Leveraging microfinance institutions to build resilience of Africa's MSME sector: what needs to be done

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Introduction

Some quick definitions

- Microfinance market broadly include microcredit, saving programs, financial payment facilitation, micro-pension and micro-insurance schemes and remittances facilitations.
- MSMEs: Definition varies widely across countries. Broad coalition around the EC definition: firms with 0 to 9 employees are micro enterprises; 10 to 99 employees are small whilst firms with 100 to 499 employees are medium enterprises
- Resilience: No all encompassing definition. In microfinance, often tied with subjective wellbeing and social inclusion. In this context narrowly defined as the “the capacity to react, recover and bounce forward” (Aldieri et al., 2022).

Introduction

- Viewed within the context of global financial crisis and COVID-19 epidemic, does microfinance provide an extra leverage for MSMEs to "react, recover and bounce forward" during or after a crisis?
- Our focus will mostly be on providing evidence from some of our empirical works in Africa

MSMEs performance – Results from our empirical works

- Access to finance is a key obstacle to entrepreneurship and firm growth in many African countries (Banerjee & Duflo, 2007; Beck, Demirgüç-Kunt & Maksimovic, 2005; Beck and Dermiguc-Kunt, 2006; Evans & Jovanovic, 1989).
- According to a survey for the Nigerian economy, other factors include poor infrastructural growth (inadequate supply of electricity, poor road network), inadequate institutional support and dumping resulting from trade liberalization (Ajuwon, 2019).
- About 75%* of MSMEs in developing economies are microenterprises domiciled mostly in the informal sector
- The informal sector contributes more than 50%* to total output and up to 75%* to employment in many developing countries.

*(Wide variations across countries)

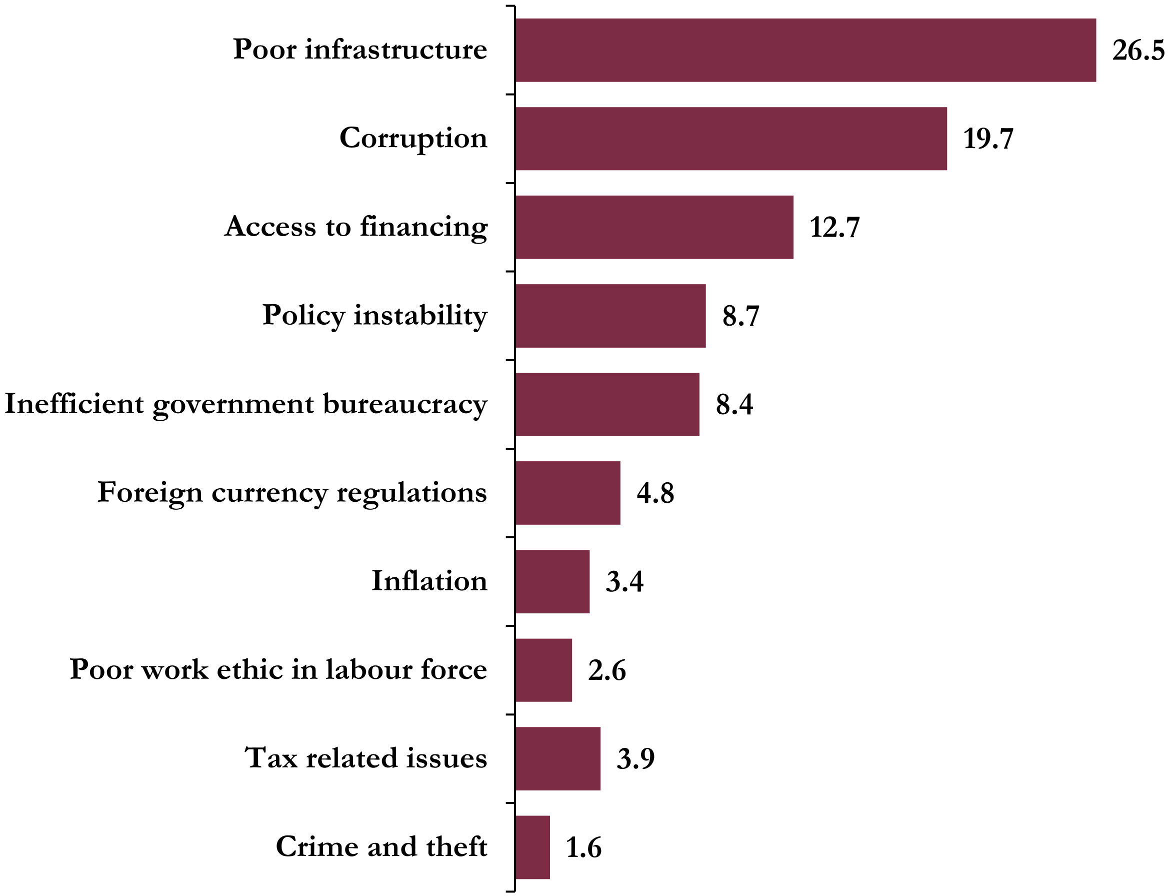
Factors that constrain MSMES output shares, output composition, market orientation and location in Nigeria

Infrastructural Deficit	Weak Institutions	Access to Finance	Globalization (Dumping)
Huge infrastructural gap	Inadequate institutional support	Unsupportive credit environment with resultant effect on low investment to bring start-ups to commercial scale	Trade liberalization has a negative effect on weak developing countries like Nigeria

All these, coupled with scarce entrepreneurship is crippling the output expansion of MSMEs in the Nigerian economy

Lack of access to basic infrastructure is affecting capacity utilization and hurting the contribution of MSMEs to the economic growth of the country…

Factors Affecting Enterprise Operations in Nigeria



Infrastructural Deficit

Sources: World Economic Forum Global Competitiveness Index (2015), World Bank Enterprise Survey (2014)

MSMEs and employment generation

- Broad spectrum of literature agreed on the role of MSMEs and employment generation. Yet, 50% or more of these MSMEs do not survive beyond five years of establishment (Smallbone, 1998).
- To what extent can MSMEs be relied upon for employment creation?
- Using a non-parametric analysis of the locally-weighted scatterplot smoothing (LOWESS) method proposed by Cleveland (1979) and modified by Neumark et al. (2008), on a data set of ….we find that:
  - MSMEs especially microenterprises performed better than large firms in term of employment generation

MSMEs and Productivity growth

- Using the non-parametric variance analysis LOWESS methodology and WBES data for 2007, 2009 and 2013 we found that
  - Small businesses have a negative productivity growth rate in Nigeria. Confirms IFC (2013) study which found small businesses have the least productivity growth rate amongst firms of all sizes
  - However, unlike IFC 2013, which found that small businesses' low productivity is tenable across all the sectors of the economy, our study established that small businesses actually recorded high productivity growth rate in some subsectors of the economy that specializes in product customization such as garment and furniture
  - Implications for countries' industrialization policy that target the MSME sector.

MSMEs and Transaction Costs of credit

- Transaction cost is the cost that both lenders and borrowers have to bear in order for credit to be traded. It is a cost that can prevent the credit market from clearing.
- The higher the transaction costs, the higher the cost of intermediation and the lower the available credit facilities (Fachini et al., 2008).
- Our results show that transaction costs are high across countries.

Microfinance and Financial Inclusion-Access, Depth and Efficiency?

- Overwhelming evidence support the financial development- economic growth nexus. However, some recent evidence indicate a ‘falling away” of this link even in countries where there is depth and efficiency. But low access.
- Raise questions about the role of financial inclusion. But what type of inclusion?
- Positive benefits of financial inclusion
    - the enlargement of access
    - increased saving
    - increased consumption smoothing,
    - increased efficiency of the financial system, and
    - increased financial stability.
- But there are also negative effects.

Microfinance and Financial Inclusion

- The negative aspects of financial inclusion as touted by the extreme finance literature include:
  - Excessive financial support (subsidy)
  - Increased transaction costs (Ajuwon and Ikhide, 2019)
  - Increased credit default due mainly to information asymmetry
  - Indebtedness and hence poverty (Lungile and Ikhide, 2017)
  - Increased financial instability arising mainly from expanding outreach to non-credit worthy borrowers (Moeti Damane & Sin Yu Ho, 2024)
- Thus to be relevant for economic development and poverty reduction, financial inclusion must focus on the core elements of financial intermediation such as savings mobilization, asset transformation, and risk mitigation
- Polices of financial inclusion that rely mainly on transactions rather than the whole gamut of intermediation while creating access may not translate into usage broadly defined.

Microfinance and Financial Inclusion

- Modern microfinance presents an opportunity to drive viable financial inclusion because it enhances outreach, efficiency and sustainability
- Our analysis of 34 MFIs in selected SADC countries in SADC revealed that MFIs that relied less on donations and grants but more on deposits and equity were more sustainable and impactful (Bayai and Ikhide, 2018).
- By leveraging on more modern methods of lending (minimalist models), loan portfolio management, and charging interest rates, microfinance institutions have become more sustainable.
- Thus, they overcome most of the negative consequences of financial inclusion especially credit default due to adverse selection and moral hazard while assimilating the positive benefits through retail deposit mobilization and enhanced access.
- When MFIs that serve lower end markets become sustainable, they reach, on average, 1½ times as many borrowers as other MFIs (Murdoch, 2007)

Are Microfinance institutions resilient?

- The pre-COVID-19 body of evidence tends to support the fact that microfinance especially microcredit has played significant roles in smoothing recessions, fluctuations, crises and adverse events both at a micro and macro levels (Gatto and Sadiq-Zada, 2022).
- Not all works support this finding. For instance, Di Bella 2011, found that the global financial crisis negatively impacted MFIs lending growth, asset quality and profitability.
- Our finding for South Africa revealed that despite more rigorous regulatory requirements occasioned by the financial crisis, bank lending to SMEs remained stable during the financial crisis as against lending to larger firms (Akinsola and Ikhide, 2019; Lupindo, 2017).

Building resilience (1)-Commercialization

- Most recent trends in microfinance place emphasis on financial sustainability-cost recovery and profitability.
- Attainment of financial sustainability is not an impediment to outreach efforts
    - Evidence from SSA supports the fact that sustainable microfinance has deeper outreach and impact (Bayai and Ikhide, 2018)
- Deposit mobilization and institutional self-sufficiency are key to sustainability. Sustainable MFIs will last into the future.
- With dynamic lending, loan is given out in small instalments and each subsequent one is subject to certain performance benchmarks or covenants, as strict as full repayments of the previous instalment.

Building Resilience (2): Regulation

- When MFIs that leverage on deposits are regulated, they are generally sustainable and expand outreach (Bayai and Ikhide, 2015, Haiyambo and Ikhide, 2015).
- An enabling regulatory environment not only makes MFIs sustainable but also enables them to grow
- The debate is no longer on whether to regulate or not. It is about what to regulate and how?

Building Resilience (2) – MFI why (not) regulate?

- Commercial microfinance would entail deposit taking. In many countries, regulation requires that Central banks regulate all deposit-taking institutions
- Fear also that MFIs might have access to external funding. Will such movements of funds complicate CBN monetary policy?
- On the converse, regulation might defeat the objective-access-as MFI's wind up to avoid the sledge-hammer wielded by the monetary authority
- The cost of regulation to the institutions being regulated is humongous. Can MFIs bear these costs?

Building Resilience (3): Regulation (3

- As a general rule, when it comes to regulation, financial institutions are classified based on objective risk measures that capture the risk-spillovers from one institution to the next
- The systemic risk from the failure of one MFI may not be such as to warrant macro-prudential regulation. The fraction of deposit held by MFIs in relation to total deposits may be too small to cause any system-wide perturbations.
- Thus it is suggested that regulation should be mostly microprudential and not “imposed by an external regulatory body”.

Conclusion

- MFIs provide building blocks for microenterprise development in Africa. They are also tools for poverty reduction.
- Policymakers committed to building a virile industrial base, reducing poverty and sustaining high level of economic growth must revisit commercialization and regulation of MFIs
- Each country must tailor regulation towards the peculiarities of their economies bearing in mind that regulation is essential for a resilient MFI subsector.