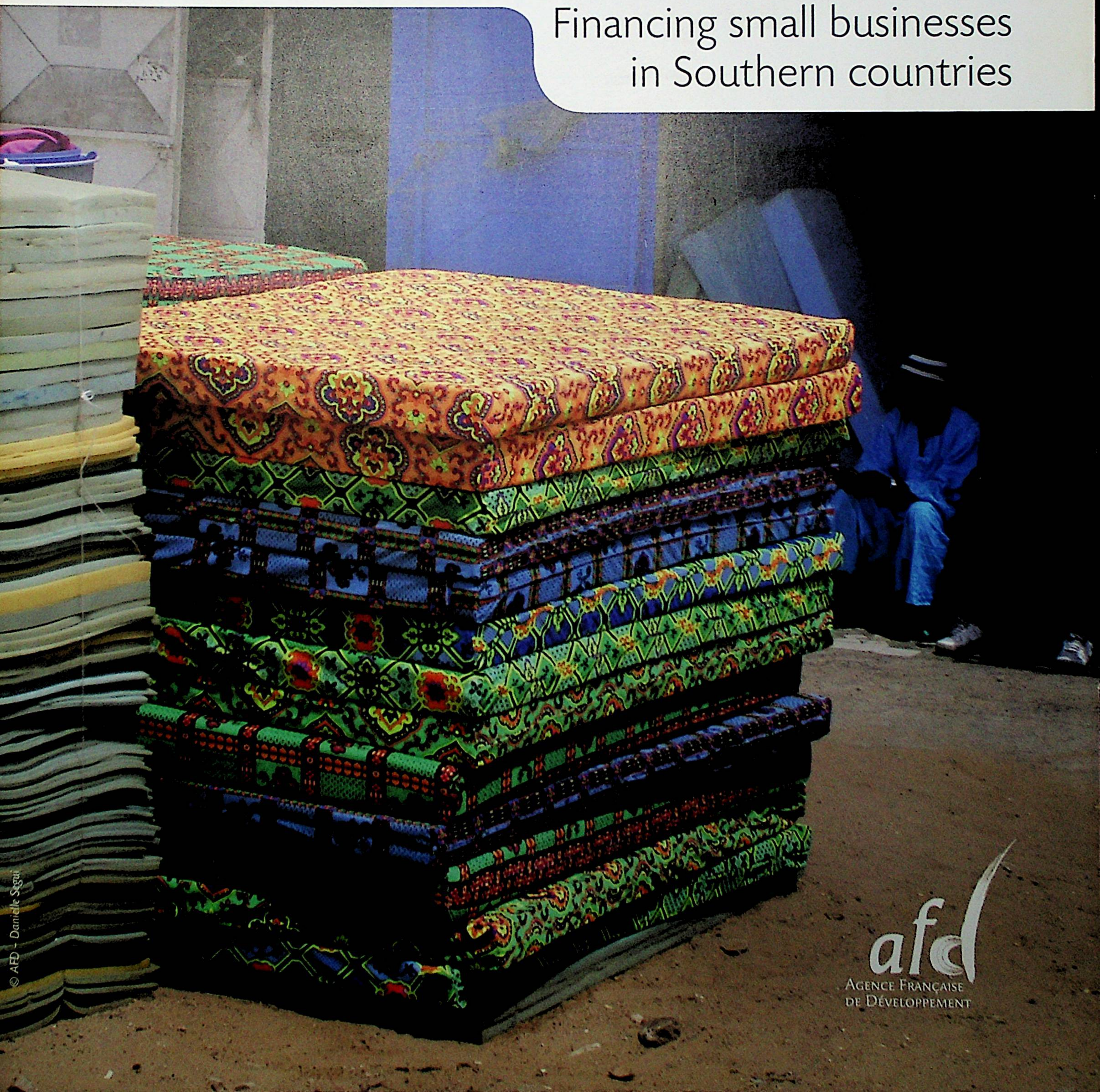


AFD AND MESOFINANCE

Financing small businesses
in Southern countries



SMALL ENTERPRISES CREATE GROWTH IN DEVELOPING COUNTRIES

Small businesses are one of the main vehicles for economic growth in developing countries. They often account for the bulk of their economic growth and play a key role in job creation, investments and innovation.

Their light structure and flexibility also mean they can be a determining factor in absorbing economic and financial crisis. Unlike corporate companies, these businesses still enjoy sizeable growth potential. In order to develop, they require a range of financial and non-financial services tailored to their needs.

Very few of the credit needs of small businesses are currently covered. This market also offers a window of opportunity for banks and other financial institutions seeking to diversify and develop their market share. .

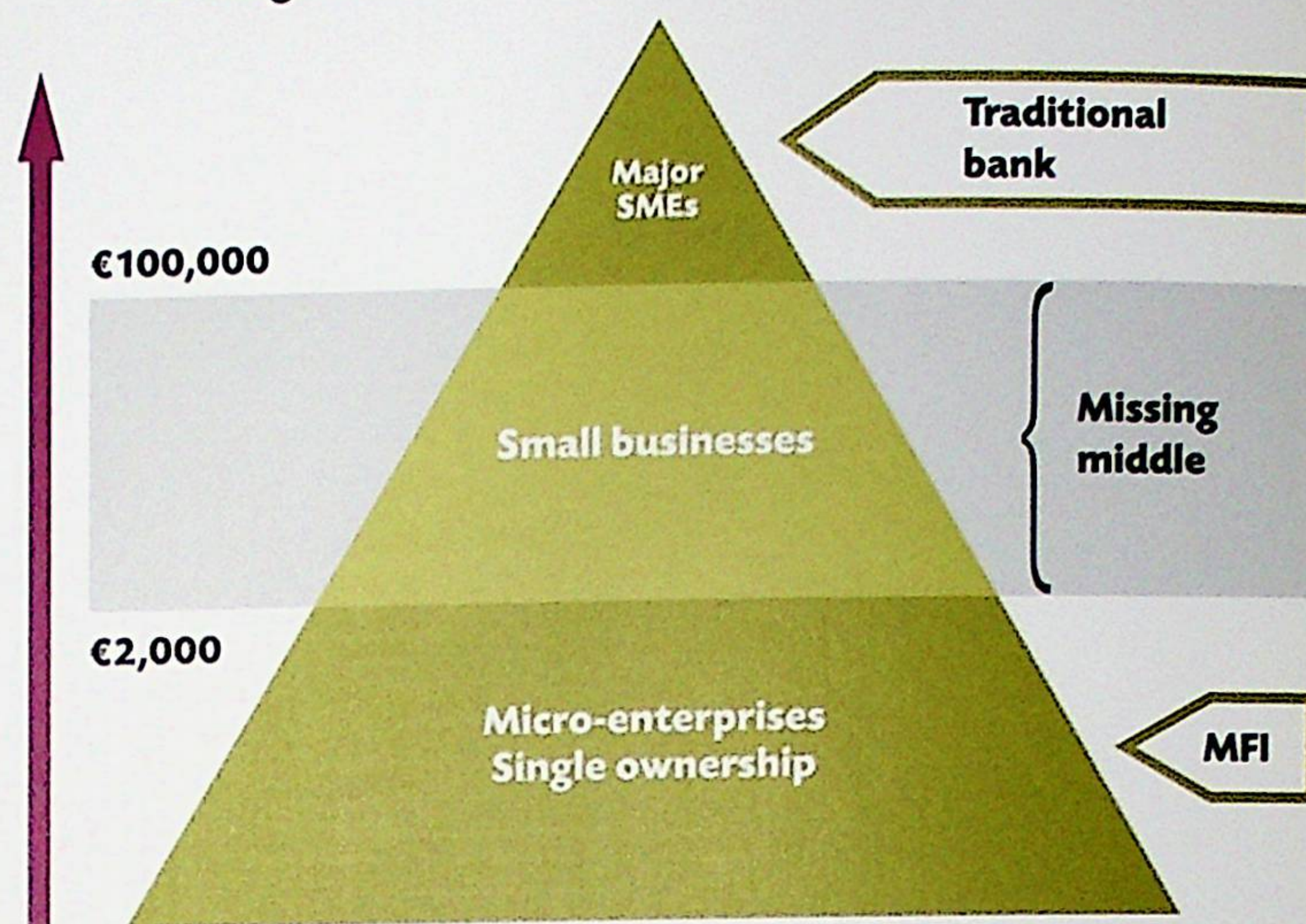
DIFFICULTIES TO ACCESS FINANCING

The conditions required for the development of Small businesses – which include access to credit – are specially lacking in developing countries. This segment of the private sector falls between micro-enterprises, which are often informal, and corporate companies. It is still on the edge of traditional financial circuits due to the lack of financial solutions tailored to its needs, which lie between the minimum amount required for traditional banks financing and the credit limits of microfinance institutions.

These businesses often have to rely on informal financing sources (friends, family, tontines...) or even inappropriate self-financing.

This lack of access to credit constitutes a real barrier to their growth and, more generally, to the economic development of these countries.

Financing needs



There are a number of obstacles to the development of credit for small businesses that stem from both the characteristics of these businesses and the organization of financial institutions.

Obstacles linked to the characteristics of small businesses:

- Low level of formalization,
- Lack of managerial skills (management, accounting, marketing...),
- Low level of equity,
- Low value of assets to provide as collaterals and difficulties encountered by financial institutions to enforce these collaterals,
- Difficulties for entrepreneurs to provide personal guarantees.

Obstacles for financial institutions:

- Financial institutions perceive risk as being high, whereas according to statistics on bankruptcies it is below the perceived risk,
- There is a lack of client segmentation with no diversified banking activities between retail banking, where entrepreneurs borrow in a personal capacity on the basis of their personal assets on the one hand, and corporate financial services on the other hand.
- Organization, methods and tools to assess risk used by banks are only configured for corporate customers and those used by microfinance institutions only for micro-enterprises.

AFD AND MESOFINANCE

Mesofinance deals with the financing requirements of small businesses that are not covered and can range between €2,000 and €100,000. These limits can be different from one country to another. AFD implements a comprehensive strategy for operations in order to bridge this gap, by integrating both support for the services provided by financial institutions and support for the financing requirements of small businesses.

Enlarging the client base of financial institutions

AFD can provide support to banks that are traditionally positioned on a client base of major SMEs for their strategies to downscale their client base in order to provide a range of financing to small businesses.

This assistance can involve both financial support for the development of products, skills and methods targeting these businesses and a partial guarantee for their credit risk during the skills acquisition period for this new client base.

Similarly, AFD works with microfinance institutions seeking to support the growth of their biggest clients and to upscale in order to finance small businesses by also offering them different types of financial support.

Support for demand: upgrading small businesses

AFD includes a "support for demand" component in its approach to mesofinance. The aim is to upgrade small businesses so that they can meet the requirements of their financial partners and thus gain access to credit.

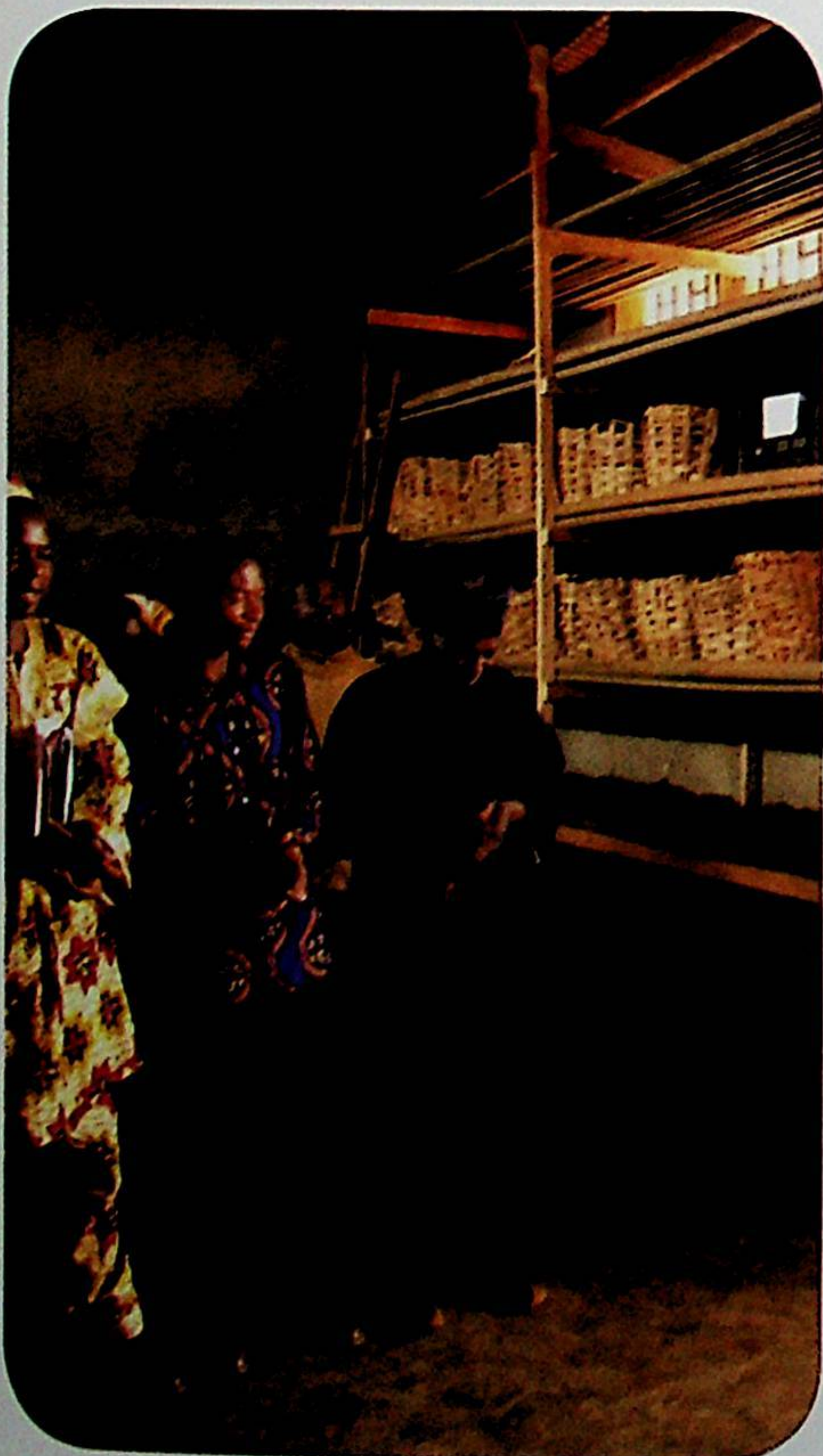
This support mainly focuses on capacity building for these businesses and the development of non-financial support services for small businesses that offer training services, assistance in formalizing financial statements, loan application preparation or coaching.

AFD can also promote business-linked cooperation activities that consist in encouraging sectoral professional associations to build business relations together by forming networks and cluster groups.

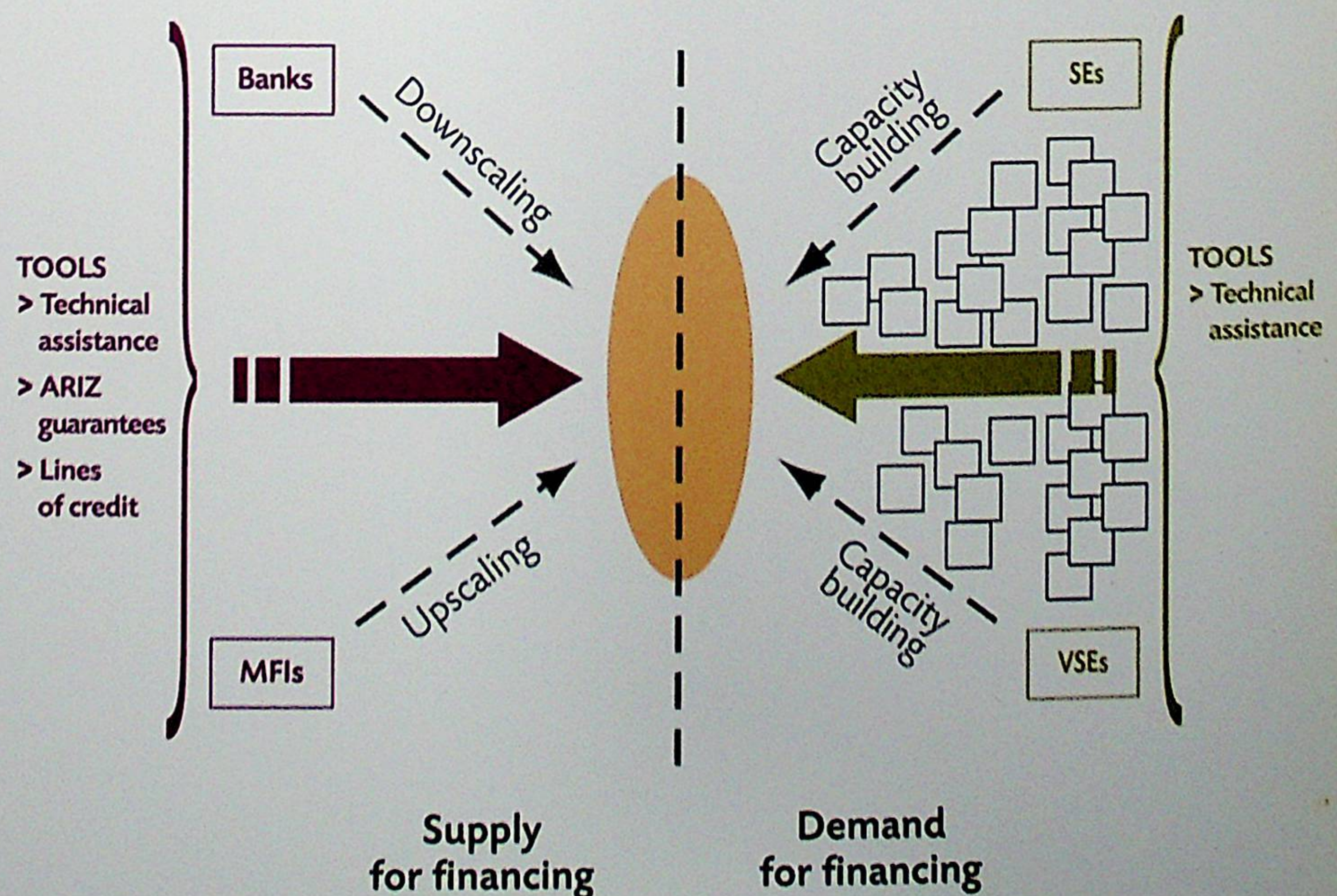
Tailored-made additional tools

AFD uses several additional tools in order to implement its integrated mesofinance approach:

- ARIZ partial portfolio guarantees to share the risk on these new client categories with financial institutions;
- Implementation of credit lines targeting small businesses segment;
- Allocation of technical assistance grants both to build the skills of financial institutions in terms of credit for small businesses and to support small businesses in a framework based on structuring demand.



Cameroun © AFD - Jean-Claude Galandrin



The mesofinance approach

ARIZ Partial Portfolio Guarantee

- This new guarantee mechanism is designed for banks that have recognized expertise in credit analysis and are seeking to develop their mesofinance activity and their SME loan portfolio.
- The guarantee is formalized by an AFD guarantee agreement.
- The guarantee package automatically covers 50% of risk on single deals approved by banks for a unit amount ranging between €10,000 and €300,000 (or its exchange value).
- AFD delegates decision-making and management for each guarantee allocated from the package under the ARIZ contract to its partner bank.



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BUSINESS CASE: SEKERBANK (Turkey)

Turkish SMEs, the vast majority of which are micro-enterprises, account for 77% of employment, 27% of investment and 38% of added value at the national level. Despite the key role they play in Turkey's economy, SMEs find it difficult to access credit, particularly in the least economically developed regions. This low level of recourse to credit mainly stems from the fact that local banks are unable to meet the needs of this category of enterprise, particularly those of small businesses.

AFD observed that there was an immense potential for Turkish banks to downscale to this client segment and at the end of 2008 consequently decided to support Sekerbank's SME strategy. Sekerbank is the eleventh largest commercial bank in Turkey and is particularly well established in the rural and semi-rural areas of Central and Eastern Anatolia. This support was initially prompted by the German donor KfW and has taken the form of a 10 million euro concessional line of credit to finance loans to small businesses, coupled with a capacity building program for the bank for its small business activity.

This program is based on two main pillars: to support the bank in implementing the changes that are required to make the small business activity sustainable (organization, procedures, methods, products) and to strengthen in-house skills (staff training). It is implemented with support from the German consultant Internationale Projekt Consult (IPC) that initiated the establishment of the ProCredit banking network and is an



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international reference in terms of mesofinance and downscaling for banks. The AFD line of credit is eventually expected to finance between 1,500 and 2,000 small businesses. It will consequently be supporting productive investment and will help create or save jobs in the targeted regions. The project may also have a knock-on effect for other financial establishments by encouraging them to move into the small business segment as well. This will help scale up access to Turkey's financial system.

BUSINESS CASE: ADVANS CAMEROON (Cameroon)

A study financed by AFD in 2007 estimates that there are roughly 280,000 businesses in Cameroon, including 250,000 micro-enterprises, 30,000 small enterprises (under 20 employees) and 800 medium-sized enterprises (20 or more employees).

Cameroon's small businesses consequently stands for a breeding ground for employment and growth that merits the right support. Their financing needs exceed what most microfinance institutions can offer but are under the limit of the minimum amount required by the country's banks (roughly FCFA 20 million, i.e. €30,000).

Small businesses are often unable to provide financial statements or securities in the form required by banks or certain microfinance institutions that have upscaled. Formal financial institutions consequently only make a very small contribution to financing Cameroon's businesses. These businesses rely on tontines or self-financing which are their main source of external financing to meet their needs.

The Advans Cameroon – Mesofinance Support Program is a project that involves a €575,000 grant and a €1.5 million ARIZ partial portfolio guarantee to Advans Cameroon, a microfinance institution founded in 2006. The project targets the client segment whose credit needs range between €10,000 and €45,000 and is based on three components:

- **Support for the creation of Advans Cameroon's Small Business Unit:** financing for technical assistance in order to implement a procedures manual and appropriate methods for risk management, marketing, products, training for loan officers, adaptation/configuration and evolution of the information and reporting system...;
- **Support for businesses:** a €100,000 grant to cofinance support/advisory/training services for small businesses by strengthening their skills and financial management capacities, business plans, standards and quality, human resources and taxation;
- **Risk sharing:** provision of a partial guarantee for the mesofinance portfolio;

It is estimated that in four years the project will support over 1,000 small businesses with a total credit amount of €16.5 million.



Cameroon © AFD – Jean-Claude Galandrin

BUSINESS CASE: SOLIDIS (Madagascar)

The mesofinance component in Madagascar concerns financing needs that range between €5,000 and €50,000. Above this cap it is generally considered that businesses are "corporate firms" or enterprises that have already access to banking services. It is estimated that two-thirds of the 20,000 to 30,000 businesses identified require access to credit. Their constraints are: fear of falling into debt, negative perception of recourse to credit (synonymous with a lack of resources or financial problems), the "secrecy culture", the difficulty to plan ahead in the medium term, the cultural gap that exists in any possible relations with banks, and their sizes (informal or quasi-formal businesses). The issue of securities – the level required in Madagascar is extremely high – is also crucial. These constraints are even greater when they seek financing with maturities that exceed 5 years or to finance start-ups.

AFD's financing will provide technical and financial assistance during the first years in business of SOLIDIS, a mutual guarantee company that targets Madagascar's small businesses. SOLIDIS was founded in 2008 under the impetus of entrepreneurs among Madagascar's employers, in partnership with professional associations (young employers, tourism sector, businesses in free zones for textiles). The mutual guarantee company insures half of the loan amounts of client businesses thanks to AFD's allocation and client contributions (10% charge on the loan amount, reimbursed when the loan reaches completion). It also provides moral guarantees from peers via the participation of the represented professional associations, as well as support for the preparation of applications for financing. Operating costs for the analysis of applications and support in their preparation are covered by the investment products created by the fund, the underwriting fees and, for the first three financial years, operating grants (including the one from AFD's financing). According to the provisional business plan, the increase in the fund's activity should allow it to reach breakeven point thanks to the allocation of roughly a hundred and fifty new guarantees every year.




Mati Marché Djéne © AFD - A. Belk Barchese

AFD stands for the *Agence Française de Développement*. AFD is a public development-finance institution that has worked to fight poverty and support economic growth in developing countries and the French Overseas Communities for more than 60 years. AFD executes the French government's development aid policies.

With offices in more than 50 countries, AFD finances and supports projects that improve people's living conditions, promote economic growth and protect the planet. AFD-funded projects provide schooling for children, support farmers and small businesses, supply drinking water, preserve tropical forests and fight climate change, among other things.

AFD committed nearly €6.2 billion to financing aid activities in developing countries and the French Overseas Communities in 2009. The funds should permit the vaccination of 1,8 million children, give 7.3 million people access to drinking water and create or save jobs for 900,000 workers engaged in private enterprise; funding for energy efficiency projects will save nearly 5 million tons of carbon dioxide emissions per year.

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PROPARCO, AFD's subsidiary dedicated to private investment, promotes private investment in emerging and developing countries in order to boost growth, promote sustainable development and reach the Millennium Development Goals. Its financing is tailored to the specific needs of investors in the productive sector, financial systems, infrastructure and private equity investment.

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DTO DEPARTMENT

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