

Access to Finance – Demand Side

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The SME Sector

We often hear that a key similarity in any country around the globe is the role of the SME – the small or medium enterprise. “SME’s represent the backbone of national economies”. “They are the backbone of the global economy”.

In Sri Lanka, roughly 70% of the economy is made up by SMEs. Worldwide, where data are available, SME’s are said to account for 50% of private sector value added, and over 60% of employment.

We also hear often that, “access to finance” is the single largest constraint to development of SME’s.

What does this mean from a demand side point of view in Sri Lanka?

There are many reasons why access to finance has become a serious constraint for SME’s in Sri Lanka:

- Affordability
- Inadequate collateral
- High interest rates
- Demanding guarantee requirements and difficult procedures for getting loans
- Banks are very reluctant to provide adequate working capital
- Perceptions concerning the ease of access to loans granted by banks
- Offers from the banks are not suited to SME needs
- The view that banks do not want to take risks in lending to SME companies
“In order to get a loan, you end up having to prove that you don’t need one”.
- Lack of venture capital
- Lack of development finance
- Inability to make bankable project proposals
- Lack of knowledge in project feasibility studies
- Lack of financial management and discipline

Although several special SME loan schemes have been launched in Sri Lanka to improve access to finance for SME's, inability to meet institutional requirements with regard to accounting practices as well as to present business plans of acceptable quality to local banks, has been a problem for local SME's.

As a result SME's:

- Use of expensive leasing or renting and overdrafts
- Large portion of the working capital is met thru overdraft facilities, post-dated cheques, or very expensive informal borrowings
- The large majority of SME's meet their financial management needs internally

Additional noteworthy issues:

The issue of the Loan Recoveries Act:

Commonly known as the Parate, the Loan Recoveries Act in Sri Lanka is alleged by SME's to be one sided - That some Banks do not have the expertise or the mechanism to assist a "sick enterprise" which has the potential to recover, and act to the disadvantage of the enterprise and its employees.

The issue of financial management and discipline:

Examples:

- Operate with insufficient equity base
- Over ambitious business acceleration
- Non separation of business and private expenditure
- Over expenditure on status symbols, such as cars and offices etc

Solutions:

SME's are a vast and heterogeneous group. From the self employed, to firms with several hundred employees. Very small entities operating in the informal economy, to incorporated firms that may have secure access to financing. Furthermore, there are major differences in the capabilities and competitiveness of SME's within different sectors and industries.

The majority of SME's in Sri Lanka are informal entities, family businesses, farmers and traders.

Blanket SME policies, one-size-fits all solutions, do not work!

SMEs that are more efficient, innovative, growth-oriented, outward-looking and learning-capable, deserve closer attention and collaborative support due to several reasons, and these SMEs must be identified and assisted:

- First, such firms have **better prospects for success being more focused and manageable**, administratively and financially.
- Second, they would be **more receptive to policy support and facilitation**, targeted with an efficiency-oriented and time-bound approach.
- Third, having been provided initial assistance and facilitation, they would also have **better success in self-diagnosis and self-improvement**.

A reasonable time period for reconstruction of “Sick Enterprises” must be allowed without compromising the collateral of the lender, while taking in to account the legal procedures, labor laws, social stigma, and the huge cost to all concerned if the enterprise is forced to close.

Provision of appropriate capacity enhancement programs can enhance their knowledge and skills, financial and operational efficiency, and consequently, their bankability:

- Technical assistance
- Business planning
- Marketing
- Financial management
- Research and development
- New technology that would help SMEs organize and systematize their business processes

Mark Gold, the President of ACCA spoke in Colombo a few weeks ago and said, and I quote:

“Without SMEs, we have no global economic recovery; we have no economic development, no economic growth. The events of the last three years have refocused attention on the issue of access to finance for SME’s, which has not only made it into news headlines but onto the agenda of the G20 itself.” Continuing with his speech he said “New SMEs face high barriers to market entry, whether it’s competition or regulation, so their high ‘birth rate’ is in spite of the odds; contrary their mortality rate is very high too. It’s a precarious existence for SMEs then, but policy-makers and lenders need to remember that every big business once began as a small one.” He stressed.

I would like to end on an important philosophical note by quoting President Franklin D. Roosevelt:

“The test of our progress is not whether we add more to the abundance of those who have much; it is whether we provide enough for those who have too little.”