

Bank of Africa Group is present in 12 countries and is one of the biggest banking groups with local capital in Sub-Saharan Africa. Its strategy focuses on SMEs and it is today one of the most exposed players in this segment of Africa's economy. In this article, Paul Derreumaux, its co-founder and President, draws on his experience at BOA Group and analyzes relations between banks and SMEs in Africa. He is aware of the brakes that are prejudicial to their collaboration and describes the solutions that have been envisaged or implemented at BOA.

The difficulties banks face in financing SMEs in Sub-Saharan Africa: who is to blame?

Firms and banks alike would seem to be responsible for the lack of SME financing in SSA: firms because of their shortfalls in meeting the classic requirements of the banking sector and banks because they could mobilize more resources in order to penetrate the SME segment. BOA's experience has shown that this client base could provide an interesting outlet for banks, provided they tailor their operating methods to the specificities of SMEs.

By Paul Derreumaux, Chairman and Chief Executive Officer of Bank of Africa

Relations between banks and SMEs have always been very similar to those between an old couple who constantly blame each other yet have to live together. This situation is no doubt especially true in SSA where banks have traditionally dominated financial systems, leaving little leeway for SMEs seeking alternative financing to bank loans. As is often the case, both sides share the blame and both actors show real weaknesses in their capacity to respect the requirements and practices of the other. However, profound changes are currently taking place on both sides which bodes well for the medium-term outlook.

Banks have been influenced by their shareholders, their working methods and their management rules, and by the effects of increasingly restrictive regulations, and feel comfortable with reliable financial statements validated by auditors. They also want to see their clients' firms with well-organized and well-managed structures. They always ask firms to give a clear and accurate vision of their future and require them to have substantial equity so that they can face the unexpected. Finally, banks always hope to back up their financing with sound guarantees that allow them to meet the requirements of their supervisory authorities.

It is extremely difficult for SMEs in SSA – regardless of their business or country – to put all this together. Indeed, experience shows that it is impossible for nearly all private firms with local capital – including large firms, as well as firms that have long been in business, have a steady turnover and good profitability – to present all the attributes that would allow them to meet the classic criteria required by banks. Most of the economic

apparatus in Sub-Saharan countries thus suffers from a lack of structuring – the exception being major international corporates and State companies – which explains the extent of the difficulties encountered by both banks and SMEs to work together and their constant mutual dissatisfaction. In view of this dilemma, what could be the main respective responsibilities for these two “partners” which cannot do without each other?

Lack of structuring in firms

On the corporate side, banks have three major concerns. The first is the widespread lack of equity in SMEs. This weakness can be explained by promoters' reluctance to seek other shareholders, the scarcity of available treasury, as well as the frequent underestimation of operating and investment costs in budgets and the underassessment of the capital required to reach the target turnover. Borrowing consequently often weighs heavily on financing plans which leads banks to toughen their naturally reticent stance or to ask for a lot of guarantees. An unbalanced financial structure also prevents firms from reaching break-even point and makes them even more vulnerable. The second major obstacle for banks is the lack of organization in SMEs, particularly in terms of human resources, accounting, administrative management and control functions. Business leaders – including in the biggest SMEs – are often the sole decision-makers in their firms. The modest, often fledgling, formalization creates a breeding ground for errors, fraud and works against the regularity of processes. This can be particularly prejudicial for firms in the manufacturing sector, and notably for exporting firms. There is usually too little reflection prior to action, yet such reflection ...

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... could help ensure the stability of manufacturing and marketing processes. Control, both internal and by auditors, is pushed into the back seat which makes it difficult to swiftly detect a firm's weaknesses. This can also encourage inclinations towards non-transparency on the part of promoters and can cause banks to lose their equanimity towards SMEs. Finally, the third main obstacle is firms' lack of forward-looking vision. Too many fledgling firms were born on an impulse on the part of the entrepreneur, without any in-depth analysis of the market or competition. This often leads to disillusion in terms of turnover and, consequently, in repayment capacity for bank loans. Too many start-ups oversize their investments when they go into business, instead of designing their project step by step and, as a result, are sure to jeopardize any chance of profitability. Too many budding SMEs make a very sketchy analysis of their potential and growth rates and consequently handicap their future, even if their businesses do get off to a perfect start.

Banks lack dedicated resources for SMEs

Banks, for their part, have at least three significant shortcomings. The first is their weakness in supervising their portfolios. In view of the understandably fragile nature of SMEs in terms of organization and forward-looking vision, bankers should closely follow firms' day-to-day running, the relevance of their investments and the difficulties they meet. SMEs are naturally reluctant to allow banks to fulfill their advisory role, banks should consequently systematically take the initiative, yet they do not do so. This lack of supervision on the part of banks can be explained by several factors: the recent increase in supervision requirements for the main traditional client base (corporates and private clients) imposed by regulations, the lack of time due to the sheer number of extremely varied SME files to deal with, and the low level of profitability of this supervision compared to other activities. This can create a vicious circle, since this lack of supervision actually causes files to deteriorate which in turn makes banks even more averse to SMEs. The second shortcoming for banks, partly responsible for the first, stems from the fact that banking teams lack a specific reference framework based on in-depth experience of SME financing. The diversity of SMEs – in size, sectors, characteristics or in terms of support required – is, of course, at the root of this situation and explains the difficulties encountered when developing solutions. Efforts to improve this are in-

adequate. In most cases, banks continue to suffer from a lack of departments specialized in SMEs, a lack of procedures adapted to the limited available financial information and supervision indicators, limited innovation capacities in terms of acceptable guarantees and a total absence of specific training in SME financing for credit analysts and client advisors. These are all factors that prevent banks from having any greater interest in SMEs. Finally, the third shortcoming for banks is related to the institutional environment where deficiencies penalize banking activities. Indeed, despite real progress brought about by the Organization for the Harmonization of Business Law in Africa (OHADA¹), certain lingering weaknesses in the legal framework (for instance, in terms of guarantees' enforcement) and the serious and widespread shortcomings of the legal apparatus make it extremely difficult to recover bad loans. These difficulties reduce interest in SME financing further still and, at the same time, lead banks to impose stiffer conditions for their financing. Similarly, the multiplicity, complexity, and sometimes rather unorthodox pressures from the administration – economic police, tax office, social security – weaken even further SMEs that - pressured by banks - are willing to join the formal sector.

Bank of Africa provides solutions

Under the combined effect of all these factors, SMEs do not obtain the support they require from banks. Yet banks that do take the risk of actively turning towards SMEs suffer from a high rate of non-performing loans and sizeable operating losses and consequently receive a poor return on their efforts. Various solutions that may greatly improve relations between banks and SMEs are, however, gradually being implemented. Four examples can be given based on Bank of Africa Group's experience.

The first – and undoubtedly the most decisive – is risk sharing with other institutions. In addition to the direct interest this has for banks which can minimize potential losses, this sharing promotes awareness among other donors of the essential nature of this public and the inherent difficulty of meeting its needs. Two main approaches are conceivable and are currently being tested by the BOA network. The first is a general approach and involves using a portfolio of guarantee lines granted for a given amount that may be allocated to an SME portfolio freely selected by the bank. The International Finance Corporation (IFC) has ...

¹ French acronym for *Organisation pour l'Harmonisation du Droit des Affaires en Afrique*.

² *Fonds africain de garantie et de coopération économique (FAGACE), African Solidarity Fund (ASF), Fonds de garantie des investissements privés en Afrique de l'Ouest (GARI), Assurance pour le risque des investissements (ARIZ)*.

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Bank of Africa

Paul Derreumaux graduated from Sciences Po, the Paris Institute of Political Studies, and began his career at Lille University before leaving for Côte d'Ivoire where he was Advisor to the Ministry of Planning for three years and, subsequently, Advisor to the Cabinet of the Ministry of the Economy, Finance and Planning. He began developing the BOA network in 1982, first in Mali, then in Benin. He is today President of Bank of Africa Group which operates at some 170 sites in 12 countries.

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... allocated this type of guarantee line, covering 50% of risk taken by the bank, to BOA Mali for FCFA 1.5 billion. It should shortly be implementing a similar mechanism for the four BOAs in East Africa for an amount totaling USD10 million. The second approach is based on individual guarantees whereby banks submit files to guarantee funds which study them on a case-by-case basis. These funds have grown in number over the years: FAGACE, ASF, GARI in West Africa, or ARIZ² (created by AFD) for the whole of Africa, are some examples. The effectiveness of these mechanisms is, however, closely tied to the quality – which is still often poor – of balance between rigour in managing these funds and flexibility in using the guarantees.

A second conceivable solution for bringing banks closer to SMEs is to create specialized departments within banks. BOA Mali's experience during the operation with IFC showed that this type of specialization can really make a positive contribution. A team of two people, supervised by a foreign technical assistant specialized in this segment, is specifically dedicated to SMEs. Analysis criteria, specifically adapted to the case of SMEs, have been defined for credit supervision. These criteria are based much more on firms' activities and expected incomes than on guarantees provided by promoters. These efforts are a clear example of the bank's will to be at the service of SMEs and mean that the latter can benefit from clearly identified correspondents that use a language they can relate to. Results have so far been conclusive and the same type of organization has been envisaged for other Group structures in the short term.

A third area to explore in order to improve relations between banks and SMEs involves diversifying financing tools offered to SMEs. Leasing and

factoring should be included in the range of instruments that can be used. However, the development of these instruments is hampered firstly by the fact that they are often outside the realms of SME culture and, secondly, by regulations that are generally not very favourable for these specialized instruments. Efforts to promote the widespread use of these instruments must, however, be pursued. Indeed, the three leasing companies in the BOA network have been demonstrating their viability and benefits for over 10 years now.

The fourth avenue has as yet not been sufficiently exploited and relates more to the future. It aims to complete and renew the range of guarantees capable of better securing SME files. New areas should be explored besides mortgages which are often inappropriate. For instance, feasible and promising solutions would be the joint guarantee provided by persons known to the bank, the creation – often evoked, but never implemented – of mutual guarantee companies on a sectoral or geographical basis, or partnering of SMEs with major companies via subcontracting (thus providing strong guarantees in terms of levels of activity).

The increase in competition among SSA banks will play a key role during the current changes. It will lead all banking institutions to scale up and accelerate their efforts to ensure they hold a strong position in this important SME segment. States will also have a key role to play. Indeed, the creation of a more explicit legal and fiscal framework that is more restrictive and resolutely turned towards development will be decisive for better cooperation between these two “enemy sisters”. ●

Access to credit in different parts of the world

Region	Getting credit	Registering property	Protecting investissors	Enforcing contract
Sub-saharan Africa	114	127	113	122
Latin America and Caribbean	64	93	83	108
Central Asia	107	73	111	70
East Asia ant Pacific	65	70	61	71
South Asia	77	89	74	121
Eastern Europe and Central Asia	42	67	70	54
Middle East and North Africa	113	77	93	113
OECD	37	53	61	36

Source: For each index, the table gives the average ranking for a chosen region. The average ranking is obtained by averaging the rankings of all the countries belonging to the region (the most efficient country being ranked No. 1). Source : Doing Business (www.doingbusiness.org), The World Bank, 2009