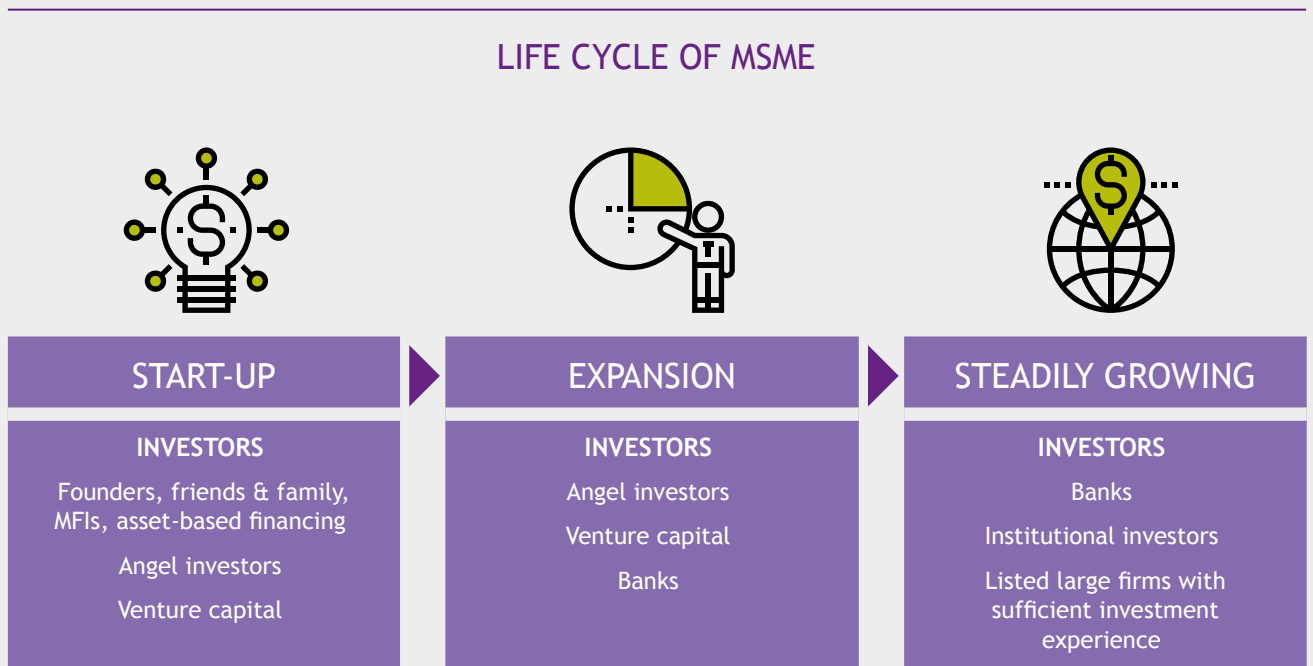
> **Grants**

The mechanisms and terms mentioned above are defined in Annexure C below (to follow).

Traditional debt finance generates moderate returns for lenders and is therefore, appropriate for low-to-moderate risk profiles.¹⁰ It typically sustains the ordinary activity and planned short-term needs of MSMEs, generally characterized by stable cash flow, modest growth, tested business models and access to collateral or guarantees when needed. Financing instruments that is an alternative to straight debt, changes this traditional risk-sharing mechanism and could therefore be more appropriate during periods in the growth cycle of MSMEs, where traditional debt is not suitable. The mechanisms differ in terms of the associated risk, with the risk increasing from asset-based lending, to alternative debt, to hybrid instruments and then to equity-based finance and platforms for public listings of MSMEs.

¹⁰ OECD (2015), *New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments*

TABLE 2: GROWTH CYCLES OF MSMEs AND CREDIT PROVIDERS



Source: The table is based on United Nations ESCAP (2017), *Small and Medium Enterprise Financing*

One view of how different types of debt match onto life cycles of MSMEs is given in Table 2 below. It should be noted that such a mapping is often dependent on the specific access to finance landscape within countries, although it does illustrate that different types of financing are appropriate during different stages of MSME growth.

Some of the alternative mechanisms listed above have been in existence in some economies for quite a length of time already, but the initial use of such mechanisms tended to be for larger and more established enterprises. The extension of such mechanisms to the MSME market is more recent. The digital-based mechanisms have developed more recently. Even so, the use of the alternative mechanisms by MSMEs, where such mechanisms are available, have been steadily increasing. The OECD Scoreboard Financing MSMEs and Entrepreneurs 2020¹¹ notes that growth continued in 2018, the last year for which data was available for the publication:

- > **Leasing and factoring volumes increased in most countries**, in line with long-term trends. Growth in factoring accelerated in 2018.
- > **Online alternative finance activities were up by 54 percent in 2018** (median value). It should be kept in mind that this is often from a very low base, due to the relatively recent introduction of such mechanisms.
- > **Venture capital investments rose by 20.9 percent as a median value between 2017 and 2018**, significantly up from the 0.4 percent growth in the previous year.

> **Public listings on SME stock markets in 2018 were down compared to 2017**, but activities remained high from a long-term perspective.

On the other hand, both new traditional lending to MSMEs and the outstanding stock of SME loans grew only modestly in 2018, with a significant drop in the median growth rate of these two indicators. The share of SME loans as a percentage of total loan books declined modestly across middle- and high-income countries in 2018. This points to MSMEs viewing alternative mechanisms as favorable and beginning to prefer such mechanisms in specific situations. It follows that alternative finance mechanisms are more prominent in addressing the MSME finance gap than ‘traditional’ lending.

From a policy perspective, the continued development of the ‘traditional’ lending access to finance ecosystem should be pursued. This is necessary, as that market will remain important and extending the reach and improving the efficiency of the market will benefit the MSME sector. At the same time many of the legal and regulatory frameworks, the infrastructural elements and the general MSME support mechanisms of the market are equally applicable to the alternative mechanisms as well, benefitting the development of the alternative mechanisms in a responsible and structured manner.

11 OECD (2020), Financing SMEs and Entrepreneurs 2020 An OECD Scoreboard



Chef working in fast-food kitchen. Kenya. (Photo by Juan Alberto Casado/iStock)

SME FINANCE WORKING GROUP SURVEY

The problems detailed above were identified within the AFI SME Finance Working Group. Overcoming all the issues related to meaningfully reducing the MSME finance gap requires a long-term plan of multiple interventions and actions. The Working Group decided to explore the availability and use of alternative funding mechanisms in the MSME funding ecosystem.

A survey was conducted among AFI members, referencing the 16 alternative funding mechanisms available in the network (see Graph 5 below). The survey provided a picture of the use of such mechanisms, what regulatory approaches are being utilized by members and what the issues are in the alternative finance ecosystem. The idea was to use the survey responses as a base to inform members of what is possible and what should be considered when introducing such financing alternatives.

The survey was administered by the Alternative Finance Working Subgroup in August 2019, based on a set of questions developed by the Subgroup. The detailed responses to the questions are included in Annexure A to this report.

In this section some of the more informative responses are presented, as these inform the principles in section 3. Overall, the survey confirmed the difficulty that MSMEs experience in accessing traditional finance and the importance of alternative finance mechanisms to reduce the finance gap. The alternative finance segment is still in a developmental phase in most countries.

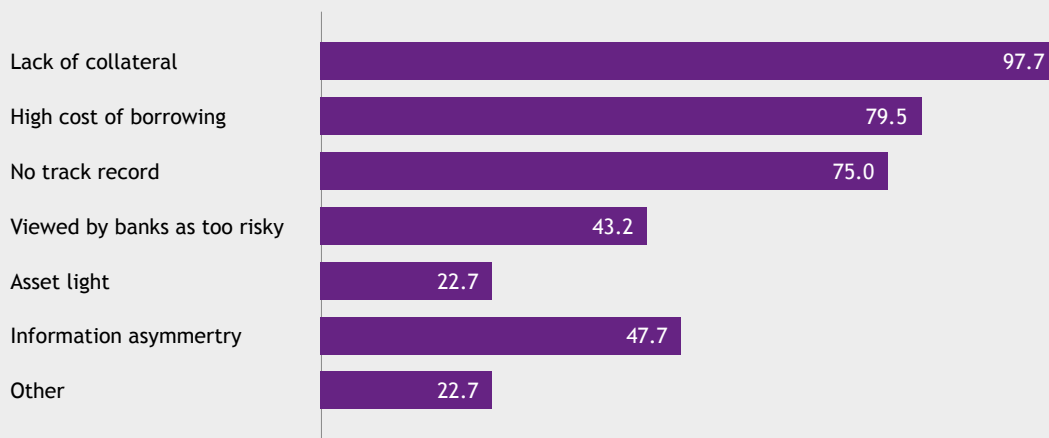
This results in the availability and use of alternative finance mechanisms that are not yet at a level to significantly reduce the MSME finance gap. However, there are examples and lessons from the survey that may be useful to regulatory authorities in advancing alternative financing mechanisms, specifically the need for appropriate and risk-based regulations, alternative regulatory approaches such as sandboxes, the need for coordinated outreach to inform MSMEs, and the need to persevere with efforts to assist the business and digital capability of MSMEs.

The challenges faced by MSMEs, in receiving funding from the traditional financial sector, are summarized in Graph 4 below. The picture emerging from this graph corresponds to Graph 1 above, which gives the view from the lenders' perspective.

It is clear that the inability of MSMEs to offer 'acceptable' collateral to banks is a serious problem, with the lack of information in various forms equally problematic.

Although the banks did not mention the high cost of borrowing, it is evident that the regulatory perspective is that the cost of borrowing is an inhibitor of loan take-up.

GRAPH 4: CHALLENGES FACED BY MSMEs IN GETTING FUNDING, %



Source: AFI Alternative SME Finance member survey 2019. The figures reflect the % of the respondents who identified the challenge as being present in their jurisdiction. Multiple responses were possible.

Graph 5 opposite reflects the availability and MSME take-up of alternative finance mechanisms. The three mechanisms that top the list in terms of availability and use are: leasing, factoring and grants. Equity finance and non-secured loans are also prominent, but there is relatively limited interest to offer and to use the different forms of digital credit. It is worth noting that availability does not translate directly in use. For all mechanisms, usage lags availability, but a few mechanisms are taken up to a greater extent than others when available. Trade finance, supply-chain finance, angel capital and P2P lending fall in this category. This is something that authorities could consider when deciding where to focus their efforts to extend alternative financing for MSMEs.

Graph 6 depicts the reasons why there is such a muted take-up of alternative finance. It confirms that lack of awareness is a major issue. While this is an addressable issue, the current mechanisms to ‘inform the market’ are largely reliant on the credit providers themselves. These providers will naturally focus on their own products and will not try to provide a broad-based perspective of what is available and how the alternative financing can match a particular MSME’s need. This issue is addressed in principle 5 in section 3 below.

Graph 7 opposite summarizes the responses to the question on the channels of information on alternative MSME financing that is available in the respondents’ countries. The fact that financial institutions are the channel most often used, while 20 percent of countries have no specific channel, begins to explain why there is a lack of awareness. Financial institutions will understandably only provide information about their products, rather than what is available in the market in total, while MSMEs in countries with no specific channel are at a disadvantage. Outreach to the MSMEs is therefore an area that requires specific focus from authorities, taking into account the circumstances within their country, as discussed in principle 5 opposite.

57%

When the question was asked whether the respondents think that MSMEs would prefer to engage with the formal banking sector, 57 percent of those who responded indicated that MSMEs would indeed prefer to deal with the sector.

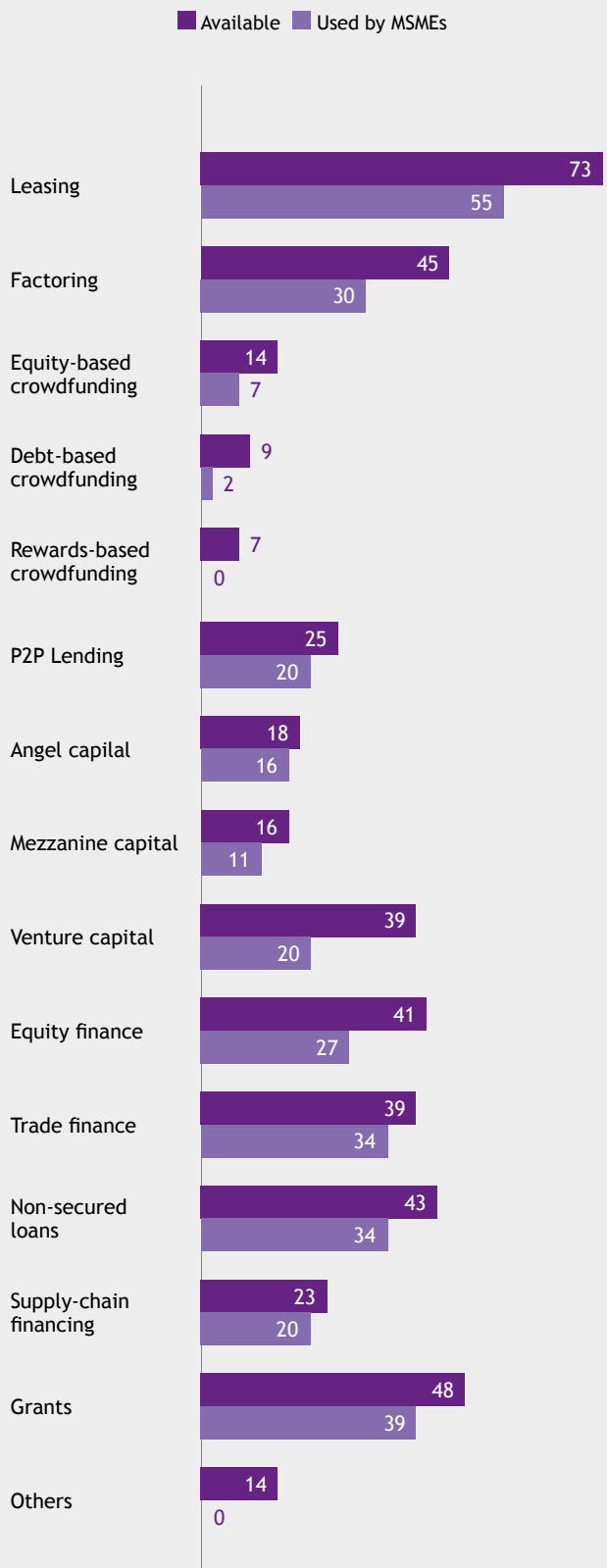
This reflects both an implied distrust of new forms of finance and of new types of credit providers. This is interesting, as it is also evident that the sector is still in

a developmental phase and that a complete regulatory framework is not yet in place in most countries. For example, less than 19 percent of respondents who stated that leasing is available in their jurisdiction indicated that a leasing law (or similar) is also in place. Given the presumed prudent nature of the MSME consumers, the expectation would be that an industry that is not perceived to be well-regulated will be avoided. In the case of leasing, it may well be that the take-up is skewed towards regulated credit providers, such as banks.

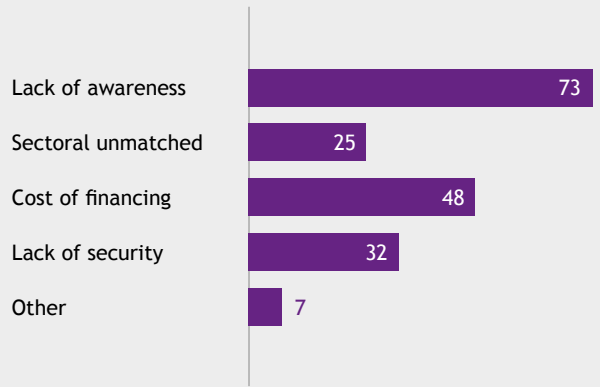
The responses to the question on what interventions the respondents’ governments have put in place to support MSME alternative finance were split almost evenly between providing a regulatory framework, creating enablers and providing a conducive ecosystem. However, 67 percent of respondents with a regulatory framework also have a conducive ecosystem in place. This points to the possibility that authorities appreciate that a holistic approach is necessary to move MSMEs to greater acceptance and use of alternative financing, rather than focusing on only one aspect. It is also clear that authorities appreciate the additional level of risk introduced by alternative finance mechanisms, as is evidenced in Graph 8 opposite. This points to the need for appropriate regulatory frameworks, both to oversee responsible service delivery and to build trust in the alternative finance system among MSME.

In terms of approaches used by the authorities to inform regulation for alternative finance, regulatory sandboxes were mentioned by 30 percent of respondents, with RegTech (11 percent) and innovation office (9 percent) also featured. All of these measures are also applicable to scenarios other than alternative MSME financing, which indicates that there is little in terms of MSME specific approaches. This is also reflected in the responses to a survey question about ‘enablers’ leveraging big data in facilitating financing to MSMEs. The majority of respondents (59 percent) reported no such enabler, with a positive response from only 23 percent. These positive responses relate to both existing infrastructure (credit information systems) and alternative sources of data, e.g. payments data and the use of mobile technology. It would appear that additional focus on developing more extensive use of data to enhance alternative MSME financing could be beneficial.

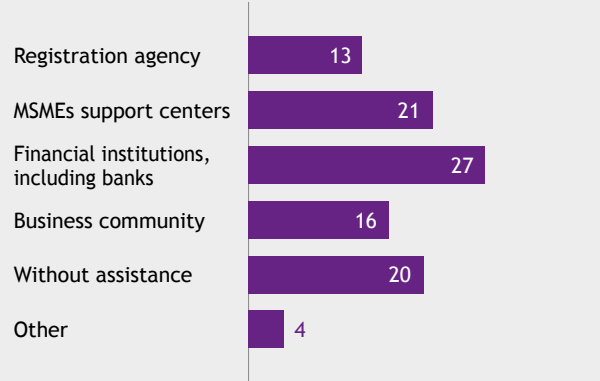
GRAPH 5: ALTERNATIVE ACCESS TO FINANCE MECHANISMS



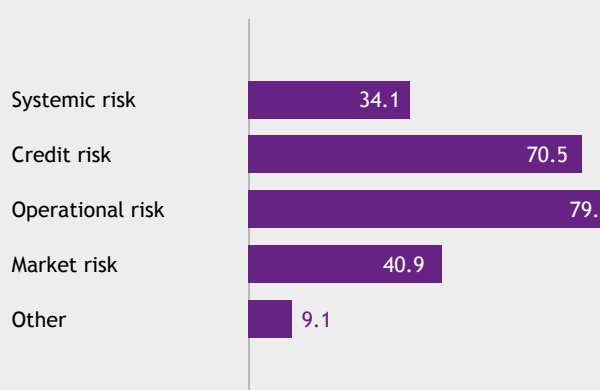
GRAPH 6: REASONS FOR NOT TAKING UP ALTERNATIVE FINANCE, %



GRAPH 7: CHANNELS FOR INFORMATION, %



GRAPH 8: RISKS ASSOCIATED WITH ALTERNATIVE FINANCING, %

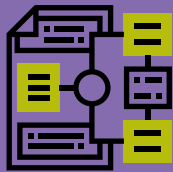


Source: AFI Alternative SME Finance member survey 2019. The figures reflect the % of the respondents who stated that a particular alternative finance mechanism is available and is being used by MSMEs. Multiple responses were possible.

PRINCIPLES FOR ALTERNATIVE MSME FINANCE

This section discusses the key principles and considerations for policymakers and regulators to establish an enabling environment and appropriate regulatory frameworks for alternative access to finance.

As is the case with such frameworks, it is an integral part of a broader financial services framework and should be established and developed with reference to the other related components, e.g. banking regulations, capital market regulations, market protection mechanisms and credit infrastructure. As noted earlier, the development of the MSME access to finance ecosystem should be done holistically, taking all aspects into consideration.



PRINCIPLE 1

Establish clear and comprehensive regulations governing all forms of access to finance available to MSMEs



PRINCIPLE 2

Establish a sound, comprehensive, enforceable and fair legal framework



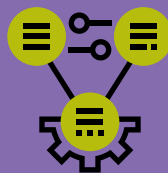
PRINCIPLE 3

Market conduct/ client protection



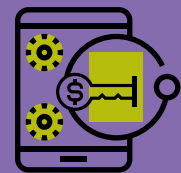
PRINCIPLE 4

Credit infrastructure



PRINCIPLE 5

Outreach and market engagement



PRINCIPLE 6

Data Protection and Cybersecurity Risks



PRINCIPLE 7

Coordination with other regulators and ministries



PRINCIPLE 8

Authorities should ensure that grants (from governments and other sources) are managed in a manner that is beneficial to the target market



PRINCIPLE 8

Development of the capital market in a MSME-friendly manner

PRINCIPLE 1

ESTABLISH CLEAR AND COMPREHENSIVE REGULATIONS GOVERNING ALL FORMS OF ACCESS TO FINANCE AVAILABLE TO MSMEs



A regulatory framework is the key enabler for the development of alternative finance mechanisms for MSMEs. As mentioned above, these instruments often carry more risk than traditional loans, primarily for investors but also for users. Designing and implementing effective regulation, balancing financial stability and investors' protection while responsibly opening new financing channels for MSMEs is a key challenge for regulatory authorities. The rapid evolution in the market, resulting from technological advances, new business models, as well as the engineering of products that satisfy the requirement for high yields from financiers, require that regulators continuously assess the state of the market and the risk associated with new developments. New financing models are emerging that may engage relatively inexperienced investors, as in the case of crowdfunding, or in which the misalignment of incentives may place the stability of the system at risk, which is made more vulnerable to risk by the increased interconnectedness of financial markets.¹²

Regulations should ideally require the licensing of all participants in the access to finance environment and detail the licensing requirements, describe the roles and services that such participants may provide and deal with responsible and fair market conduct, both to investors and to users. Key regulatory issues, e.g. any capital adequacy requirements, will depend on market maturity and the particular characteristics of each regulatory environment. The licensing requirements should strike a balance between the need for stability and increasing access, e.g. capital adequacy should not be set at levels that inhibit viable and responsible credit providers from participating in the market, but the requirements should still protect the integrity of the market.

LEASING AND FACTORING

Supervision of leasing by the regulatory authority should be determined based on country-specific factors. If the lease is financed by an institution that is already under regulatory supervision, supervision by the same structures would be prudent. Establishing minimum capital requirements for leasing institutions might help

eliminate inadequately capitalized leasing companies, but this restriction may also inhibit the development of the leasing industry, particularly in nascent markets where it may be slow to develop. Hence, the establishing of obligatory capital requirements for leasing calls to carefully evaluate in the context of the existing legal and regulatory framework, as well as other national development factors.¹³ A related issue is whether institutions subject to prudential regulation (particularly banks) should be permitted to provide leasing services. It can be argued that they should be permitted to provide finance leases because these are not riskier than loans.¹⁴

Factoring has developed in a variety of legal and regulatory settings, specific to the individual country in which the factoring is provided. In a dissertation¹⁵ on factoring, Hamanyati identifies three approaches to the regulation of factoring. These are factoring markets with no regulations, factoring that is governed by a regulatory authority and a factoring sector with regulations:

- > **Factoring markets without regulations** have no specific regulatory body overseeing the market. Factors are guided by their corporate governance rules and contractual relationships. Some developed markets operate using this model, e.g. the USA, UK and some European countries, as do some emerging economies.
- > In the second model, a **regulatory authority governs factoring**. This could either be the banking regulator or the primary regulator for non-banking financial services, using factoring-specific rules. This model is used in some emerging economies.
- > In the third model, the **factoring industry is closely regulated by law** and minimum requirements are set out as to which institutions qualify to engage in providing the service, which typically includes the stipulation of capital requirements. Russia is an example of this model where factoring is the preserve of commercial banks. Such a model may restrict the development of the factoring industry, but it enhances professional conduct and promotes transparency, thereby enhancing user confidence.

Countries should carefully evaluate which model will fit their circumstances the best, but emerging economies should carefully consider the implications of the first

12 OECD (2015), *New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments*

13 IFC (2011), *SME Finance Policy Guide*

14 World Bank (2004), *Leasing - An Underutilized Tool in Rural Finance*

15 Hamanyati, Mwenda (2017); *Factoring as an International Trade Finance Product*

model before deciding that it is the model that should be adopted.

DIGITAL CREDIT PROVIDERS

This class of service provider requires a risk-based regulatory framework that encourages responsible innovation and aligns with the core regulatory mandate of maintaining financial stability, financial sector integrity and market competition.¹⁶ This requires:

- > A rigorous and comprehensive risk and regulatory gap analysis to determine the risks associated with new technologies, products, and services and the appropriate and timely regulatory responses. This should consider:
 - level of financial inclusion;
 - the risks (and benefits) presented by new technologies, products and services;
 - the application and effectiveness of the existing legal and regulatory framework, including the existence and the effectiveness of self-regulatory initiatives;
 - the scope and stage of development of the relevant types of FinTech businesses;
 - the regulators' supervisory/examination capacity;
 - the regulatory burden on Digital Financial Service (DFS) providers and/or consumers, including MSMEs.
- > Establishing effective methods to keep abreast of new and emerging technologies, products and services. This could include the creation of an innovation office as a way to facilitate regulator-innovator engagement and learning.
- > Deploying test environments, e.g. regulatory sandboxes, to determine whether innovative DFS can comply with existing regulatory requirements

and if not, whether there are alternative means that would enable the innovation to achieve regulatory objectives.

Digital credit requires a supporting environment to function effectively. Some of the environmental issues fall outside the direct regulatory mandate, but regulatory authorities can advocate for:

- > Enterprise digital identity, i.e. encouraging a trustworthy, robust, and secure digital identity system for individuals and MSMEs.
- > Improving MSME credit information data - Improving the availability of MSMEs information, expanding credit information sharing and enabling responsible cross-border data exchanges. This should include the use of additional sources of information, e.g. digital payments data. The use of such alternative data is also a significant lever in reducing informality in the MSME sector, as it provides real benefit to MSMEs and may influence a greater move to formality.
- > Promoting financial, business, and digital capability support strategies.
- > Supporting digital payment systems. This is usually part of the regulatory mandate, so authorities should establish robust, safe, efficient and accessible digital payment systems and coordinate incentives for merchants and MSMEs to accept and for consumers to use them.
- > Creating the conditions for Bank/FinTech partnership. Such partnerships hold significant promise for

16 GPF (2020), Promoting Digital and Innovative SME Financing

17 United Nations ESCAP (2017), Small and Medium Enterprises Financing



Coffee farmer in front of a plantation. Armenia. (Photo by AJR_photo/Shutterstock)

extending and deepening financial services and reducing costs for MSMEs. Regulations should be structured in such a manner that there is clarity about the roles in such partnerships and that restrictions on the structure of such partnerships are kept to a minimum.

NON-BANK FINANCIAL INSTITUTIONS

Non-bank financial institutions (NBFIs) play a major role in financing MSMEs. It is therefore important that a holistic policy and regulatory framework for NBFIs is established to ensure an orderly market and a sound competitive environment between banks and NBFIs.¹⁷ In many countries, different classes of banking-type institutions are better suited to engage the MSME market than traditional banks, e.g. micro-finance institutions, credit unions and rural banks, and these should be accommodated in the regulatory framework. Such institutions should only play a defined role in the credit space and as such, typically pose a smaller risk, particularly a smaller systemic risk, than traditional banks. A proportional regulatory approach should therefore result in lower capital adequacy requirements for such institutions, thereby reducing cost-of-operations and increasing the ease of market entry.

Regulators should ensure that NBFIs are not at a competitive disadvantage vis-à-vis banks. As a practical example, existing credit information systems often cover only borrowing and transactions within the traditional banking sector. Coverage should be extended to include all lenders, including NBFIs and Microfinance Institutions (MFIs).

In establishing the regulatory framework for NBFIs the following issues should be considered:¹⁸

- > The regulatory framework should minimize adverse effects on competition and encourage competition.
- > The regulatory framework should clearly define the power of the regulator and the permissible activities of NBFIs.
- > Similar risks and functions should be supervised similarly to minimize scope for regulatory arbitrage.
- > The links between NBFIs and other players in the financial sector should be closely monitored.
- > The unique risks of NBFIs should be recognized within the supervisory structure and when defining prudential norms.
- > Supervision should be proportionate and consistent with costs and benefits.

PRINCIPLE 2

ESTABLISH A SOUND, COMPREHENSIVE, ENFORCEABLE AND FAIR LEGAL FRAMEWORK



In this section, the additional legal framework, other than the legal framework for the regulatory structures, are addressed. These frameworks deal with defining different contractual types (e.g. leasing and factoring) and the obligations of the involved parties in such an agreement, as well as the legal processes for debt review and insolvency proceedings.

A legislative framework for leasing should:¹⁹

- > Clarify rights and responsibilities of the parties to a lease;
- > Remove contradictions within the existing legislation;
- > Create non-judicial repossession mechanisms; and
- > Ensure only the necessary level of leasing industry supervision and licensing.

Strengthening the legal framework for leasing can be achieved through a specialized leasing law combined with appropriate changes in related legislation. Among others, the definition of leasing needs to be clear and a fair balance established between the rights and responsibilities of the parties to a lease. It is important to establish regulations for other forms and types of leasing, such as sale & leaseback and sub-leasing. In addition, a leasing law should address the following elements:

- > The process for registering leased assets should be defined and strengthened.
- > Repossession procedures need to be defined and be made enforceable.
- > Tax rules should be clear and neutral, removing any bias against leasing. Tax rules should reflect that a leasing operation is a financial service, not the sale or a rental of a good.
- > Insolvency regimes must clarify the rights of lessors and lessees under bankruptcy. Lessors' rights under bankruptcy should be preserved - leased assets should be returned to the lessor.

18 IMF (2005), *Assessing the Supervision of Other Financial Intermediaries*

19 IFC (2011), *SME Finance Policy Guide*

The International Institute for the Unification of Private Law (UNIDROIT) has published a Model Law on Leasing,²⁰ which can serve as a useful starting point when considering establishing or strengthening countries' leasing laws.

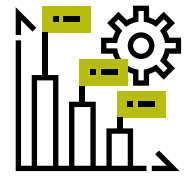
> **Factoring only requires the legal environment to sell**, or assign, receivables and depends relatively less on the business environment than traditional lending products. Another merit of factoring is that the factored receivables are removed from the bankruptcy estate of the seller and become the property of the factor. In this case, the quality and efficacy of bankruptcy laws are less important than it would have been if the receivables were still the property of the seller, as it would be under a loan agreement.

The United Nations Commission on International Trade Law's (UNCITRAL) work on secured transactions,²¹ the UNCITRAL Model Law on Secured Transactions, could serve as a useful guide when considering strengthening the legal environment.

- > **The legal framework should include a comprehensive and transparent debt review and insolvency regime:**
- > **Based on the objective of balancing the need to protect creditors' rights** (e.g. through liquidation) and maintaining productive capacity, and thus, jobs (reorganization or restructuring an enterprise).
- > **Make provision for the different stages of the debt review and insolvency regime:**
 - Out-of-court workouts (debt reviews)
 - Pre-insolvency proceedings
 - Specialized insolvency proceedings for MSMEs with risk-appropriate processes, reducing cost and legal resources to reach finality.

PRINCIPLE 3

MARKET CONDUCT/ CLIENT PROTECTION



- > **All providers of access to finance for MSMEs**, including all providers of alternative mechanisms, should be covered by market conduct regulations, with appropriate oversight to ensure compliance with the regulations.
- > **The regulations should cover minimum disclosure requirements**, full product explanation and ensure that the product is matched to user's needs. This is required for all credit providers, but specific attention should be given to the need for digital access to credit, which should be provided in a fair and transparent manner.
- > **Consideration should be given to protecting investors** as well, especially in situations where investors can participate directly in digital access to finance, as is the case for P2P and crowdfunding services.
- > **Dispute resolution mechanisms**, e.g. ombudsman structures, should also be available for alternative finance mechanisms.

20 UNIDROIT (2008), Model Law on Leasing

21 UNCITRAL (2016), Model Law on Secured Transactions & UNCITRAL (2020), Practice Guide to the Model Law on Secured Transactions



Uzbek trader selling clothes in the Margilan market in the Fergana valley, Uzbekistan. (Photo by rchphoto/iStock)

PRINCIPLE 4

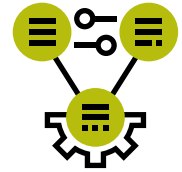
CREDIT INFRASTRUCTURE



- > **An efficient and inclusive credit information system is a crucial element in the granting of credit.** The system should be available to all providers of access to finance, including the providers of alternative finance mechanisms. These providers should contribute data to the credit information system to ensure that the system is as comprehensive as possible. An inclusive credit information system implies that all information relating to the use of credit, both positive and negative, should be included.
- > **The credit information systems should ideally incorporate alternative data**, i.e. data not directly derived from the application for and use of financing mechanisms, e.g. it could include digital payments and receipts. This will allow alternative credit providers that are not depending on collateral to better assess credit for MSMEs with limited traditional credit information.
- > **A well-functioning credit guarantee scheme is required to extend the reach of traditional credit providers** through effective management of credit (i.e. default) risk. Such a scheme could also be used to strengthen the credit market engagement of some of the alternative credit providers, particularly NBFIs.

PRINCIPLE 5

OUTREACH AND MARKET ENGAGEMENT



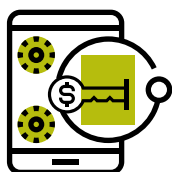
- > **The survey highlighted the lack of awareness of what is available to MSMEs in the access to finance ecosystem.** The level of awareness is a major contributing factor to the low use of some of the alternative mechanisms that are available. This requires a concerted and coordinated effort to address. Authorities should therefore ensure that a particular entity is tasked with the responsibility to inform the MSME sector of all available access to finance mechanisms. The specific situation in a country will determine which entity is best placed to fulfil this role. The communication effort should include capability building to guide MSMEs to a situation where these enterprises are in a position to match access to finance mechanisms to their particular needs, improving the beneficial use of these mechanisms. It is crucial that this outreach is operationalized in such a manner that coordination with MSME business development services (BDS) is achieved. BDS encompasses far more than informing the sector of what is available in terms of access to finance, but this aspect should be aligned with these services to ensure maximum coverage and beneficial use.
- > **The communication should address the issue of the possible lack of trust in alternative finance providers.** As all providers should at least be licensed and subject to some regulatory oversight, this should be communicated to improve trust in and the use of the alternative finance systems.



Hat aking, Fiji. (Photo by kazsano/iStock)

PRINCIPLE 6

DATA PROTECTION AND CYBERSECURITY RISKS



Authorities should:²²

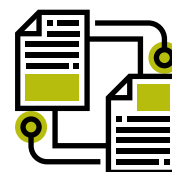
- > **Minimize the risks associated with the increased digitalization of MSMEs**, particularly by ensuring data protection and privacy rights through appropriate legal frameworks. Operationally, authorities should take cognizance of and manage cybersecurity risks for the credit industry, including alternative finance providers and credit information systems.
- > **Create data privacy regulations that guarantee there are appropriate rules for the use, security, and control of MSMEs' data.** The regulations should ensure that data from MSMEs is protected and only disclosed and shared with other parties when that would benefit market transparency and improve access to finance. This is crucial for the efficient operation of the alternative finance market, particularly for digital credit providers.
- > **Design national data security strategies, with MSMEs as a specific segment.** These strategies should ensure cooperation and information sharing on threats and incidents with national agencies that are active in the field of cybersecurity.



Mobile Payment. China. (Photo by Asia-Pacific Images Studio/iStock)

PRINCIPLE 7

COORDINATION WITH OTHER REGULATORS AND MINISTRIES



- > **The development of the MSME sector, to reach its potential as the primary driver of economic development**, requires a concerted development effort across multiple ministries, statutory organisations and the private sector. Although it is typically not the regulatory authorities that should act as the coordinator, the regulator(s) should ensure that such coordination takes place and actively participate in the development efforts according to the mandate(s).
- > **Where there are multiple financial regulators, e.g. banking and NBFIs regulators, active coordination is required on a variety of issues:**
 - Coordinated development of the access to finance ecosystem for alternative mechanisms.
 - Development and extending the credit information infrastructure.
 - Promoting and overseeing market protection.
 - Ensuring consistency in regulation and licensing requirements to ensure that no regulatory arbitrage takes place.
- > **As noted in the survey, informality is a significant factor among MSMEs and contribute to the lack of access to finance, including alternative finance.** Authorities should develop a clear roadmap to guide MSMEs to greater formality. Such a strategy should be developed with input from the informal sector. The input should be gender-balanced and should be used to determine what hurdles such enterprises face on the path to formality and whether women-owned MSMEs face specific challenges.

22 GPFI (2020), Promoting Digital and Innovative SME Financing

PRINCIPLE 8



AUTHORITIES SHOULD ENSURE THAT GRANTS (FROM GOVERNMENTS AND OTHER SOURCES) ARE MANAGED IN A MANNER THAT IS BENEFICIAL TO THE TARGET MARKET

- > Grants, as is evident from the results of the survey, remain one of the most important sources of alternative funding for MSMEs.
- > It is important that grant schemes should be established with a clear objective and are well-managed to ensure that the objective is met in a measurable manner. The objective should relate to a specific target market and a specific timeframe, i.e. it should not be a general or perpetual grant scheme.
- > Grants should be allocated on a sound basis, e.g. to enterprises that are in a position to utilize such funding; not to already over-indebted enterprises.
- > Ideally the impact of the grant scheme should be measured in an objective manner.
- > Care should be exercised to ensure that grant schemes do not distort or disrupt the access to finance market, e.g. by establishing a culture of non-repayment.

PRINCIPLE 9



DEVELOPMENT OF THE CAPITAL MARKET IN A MSME-FRIENDLY MANNER

A number of the alternative funding mechanisms rely directly on the capital market. These mechanisms potentially provide access to a significant additional source of funding, but it requires the capital market to develop to a level of maturity where MSME-specific access is possible, e.g. for equity financing, angel investors and venture capital.

Equity financing, for MSMEs, for example, is premised on the existence of a well-regulated and professionally supported stock exchange, with active participation from institutional and private investors.

A well-developed insolvency regime, as described in Principle 2, is a prerequisite for all forms of equity-based financing.







Moroccan shopkeeper. Zagora, Morocco. (Photo by Photo Cheryl Ramalho/iStock)



COUNTRY EXAMPLES OF ALTERNATIVE MSME FINANCE REGULATIONS AND INTERVENTIONS

The table below gives some examples of what a number of countries are doing or are busy implementing, relating to alternative SME finance. The table focuses on the AFI network, but informative examples from other countries are also included.

AFI NETWORK




COUNTRY	RESPONSIBLE AUTHORITY	AREA OF FOCUS	DESCRIPTION
CHINA 	Financial services regulator	P2P marketplace lending	<p>Before 2015, P2P/Marketplace lending firms in China could test their new business activities without immediate regulatory response from the regulator. The result was an explosion of such firms in the country, with more than 3,000 emerging in less than two years. However, this tremendous growth created significant risks related to platform failures and fraudulent activities, with the regulator determining that approximately one-third of all P2P/Marketplace lending platforms were ‘problematic’, many of them conducting fraudulent activities. The central bank, the People’s Bank of China and China Bank and Insurance Regulatory Commission initiated a sweeping rectification program to regulate P2P/Marketplace lending. Under the new rules:</p> <ul style="list-style-type: none"> > Microlenders are not allowed to extend online microloans when proceeds are not earmarked for a specific purpose. > Financial institutions cannot provide funding to marketplace lenders for their loans. > All P2P/Marketplace lending platforms must become small loan providers (i.e. licensed providers) within two years. > Lending platforms must meet a minimum capital requirement of \$7 million to become a regional small loan provider and \$141 million to transition into a small lender qualified to operate nationwide. > All marketplace lenders must adhere to AML/CFT obligations. <p>P2P/Marketplace lenders that contained serious credit risks and fraudulent ones would be banned from making the transition and forced to close.²³</p>
FIJI 	Ministry of Commerce, Trade, Tourism and Transport	MSME development and outreach	<p>The Government of Fiji realized that a central coordinating agency to support MSME development is required to ensure that the necessary support and guidance reaches MSMEs to enable growth and sustainability. The agency ‘MSME Fiji’ was established as a Department under the Ministry with the purpose to “implement, monitor and evaluate MSME development in collaboration with various stakeholders”.</p> <p>In particular, MSME Fiji will aim to improve MSMEs access to finance and access to business training services. Pertinent issues, such as addressing financial capability and informality will be part of the work of the agency.²⁴</p> <p>A separate Act dealing with MSMEs only, is also under development. Currently, the business of MSMEs fall under the Companies Act, which does not adequately address MSME-specific issues.</p>

COUNTRY	RESPONSIBLE AUTHORITY	AREA OF FOCUS	DESCRIPTION
KENYA 	Various financial regulatory authorities	Regulatory cooperation	<p>There are 5 regulatory authorities in Kenya, each regulating a particular segment of the financial system. In terms of MSME access to finance, the banking sector with the Central Bank of Kenya (CBK) as regulator, sacco societies with the Sacco Societies Regulatory Authority (SASRA) as regulator and the securities market with the Capital Markets Authority as regulator are the sectors that are most relevant. It is crucial that the regulators coordinate their interventions and regulatory objectives, particularly as the markets develop to alternative mechanisms and structures, e.g. alternative MSME access to finance. This alignment is ensured through a structural involvement of each regulator in the board of the other regulators. For example, the governor of CBK sits on the board of SASRA.</p>
MALAYSIA 	Securities Commission Malaysia (Suruhanjaya Sekuriti Malaysia)	Licensing of alternative MSME financing providers in the capital market	<p>The Securities Commission licenses all participants in recognized markets, based on the Capital Markets and Services Act 2007 (CMSA). The CMSA introduced a single licensing regime for capital market intermediaries. Under this regime, a capital market intermediary needs one license to carry on the business in any one or more of the regulated activities. The Securities Commission</p> <p>Publishes Guidelines for the recognized markets,²⁵ with regular amendments.²⁶ Currently, the Commission recognizes the following markets, with the number of licensed participants shown in brackets:</p> <ul style="list-style-type: none"> > e-Services (3) > Equity crowdfunding (10) > Peer-to-peer financing (11) > Digital asset exchange (3) > Property crowdfunding (1)
	CapBay (FinTech company)		<p>CapBay²⁷ is a supply-chain financing and P2P lending service provider. It provides services to assist MSMEs to manage their cash flow through their payables and receivables. The services include invoice financing, invoice factoring and contract financing. A key aspect of the services is the integration into supply chains, achieved through two of CapBay's business units focusing on technology solutions and platform services. Both these entities are also regulated by the Securities Commission.</p> <p>For example, CapBay integrated its services with TheLorry, an online logistic platform,²⁸ This resulted in an integrated service that enabled MSMEs in the logistics space access to affordable and collateral-free financing. It began as a pilot project under United Nations Capital Development Fund's Financial Innovation Lab, in collaboration with Malaysia Digital Economy Corporation, Bank Negara Malaysia and Metlife Foundation. It is now a fully operational service.</p> <p>CapBay itself is supported by venture capital.</p>

COUNTRY	RESPONSIBLE AUTHORITY	AREA OF FOCUS	DESCRIPTION
MEXICO 	NAFIN Development Bank	Factoring	<p>Nacional Financiera (NAFIN) is a Mexican development bank that created an online platform for financial intermediaries to provide factoring services to SMEs. In 2001 NAFIN established and launched a program called Cadenas Productivas (Productive Chains) to facilitate factoring services to SMEs through the online platform.</p> <p>The program works by creating chains between large buyers and their suppliers. The buyers participating in the program invite suppliers to join their chain. Buyers are typically large and creditworthy firms. Suppliers are typically small and less-established firms that have difficulty accessing credit from commercial lending institutions. The program enables these firms to acquire working capital financing via factoring transactions with participating private financial institutions. All transactions are carried out on the electronic platform.</p> <p>Once a supplier delivers goods to the buyer and issues an invoice, the buyer posts an online negotiable document equal to the value of the receivable on its NAFIN webpage. Participating financial institutions that are interested in factoring the receivable will then post their interest rate quotes for the transaction. The supplier can access this information and choose the best quote. Once the factor is chosen, the amount of the discounted receivable is transferred to the supplier's bank account.²⁹</p>
	National Banking and Securities Commission (CNBV)	Open banking	<p>Open banking can enable SMEs to gain access to finance more easily and also aid in their digital transformation. Mexico has established an open banking regulatory framework as part of the FinTech Law introduced in 2018. Like the Open Banking Standard of the United Kingdom, Mexico's open banking regulation promotes protection of consumer data and fosters competition. However, a major difference is that the Mexican open banking regulation not only applies to the banking sector, but also to all financial institutions and all financial transactions. In addition, Mexico's open banking framework makes the introduction of open APIs mandatory, increasing efficiency and accessibility.²³</p>
MOROCCO 	Bank al Maghrib	Factoring	<p>In Morocco, factoring operations qualifies as credit transactions. Factoring operations are regulated by the banking regulator (Bank al Maghrib), which issues licenses for performing factoring activities and supervises their activities. Banking business is restricted to licensed credit institutions (banks and financing companies), so these are the institutions that offer factoring services.</p> <p>The license granted will vary with the activity that is applied for and can be limited to specific banking transactions, such as factoring operations. Capital adequacy requirements as per Basel III have been implemented in Morocco. Credit institutions, including the ones offering factoring, must comply and must report, twice a year to Bank al Maghrib to verify that they are compliant.³⁰</p>

OTHER COUNTRIES

COUNTRY	RESPONSIBLE AUTHORITY	AREA OF FOCUS	DESCRIPTION
ABU DHABI, THE UNITED ARAB EMIRATES 	Financial Service Regulatory Authority (FSRA)	Digital banking	<p>The FSRA introduced a digital banking license to extend the range of providers and to utilize digital technology developments. Three types of providers are enabled:</p> <ul style="list-style-type: none"> > Traditional banks looking to develop a digital arm; > FinTech companies with an innovative value proposition; > Partnerships between FinTech and financial institutions. <p>The digital banks will only be allowed to set-up and operate in Abu Dhabi Global Market and they need a minimum paid-up capital of \$10 million. To support the open banking architecture of such digital banks and facilitate innovation with FinTech firms, guidance on technology and data standards for the development and use of APIs was issued, enabling different systems to connect and share data securely.²³</p>
BRAZIL 	National Monetary Council (CMN)	Equity crowdfunding and P2P lending	<p>The CMN issued a resolution to increase accessibility to equity and P2P financing in 2018. The resolution provides for the creation of two new types of financial institutions to fund clients through electronic platforms:</p> <ul style="list-style-type: none"> > Direct credit companies are allowed to fund their loans exclusively through equity capital. > P2P loan companies are allowed to connect lenders and borrowers and to intermediate the negotiation through digital platforms. <p>The licensing process is simplified compared to that of a traditional financial institution. These companies can operate independently, without collaborating with traditional banks.²³</p>
	Central Bank of Brazil (BCB)	Collaborative innovatio	<p>BCB and the National Federation of the Central Bank Employees Association created a multi-jurisdictional sandbox model, with features to accelerate innovation through collaboration. The Laboratory of Financial and Technological Innovation (LIFT), launched in 2018, is a “sectoral sandbox” that fosters innovative technological solution prototypes for the Brazilian financial market.</p> <p>LIFT is based on an open architecture platform where FinTech, technology companies and financial institutions can collaborate on new product and services in an experimental environment without consumers. According to the creators of LIFT, “The intention is to create a continuous process of proposition, appreciation and development of ideas to strengthen the innovation ecosystem in the financial system.”²³</p>

COUNTRY	RESPONSIBLE AUTHORITY	AREA OF FOCUS	DESCRIPTION
SAUDI ARABIA 	Capital Market Authority	Equity crowdfunding	<p>The crowdfunding model in the Saudi financial marketplace is equity-crowdfunding, supervised by the Capital Markets Authority (CMA). Saudi Arabia has taken an experimental approach to regulating this market. The CMA granted experimental permits to two equity crowdfunding platforms: Manafa and Scopeer. Under the equity crowdfunding regulations:</p> <ul style="list-style-type: none"> > The platforms need to meet AML/CFT requirements; > Only small businesses with a market valuation of less than about \$2.5 million can raise funds through equity crowdfunding; > Investor limits apply, with a minimum of about \$250 and a maximum investment limit of \$25 000 in five investment opportunities. <p>The equity-crowdfunding regulation is helping SMEs raise capital in Saudi Arabia from a source other than banks and venture capital firms.²³</p>
SINGAPORE 	Singapore Government	SME digitization	<p>The SME Go digital program set up by the Singapore government is a comprehensive digital transformation programs for SMEs, in partnership with telecommunications, financial services, and technology providers. Launched in 2017, the program aims to help SMEs use digital technologies and establish digital capabilities to seize growth opportunities. A study performed in Singapore in 2019 shows that the use of digital technologies, such as e-commerce, digital payments, AI/ML, and Big Data analytics can increase SME's added value and productivity by 26 percent and 17 percent, respectively. The SME Go Digital program provides a step-by-step guide on how to adopt digital solutions at each stage of their growth by using Industry Digital Plans (IDPs). The IDPs provide a roadmap to digitalization for SMEs in a particular industry or sector. The SME Go Digital program has supported more than 15,000 SMEs and numerous small businesses have been able to significantly increase their productivity and profitability by digitalizing their operations, enabling greater leverage for increased funding for future growth and expansion.²³</p>
TURKEY 	Banking Regulation and Supervision Agency (BSRA)	Leasing, factoring & financing	<p>Financial leasing, factoring and financing companies in Turkey are regulated by the BRSA. Any legal entity wishing to provide any of the services falling under the scope of financial leasing, factoring or financing in Turkey is required to obtain permission from the BRSA to operate. The Law on Financial Leasing, Factoring and Financing Companies Nr 6361 published in 2012 provides the legal framework.</p> <p>It regulates the establishment and operating principles of financial leasing, factoring and financing companies operating as financial institutions. The Law defines what constitutes a leasing contract, what the activities for factoring are and what the scope of financing is. Minimum capital of nearly \$4m is required with registration.³¹</p>

22 GPF (2020), Promoting Digital and Innovative SME Financing

24 Government of Fiji (2020), Micro, Small, and Medium Enterprise Fiji - Policy Framework

25 <https://www.sc.com.my/development/digital/list-of-registered-recognized-market-operators>

26 Securities Commission (2020), Guidelines on Recognized Markets

27 <https://capbay.com/>

28 <https://capbay.com/capbay-partners-with-thelorry-to-offer-inclusive-financing-for-sme-lorry-drivers/>

29 WBG (2017), Innovative Experiences in Access to Finance

30 EBRD (2016), Factoring Survey in EBRD Countries of Operation

31 Cosar & Akkaya Law Firm, Financial Leasing, Factoring and Financing Companies in Turkey

CONCLUSION

The survey and the report confirmed the need for alternative finance mechanisms and sources for MSMEs. Traditional finance will not significantly reduce the MSME finance gap, for a variety of reasons. These require longer-term interventions to remove constraints and to make finance more accessible to MSMEs, hence other solutions are required to address the MSME financing requirements.

The MSME needs are immediate, exacerbated by the COVID-19 pandemic, and necessitates shorter-term solutions. The alternative MSME finance ecosystem is still in a developmental phase in most countries. This gives authorities the opportunity to consider strengthening and extending this ecosystem in a country-specific manner, addressing the most immediate needs in the country. At the same time, strengthening the overall MSME finance ecosystem should still be an objective, as it is required for both traditional and alternative MSME financing.

Countries wishing to strengthen their alternative finance ecosystems and to promote take-up and use of these mechanisms, could consider the following steps:

- > **Assessing of the current state of MSME financing**, the MSME gap and the reasons for the gap within their country context;
- > **Evaluating what financing mechanisms are available** and what the maturity of the alternative finance sector is, i.e. what is possible;
- > **Mapping which mechanisms and providers should be enabled/further enabled** to have the biggest impact on the finance gap and the most urgent needs of MSMEs;
- > **Strengthening the regulatory framework** to accommodate the additional alternative finance mechanisms while mitigating identified risks;
- > **Ensuring that the supporting systems are in place** to assist MSMEs in the awareness of and the beneficial access to alternative financing;
- > **Establishing a feedback loop** to determine the impact of extending alternative financing (measurement and evaluation).

These steps will lead to improving MSME access and use of finance, resulting in improved sustainability and growth of the sector. This in turn will positively contribute to increased employment and national economic development.



Market Vendor at Central Market in Alausí, Ecuador. (Photo by Photo ampueroleonardo /iStock)

ANNEXURE A: DETAILED RESPONSES TO THE SURVEY

1. INTRODUCTION

The MSME funding gap of nearly 60 percent of the potential MSME demand for finance²³ is of major concern. There are a multitude of reasons why the gap exists, including:

- > Stringent loan criteria from traditional credit providers, e.g. banks. This in itself is the result of the prudential requirements by banks, insufficient credit information on MSMEs, insufficient collateral offered by MSMEs and a perception of high risk associated with MSMEs resulting in high interest rates.
- > The credit infrastructure that supports and informs credit providers is often insufficient and does not address MSME-specific need.
- > The legal environment may not be sufficiently developed to provide predictable, fair and efficient protection of creditors' (and debtors') rights, adding to the reluctance of credit providers to extend their activities into the MSME segment.
- > The business capability of some MSMEs is often of concern to credit providers, as it impacts the sustainability of the enterprises.
- > Informality of MSMEs is a hindrance to accessing finance from any regulated provider.

Realizing that these issues cannot be solved in the short term, the Alternative Finance Working Subgroup in AFI decided to explore other sources of funding that could be available to MSMEs. Thus, the idea to explore alternative financing options for MSMEs, other than the mainstream banking sector, was formulated. The goal was to produce a knowledge product that would provide guidance on various alternative financing mechanisms that the MSMEs may utilize to address the existing funding gap.

To achieve this, the Subgroup came up with a set of questions, which was administered to members through a survey in August 2019. A total of 71 responses were received, with 44 sufficiently completed for analysis. The survey focused on 16 alternative finance mechanisms available in AFI member countries. These are listed in Question 3 below.

This Annexure provides an analysis of the responses received from the survey.

2. THE TEAM MEMBERS

The Alternative Finance Working Subgroup consists of the following team members:

Name	Institution	Country
Peter Owira (Leader)	Sacco Societies Regulatory Authority (SASRA)	Kenya
Jason Barrantes	General Superintendent of Financial Institutions (SUGEF)	Costa Rica
Gul Badshah	Da Afghanistan Bank	Afghanistan
Olga Ilyukevich	National Bank of the Republic of Belarus	Belarus
Ugyen Choden	Royal Monetary Authority of Bhutan	Bhutan
Marie Thérèse	Banque de la République du Burundi	Burundi
Ismail Adam	Bank of Ghana	Ghana
Elijah Osha/Sale Lukman A.	Central Bank of Nigeria	Nigeria
Kalubi Kayembe/ Kikata Kiowe Cynthia	Banque Centrale du Congo	Democratic Republic of the Congo
Jan Ullah Zahir	Da Afghanistan Bank	Afghanistan

3. ANALYSIS OF THE SURVEY RESPONSES

The responses to the questions are summarized below, in the order of the questions posed in the survey.

1. What is the current funding gap/credit gap (in volume) for the MSMEs in your country relative to the level of MSMEs lending?

The objective was to identify the existing funding/ credit gap in the member institutions' countries. None of the respondents gave an estimate, pointing to the lack of information about the extent to which MSME's' funding needs are not met.

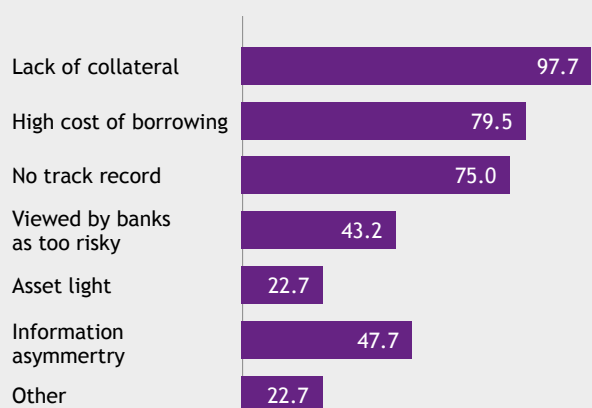
2. What are the challenges faced by MSMEs in getting funding from traditional formal financial sector?

Lack of collateral is the major reason amongst the

23 IFC 2017), MSME Finance Gap

challenges faced by MSMEs, with nearly all respondents indicating that this is a problem (see Graph 1 below). The high cost of borrowing and the lack of a track record (i.e. insufficient information) were mentioned by nearly 80 percent of respondents. Being asset light was the challenge mentioned least. Others notable challenges include lack of knowledge, lack of suitable products and geographical restrictions.

ANNEXURE 1 GRAPH 1: CHALLENGES FACED BY MSMEs IN GETTING FUNDING



The % of the respondents mentioning a specific challenge is depicted. Multiple responses possible

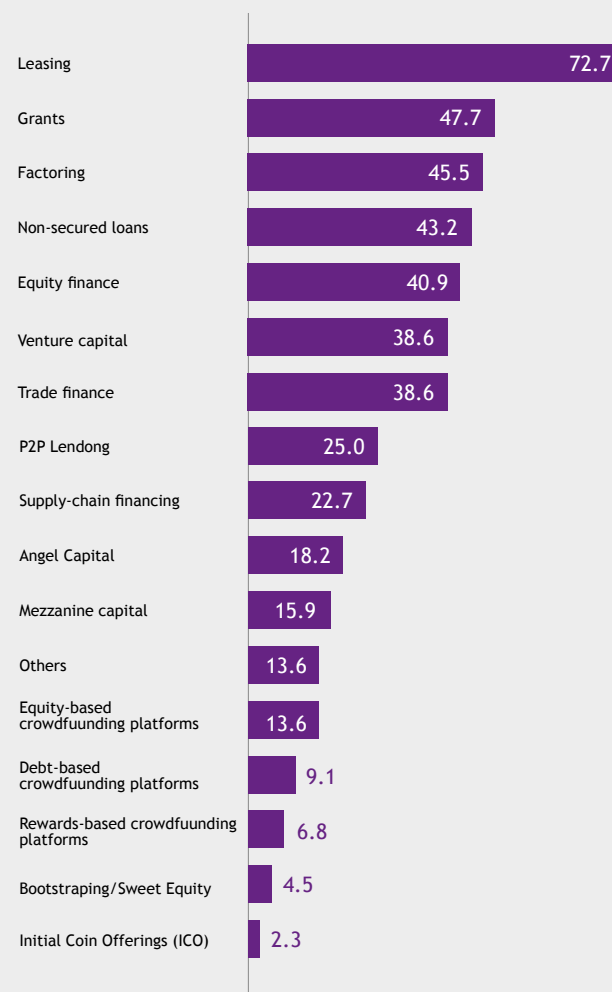
3. WHICH OF THE FOLLOWING SOURCES OF ALTERNATIVE FINANCE ARE OFFERED IN YOUR COUNTRY?

It is informative to note that most countries only offer a few alternative finance products, as can be seen from the table below. This indicates that the alternative MSME financing landscape is in various phases of development in member countries and is not yet a mature market that MSMEs can benefit from. Only a few countries have established a variety of alternative mechanisms.

Number of alternative finance mechanisms	Number of countries
None	3
1 to 4	22
5 to 8	15
9 to 12	3
13 and above	1
Total	44

Malaysia has thirteen alternative financing mechanisms other than the traditional formal bank. Thailand, Philippines and Costa Rica have between 9 and 12, while Vanuatu, Bhutan and Ecuador currently have no alternative sources of funding.

ANNEXURE GRAPH 2: ALTERNATIVE FINANCE MECHANISMS AVAILABLE



The % of respondents indicating that a particular funding mechanism is available is depicted. Multiple responses possible.

From the Graph 2 above, it can be seen that leasing is the most common alternative source of financing, followed by grants and factoring. Bootstrapping/sweat equity and Initial Coin Offering (ICO) are the least frequently mentioned alternative finance mechanisms, with only Thailand mentioning ICOs while bootstrapping/sweat equity is only mentioned by Samoa and Seychelles.

4. FROM THE ABOVE ALTERNATIVE FUNDING SOURCES, WHICH ONES ARE BEING UTILIZED BY THE MSMEs IN YOUR COUNTRY?

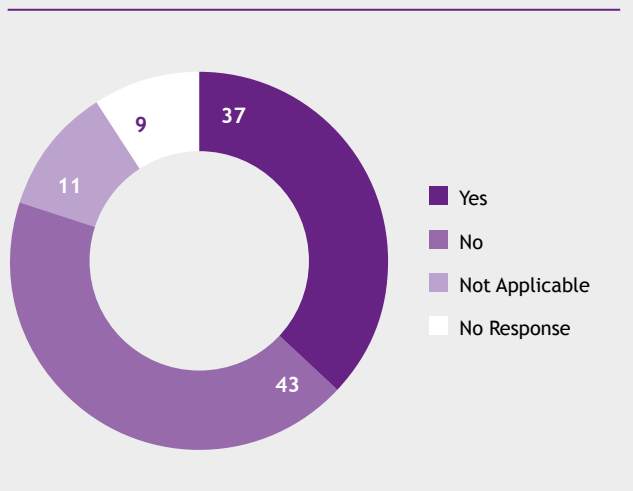
The availability of an alternative finance mechanism in a country does not guarantee use by MSMEs. This can be seen in Graph 3 below. There is no alternative MSME finance mechanism that is always taken up when it is available. Three mechanisms (rewards-based crowdfunding, bootstrapping and ICOs) are not being used by MSMEs at all. There are a few mechanisms, notably trade finance, supply chain financing, angel capital and P2P lending, that appear to be readily taken up if available. Graph 3 below illustrates the gap between availability and use of alternative finance mechanisms by MSMEs.

5. ARE THERE ANY SPECIFIC REGULATIONS ISSUED BY THE REGULATORY AUTHORITY IN YOUR COUNTRY FOR THE ALTERNATIVE FINANCING SOURCES YOU MARKED?

The responses to this question are summarized in Graph 4 below.

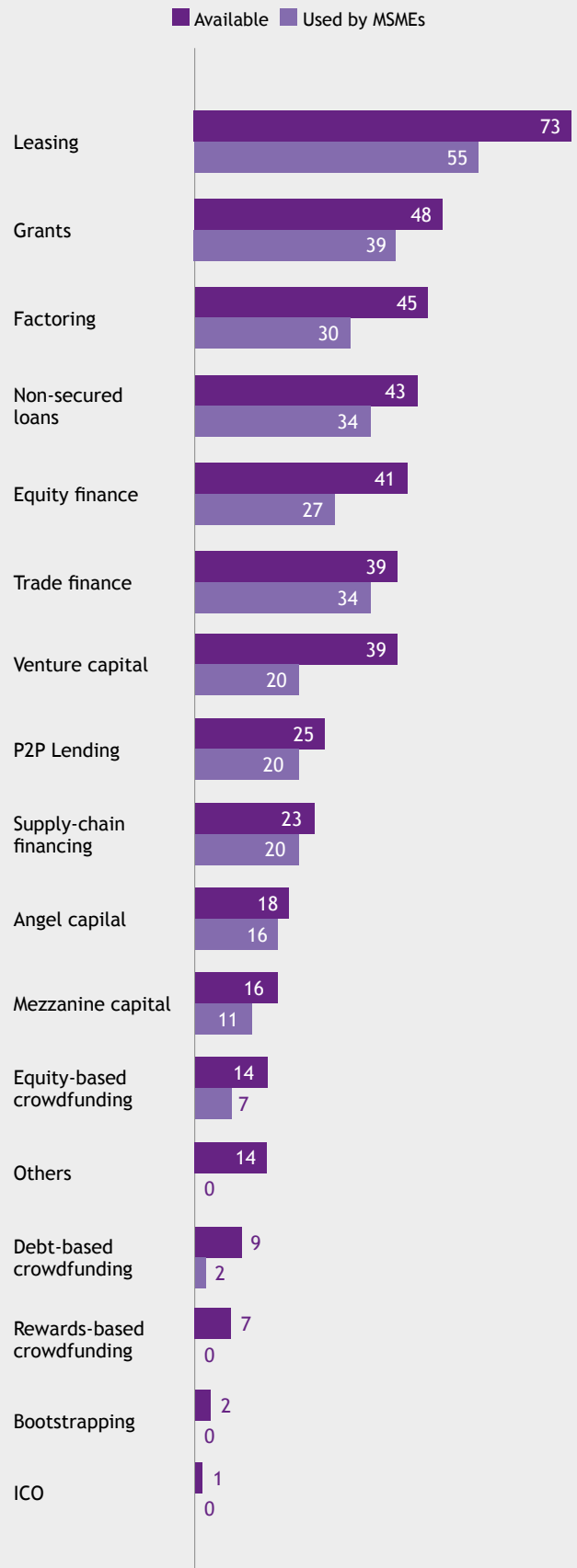
Only 37 percent of respondents indicated that there are specific regulations for the alternative financing mechanisms in their countries, with the majority indicating that there are no regulations in place or that the question is not applicable or simply did not provide a response. This also indicates that alternative finance is still in a developmental phase in most countries. It should be noted that lack of regulation of a specific set of providers, or inadequate regulation, is often associated with a lack of trust in those providers.

ANNEXURE GRAPH 4: SPECIFIC REGULATIONS FOR ALTERNATIVE FINANCING?, %



The graph shows the % of respondents

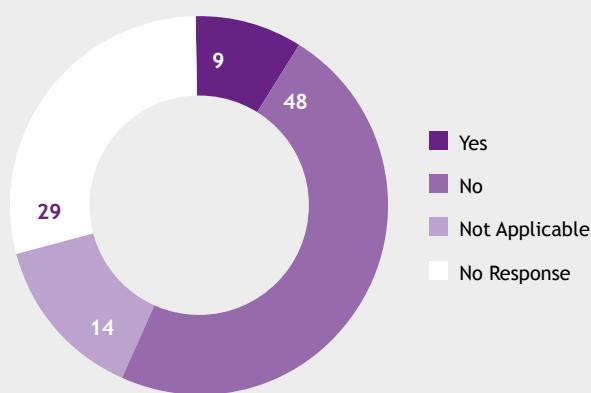
ANNEXURE GRAPH 3: ACCESS TO ALTERNATIVE FINANCE MECHANISMS



6. IS YOUR INSTITUTION OR OTHER REGULATOR/ AUTHORITY WORKING ON A NEW REGULATION FOR ALTERNATIVE FINANCE SOURCES AT THIS MOMENT?

Only 9 percent of the respondents are working on a new regulation for alternative finance sources, 48 percent are not working on any regulations, 14 percent of respondents found the question not applicable while 29 percent equivalent to 13 respondents did not respond. This is largely a consequence of the status of development as remarked in the previous section.

ANNEXURE GRAPH 5: CURRENTLY WORKING ON REGULATIONS FOR ALTERNATIVE FINANCING, %



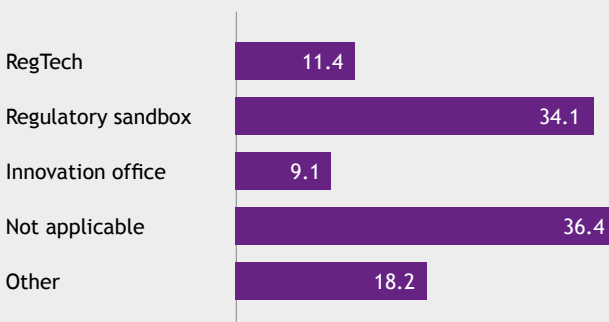
The % of respondents is shown in the graph

7. WHAT IS THE APPROACH YOUR INSTITUTION TAKES IN DEVELOPING THE REGULATION FOR ALTERNATIVE FINANCE?

Regulatory sandbox was the approach mentioned most often by respondents, although it was mentioned by only 34 percent (see Graph 6 below). RegTech and an innovation office were mentioned by about 10 percent of the respondents as well. Research and landscape mapping were mentioned to a lesser extent.

The % of respondents mentioning an approach is shown in the graph. Multiple responses possible

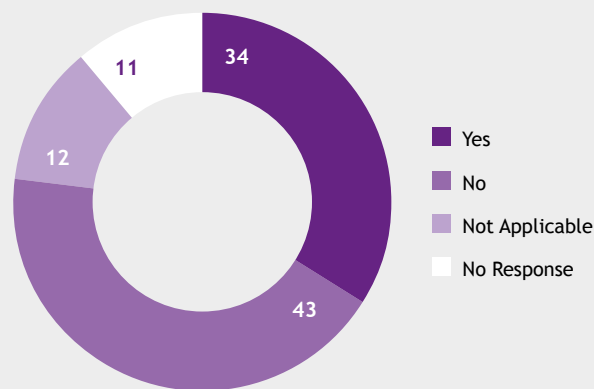
ANNEXURE GRAPH 6: INSTITUTIONAL APPROACH TO DEVELOPING ALTERNATIVE FINANCING REGULATIONS, %



8. IS THERE SPECIFIC INFRASTRUCTURE, INCLUDING FINTECH FACILITIES, IN YOUR COUNTRY FOR ALTERNATIVE FINANCE PROMOTION?

Graph 7 summarizes the response to this question.

ANNEXURE GRAPH 7: AVAILABILITY OF SPECIFIC INFRASTRUCTURE, %



The % of respondents is shown

As could be expected from the responses in question 5 and the developmental nature of alternative MSME finance, only 34 percent of respondents cited the availability of some infrastructure. Regulations and guidelines were mentioned, such as:

- > Leasing law (and regulation)
- > Law on joint stock companies and protection of shareholder rights
- > Banking code
- > Financial Institutions Act
- > Crowdfunding regulation
- > Fund management rules and regulations
- > Guidelines on recognized markets (digital marketplaces guidelines)
- > P2P lending guidelines
- > Non-bank financial institutions laws

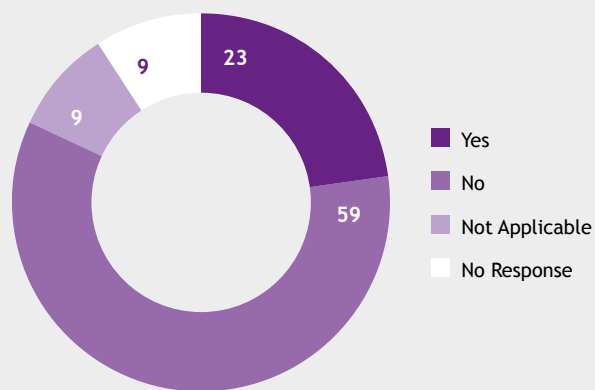
9. BESIDES FINANCING, IS THERE ANY OTHER 'ENABLER' THAT LEVERAGES BIG DATA IN FACILITATING CREDIT FINANCING TO MSMEs IN YOUR COUNTRY? (E.G. THE USE OF PSYCHOMETRICS TO ASSESS THE CREDIT RISK/ CREDIT UNDERWRITING)

As can be seen from Graph 8 above, the majority of respondents do not have any enabler leveraging big data. In fact, only 23 percent mention some enablers. These include the following:

- > Credit information systems
- > Credit and collateral registers

- > Utility and payment transaction data
- > Loan applications using mobile technology.

ANNEXURE GRAPH 8: ENABLERS LEVERAGING BIG DATA, %



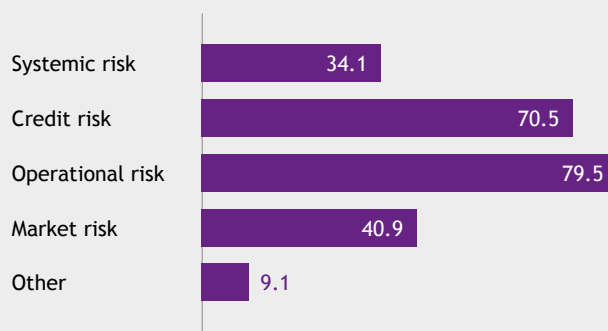
The % of respondents is shown

10. WHAT ARE THE KEY RISKS ASSOCIATED WITH ALTERNATIVE SOURCE OF FINANCING?

The members who responded to the questionnaire are well aware of the risks associated with the alternative MSME finance. Graph 9 below indicates that operational risk and credit risk are major concerns, with more than a third of respondents being of the view that alternative finance providers have to be considered from a systemic risk perspective. Some of the other risks mentioned include:

- > Reputational risk
- > Data privacy and consumer protection issues
- > Solvency risk

ANNEXURE GRAPH 9: RISKS ASSOCIATED WITH ALTERNATIVE FINANCING, %



The % of respondents mentioning a specific risk is shown. Multiple responses possible.

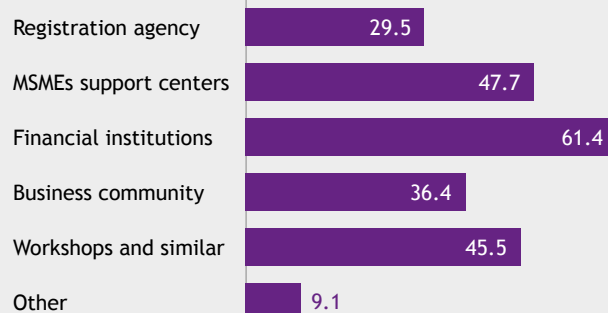
This situation points to two important intertwined

issues in the extension of alternative finance to MSMEs:

- > Regulators need additional tools to regulate and oversee the alternative sector.
- > The sector needs regulations and guidelines to reduce the risks and increase the level of trust in the sector.

11. WHAT CHANNELS OF INFORMATION ABOUT ALTERNATIVE FINANCING INSTRUMENTS ARE AVAILABLE FOR MSMEs IN YOUR COUNTRY?

ANNEXURE GRAPH 10: CHANNELS FOR INFORMATION, %



The % of respondents mentioning a specific channel is depicted. Multiple responses possible.

As can be seen from Graph 10 above, a variety of channels are used to distribute information about alternative financing to MSMEs. Not surprisingly, since financial institutions are involved in providing some of the mechanisms, these institutions are mentioned by the most respondents. There are also countries with MSMEs support centres where information can be obtained. Other channels of information include dedicated ministries, departments and registration agencies for MSMEs.

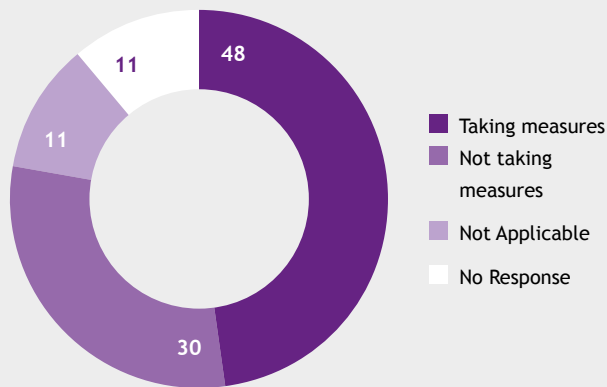
The variety of channels being used and the level of take-up (see question 4 above) indicate that MSMEs might benefit from a coordinated and resourced approach. Financial institutions, by their nature, will only focus on the mechanisms that they have available and will not necessarily inform MSMEs of other alternative mechanisms.

12. IS THE FINANCIAL REGULATOR IN YOUR COUNTRY TAKING ANY MEASURES TO INVOLVE MSMEs IN ALTERNATIVE FINANCE?

Financial regulators involve MSMEs in many countries, as depicted in Graph 11 above. This confirms that financial regulators appreciate that they have a key role to play in mainstreaming MSMEs into a country's financial system and to assist in the development of the access to finance system.

Some of the measures taken by regulators include the issuing of guidelines, enhancing credit infrastructure such as credit guarantee schemes to meet the needs of MSMEs, credit information systems recognizing the specific nature of MSMEs, regulatory sandboxes and digital platforms for lodging and developing business ideas, e.g. Jab-Chor in Bhutan.²⁴

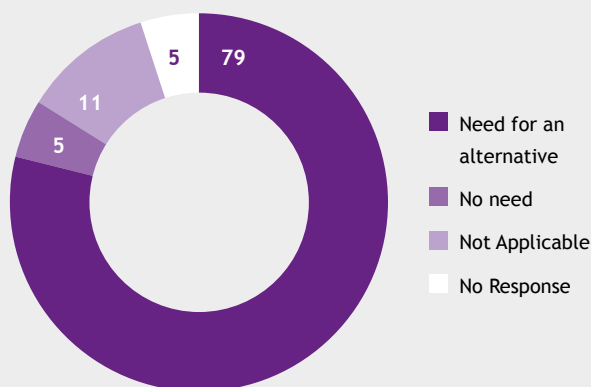
ANNEXURE GRAPH 11: MEASURES TO INVOLVE MSMEs, %



13. IS THERE A NEED FOR MSMEs TO SOURCE ALTERNATIVE FUNDING, OTHER THAN FROM COMMERCIAL BANKS?

The vast majority of respondents, nearly 80 percent, indicated the need for alternative finance mechanisms in their countries. Only 5 percent are of the view that it is not needed. This is a strong indication that regulators are of the view that the traditional sources of MSME finance, on their own, are not in a position to adequately address the MSME funding gap.

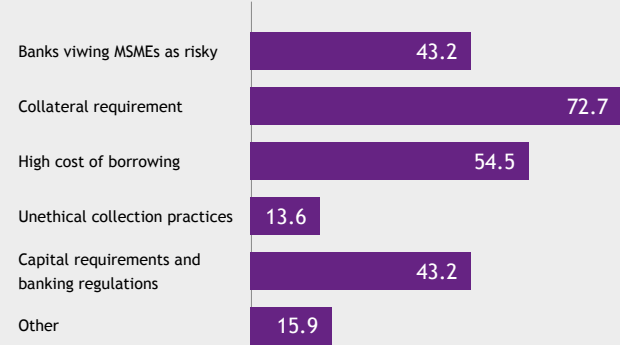
ANNEXURE GRAPH 12: IS THERE A NEED FOR ALTERNATIVE FINANCING?, %



The % of respondents is shown

14. WHY DO YOU THINK THERE SHOULD BE ANOTHER AVENUE FOR MSME FINANCING BESIDES COMMERCIAL BANKS?

ANNEXURE GRAPH 13: REASONS WHY ALTERNATIVE FINANCING IS REQUIRED, %

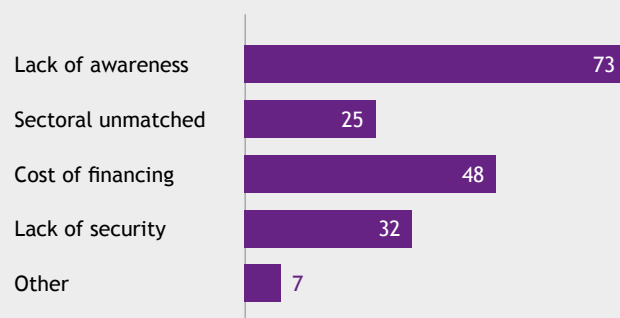


The % of respondents mentioning a particular reason is depicted. Multiple responses possible.

Graph 13 above shows that the majority of respondents (73 percent) indicate that the inability of MSMEs to provide what would be deemed to be adequate collateral as the main reason for alternative financing. The high cost of borrowing and the related issue of banks viewing MSMEs as too risky were also important responses. Among the other reasons identified are the lack of bank branches (inadequate reach) and the traditional method of banking that does not focus on MSMEs (e.g. the requirement for detailed information that MSMEs might not have available).

15. DESPITE THE AVAILABILITY OF ALTERNATIVE FINANCE PLATFORM, THE TAKE-UP IS RELATIVELY LOW. IN YOUR OPINION, WHAT ARE THE CHALLENGES IN ACCESSING THE ALTERNATIVE FINANCE AVENUE?

ANNEXURE GRAPH 14: REASONS FOR NOT TAKING UP ALTERNATIVE FINANCE, %



²⁴ Jab-Chor - a platform for young Bhutanese entrepreneurs to nurture and grow their businesses ideas through access to financing. <https://www.rma.org.bt/pressrelease/press%20release%20jabchor.docx>

The % of respondents mentioning a reason is depicted. Multiple responses possible,

Graph 14 shows that the dominant factor for the relatively low take-up of alternative financing by MSMEs is lack of awareness. This is a reflection of the efficiency of the channels of information mentioned in question 11 above and points to the requirement for improved communication. As with the previous question, the cost of financing (partially dependent on perceptions of risk) is the next most mentioned factor. Among the other reasons mentioned are the lack of information from MSMEs and the lack of innovative products for MSMEs, such as Shariah-compliant products.

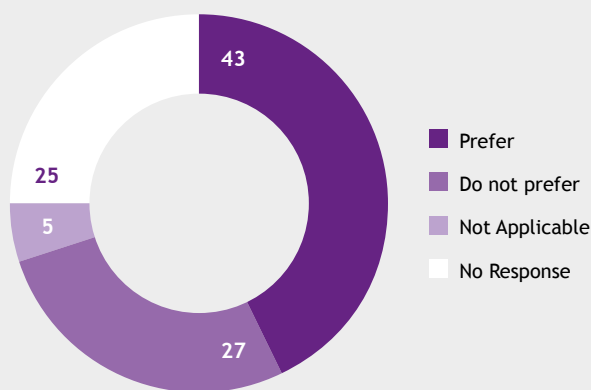
16. BASED ON Q15, FROM THE REGULATOR PERSPECTIVE, DO YOU THINK MSMEs WOULD PREFER TO GET THE FINANCING FROM THE TRADITIONAL FORMAL FINANCIAL SECTOR?

Despite the challenges mentioned in question 15, respondents were mostly of the view that MSMEs would prefer to deal with the established formal sector rather than alternatives (43 percent vs. 27 percent, as depicted from Graph 15 below). Some of the reasons advanced for this include:

- > Familiarity with existing providers.
- > Concerns about consumer protection.
- > Lack of trust in the new providers.

Even so, the frustration of MSMEs in not getting the services that they require from traditional sources was mentioned as a major issue.

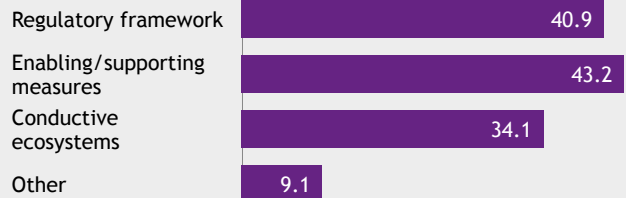
ANNEXURE GRAPH 15: MSME PREFERENCES FOR ACCESS TO FORMAL FINANCIAL SECTOR, %



The % of respondents is shown

17. WHAT ARE THE INTERVENTIONS YOUR GOVERNMENT PUT IN PLACE TO SUPPORT MSME ALTERNATIVE FINANCE?

ANNEXURE GRAPH 16: GOVERNMENT INTERVENTIONS, %



The % of respondents mentioning an intervention is shown. Multiple responses possible

Regulatory frameworks and supporting measures are the most commonly mentioned interventions by the respondents. Some governments use a combination of interventions as illustrated below, demonstrating that governments realize that ensuring MMEs have adequate access to financing is a multi-faceted issue:

One intervention	29%
Two interventions	46%
Three interventions	25%

ANNEXURE B: DEFINITIONS OF ALTERNATIVE MECHANISMS AND TERMS²⁵

ANGEL INVESTING

Angel investing refers to an individual who provides capital for a business start-up. This could be done in exchange for convertible debt or some equity share (share in ownership). Angel investors usually give support to start-ups at the initial moments (where risks of the start-ups failing are relatively high) and when most investors and formal credit providers are not prepared to provide access to funding.

BOOTSTRAPPING AND 'SWEAT EQUITY'

Bootstrapping refers to an approach to financing an enterprise by the owner(s) through personal savings, taking no income from the enterprise by retaining all income in the enterprise ('sweat equity') and establishing a cash runway. This is typically supported by lean operations and quick inventory turnover. The owner retains full control over the enterprise, but also carries significant financial risk.

CROWDFUNDING

DEBT CROWDFUNDING

Debt-based crowdfunding refers to obtaining finance through an online platform from multiple investors. It is similar in nature to P2P (see below) but could be labelled informed P2B (person-to-business). Enterprises apply online and their application is reviewed and verified by the digital platform, also determining the credit risk and interest rate. Investors buy into a fund which makes the loans to individual enterprises or bundles of enterprises. Investors make money from interest on the unsecured loans; the system operators make money by taking a percentage of the loan and a loan servicing fee.

EQUITY CROWDFUNDING

In essence, equity crowdfunding is raising capital from the crowd (using an online platform) through the sale of securities in a private enterprise (company) that is not listed on stock exchanges. It is similar to debt crowdfunding, but instead of generating loan capital the enterprise raises equity capital, i.e. the enterprise offers securities. The terms of the transactions are determined by the enterprise/entrepreneur.

REWARDS CROWDFUNDING

Rewards crowdfunding involves individuals contributing amounts of money to projects in return for some kind of reward, other than debt or equity. A crowdfunding platform facilitates the process. The size of the reward is usually a reflection of the amount contributed. Rewards can range from something simple such as a thank-you postcard to a production version of the crowdfunded product. It has been used for a wide range of purposes, such as motion picture promotion, free (public) software development, inventions development, scientific research and social projects.

FACTORING

Factoring is a financial transaction in which an enterprise (the "debtor") sells its accounts receivable (i.e. invoices) to a third party (called a factor). An enterprise will sometimes factor its receivable assets to meet its present and immediate cash needs. This form of alternative financing does not rely on the creditworthiness of the enterprise as the factor takes ownership of the receivables. Essentially, the enterprise selling the receivables is transferring the risk of default (or non-payment) by its customers to the factor. As a result, the factor charges a fee to compensate for that risk.

INITIAL COIN OFFERING

An Initial Coin Offering (ICO) is the cryptocurrency industry's equivalent to an Initial Public Offering. ICOs act as an alternative way to raise finance. It is used when an enterprise plans to raise money to create a new digital coin, an application relating to the use of digital currency or a service relating to digital currency. Investors can buy into the offering and receive a cryptocurrency token issued by the company or that is associated with the application or the service. This token may have some utility in using the product or service the company is offering, or it may just represent a stake in the company or project.

LEASING

Leasing refers to a contractual agreement between two parties, the lessor and the lessee. The lessor is the legal owner of the asset, while the lessee obtains the right to use the asset in return for regular rental payments. Property, buildings and vehicles are common assets

²⁵ These definitions combine a number of sources, including the author's knowledge and the descriptions and discussions from a number of other sources, particularly Investopedia (www.investopedia.com), Wikipedia (www.wikipedia.com), the Harvard Business Review (www.hbr.org) and Forbes Magazine (www.forbes.com).

that are leased. Industrial or business equipment is also leased. The advantage to the lessee is that no capital outlay is required to obtain use of the asset being leased. The lessor's risk (when compared to a loan agreement) is reduced because ownership of the asset is retained. Leasing is advantageous when the lessee's creditworthiness is still being established, because of the reduced risk inherent in a lease agreement. It is also a mechanism that is used in the expansion phase of an enterprise, because there is no need to invest capital in additional equipment or property, typically when an enterprise needs all the available capital to increase production or extend its market engagement.

MEZZANINE CAPITAL

Mezzanine financing or mezzanine capital is a hybrid of debt- and equity financing. It gives the lender the right to convert to an equity interest in the company in case of default and is typically a form of subordinated debt, i.e. venture capital companies and other senior lenders will be paid before the mezzanine lender is paid. Mezzanine financing is frequently associated with acquisitions and buyouts. In this scenario, it may be used to prioritize new owners ahead of existing owners in case of bankruptcy.

PEER-TO-PEER LENDING (P2P LENDING)

Peer-to-peer lending (P2P lending) is the practice of lending money to individuals or businesses through online services that match lenders with borrowers. Peer-to-peer lending companies often offer their services through an online platform and attempt to operate with lower cost and provide their services cheaper than traditional financial institutions. The P2P lending company takes a fee for providing the matchmaking platform and assessing the creditworthiness of the borrower. The lender carries the full risk of defaults.

SUPPLY CHAIN FINANCE

Supply Chain Finance (SCF) is a term describing a set of technology-based finance solutions that aim to provide appropriate financing and improve business efficiency for buyers and sellers linked in a sales transaction. SCF methodologies work by automating transactions and tracking invoice approval and settlement processes, from initiation to completion. In SCF arrangements, buyers typically agree to approve their suppliers' invoices for financing by a bank or NBFI, i.e. factoring is part of most SCF arrangements. In addition, short-term credit is made available to optimize working capital for all parties, depending on the cycle of the particular

value chain. Supply chain finance works best when the buyer (or eventual buyer) has a better credit rating than the seller and can therefore, source capital from a bank or NBFI at a lower cost.

TRADE FINANCE

Trade finance represents the financial instruments and products that are used by enterprises to facilitate trade and commerce, often but not always, international trade. Trade finance makes it possible and easier for importers and exporters, manufacturers and distributors, to transact through trade. Trade finance is an umbrella term meaning it covers many financial products that banks and companies utilize to make trade transactions feasible. The products are typically geared to the particular characteristics of the segment/commodity/product group in which the trade takes place. The products are often in the form of letters of credit, guarantees or insurance and is usually provided by financial intermediaries. Trade finance help to reduce the risk associated with global trading by reconciling the needs of the exporter and importer (or the producer and the distributor).

VENTURE CAPITAL

Venture capital relates to a private equity investor who invests in an enterprise until it reaches a sufficient size and credibility so that it can be sold to a corporation; the investment can be provided by other participants in the capital market. In essence, the venture capitalist buys a stake in an entrepreneur's idea, nurtures it for a short period of time, and then exits. Venture capital exists because of the nature of capital markets. Entrepreneurs with a new idea or technology often have very limited options in terms of accessing finance. The risk of failure is too high for traditional lenders (e.g. banks) to take an interest. The unproven nature of such an enterprise practically prohibits any public listing. The venture capitalist fills this void, with a typical high-risk/high-reward investment approach.

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Alliance for Financial Inclusion

AFI, Sasana Kijang, 2, Jalan Dato' Onn, 50480 Kuala Lumpur, Malaysia
t +60 3 2776 9000 e info@afi-global.org www.afi-global.org

 Alliance for Financial Inclusion  AFI.History  @NewsAFI  @afinetwork