

## Transforming SME finance



By James Kashangaki

To varying degrees, growing enterprises around the world continue to find it extremely difficult to access financial services appropriate to their needs. This is true particularly for credit, but also payments, savings, current accounts, trade services, working capital support, long term capital raising, insurance, pensions, and many others. This situation is mirrored in Kenya despite numerous, costly and largely unsuccessful interventions aimed at improving the situation by government, donors, industry associations and financial institutions (FIs). The situation is amplified by the fact that financial institutions in Kenya continue to make profit for their shareholders without having to innovate, enter new lines of business or take on unfamiliar risks.

Despite having 43 banks, it is the case that 6 institutions control 80% of the market. This oligopoly manifests itself in the lack of an incentive for these banks to differentiate an offer for the small and growth business market. Financial Institutions have what might be termed pseudo strategies for tackling the SME market

however these are primarily marketing strategies and dominated by sales and marketing targets. Teams of sales people, called relationship managers, sell largely unsuitable products to an audience of entrepreneurs unable to differentiate one financial offer from another (after all it's just money). Most institutions have overly intricate reporting structures which result in unhealthy internal competition or incompatible goals which in turn militate against optimising SME client opportunities. To compensate for unsophisticated or non-existent risk assessment practices, credit providers have developed, by default, difficult and often lengthy origination processes compromise effective lending to SMEs. Delays in decision making are compounded further by unrealistic demands for a limited type of fixed asset, usually urban land and buildings, to collateralise the lending.

All of this complexity creates an opaqueness for SMEs and serves to restrict the extent to which FIs are able to effectively serve this potentially lucrative market. In addition, it leads to huge amounts of mistrust between the FIs and their potential customers. The results are evident. Growing businesses are still largely self-financed, or use family and friends or more expensive semi-formal money lenders to bridge their funding gap. At best, Kenya's financial sector is able to assist a small proportion of smaller businesses to continue

### About GrowthCap

Over the past few years FSDK has been at the forefront of SME banking development through conducting market assessments and studies in areas such as trade finance and SME equity funds, as well as supporting development of the credit reference bureau. Through its partnerships with its Action Research Partners (ARPs), FSDK's GrowthCap initiative is supporting adoption of SME best practices by individual financial service providers.

In this Note, James Kashangaki presents the rationale for Growth Cap's work and kicks off a series of resources that are being developed out of work with the ARPs. The Notes provide information on best practices and are intended for use by financial service providers and those supporting such institutions which are entering the SME market.

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existing but it is not currently set up to help the majority develop and grow.

In order to change the status quo, it is necessary to engineer a mind shift in the way our FIs operate. This need for a mind shift change is not about tinkering at the margins. Just developing a few new products, conducting training in cash flow lending or reviewing best practice credit analysis which is what most technical assistance interventions have been centred around will not accomplish this shift. Nor will the provision of cheap lines of credit or guarantees for small business lending in the absence of credible internal change achieve sustainable growing and profitable SME business for FIs in Kenya

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There are few examples across the globe where FIs have been able to capture the SME market for any great length of time. It is true however that where FIs have made an effort to develop and implement an SME centred strategy, there has been a considerable upside. At the heart of an SME centric approach in financial services is the FIs complete understanding of their SME clients and their needs and then tailoring the financial offer to meet those needs. It requires a sustained effort to achieve an institutional SME focus, developing and implementing a strategy with specific, measurable, attainable, realistic and time bound (S.M.A.R.T.) objectives, optimising the institutional structure and operations to serve target customers, developing or acquiring SME focussed human resources to fill defined competencies, and all the while reorienting credit and risk systems to ensure that timely and consistent services can be delivered. Challenging mindsets, focusing strategy and developing SME centric approaches to meet SME needs is what the Growth Cap project is about.

GrowthCap is a sector and institutional change project set up by FSD Kenya designed to bring about industry-defining change in the Kenyan SME finance market by working with key partner FIs known as Action Research (Banking) Partners or ARPs. Working extensively with ARPs, GrowthCap facilitates the design and implementation of SME finance strategies that are realistic, customer-centric and reflect international good practice. These banking partners then act as catalytic change agents that will establish a new and elevated performance benchmark for SME finance in Kenya, and re-define customer expectations and industry standards.

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The staff of the ARP's are actively engaged in developing solutions rather than merely being recipients of externally derived solutions. By participating in this developmental process, our partners are developing their own competencies, gaining greater ownership of the action plans, getting closer to their SME customers and better understanding the needs of entrepreneurs growing their own businesses. Over the life of the project, the knowledge and experience gained is being rigorously documented in order to produce a series of well tested resource kits and disseminated beyond the ARPs to those in the wider financial industry and local consultants. In this way Growth Cap will help build local capacity and stimulate innovation in the wider Kenyan SME finance market.

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The Kenya Financial Sector Deepening (FSD) programme was established in early 2005 to support the development of financial markets in Kenya as a means to stimulate wealth creation and reduce poverty. Working in partnership with the financial services industry, the programme's goal is to expand access to financial services among lower income households and smaller enterprises. It operates as an independent trust under the supervision of professional trustees, KPMG Kenya, with policy guidance from a Programme Investment Committee (PIC). In addition to the Government of Kenya, funders include the UK's Department for International Development (DFID), the World Bank, the Swedish International Development Agency (SIDA), Agence Française de Développement (AFD) and the Bill and Melinda Gates Foundation.



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