Changing Course

An interview with IFC's Assaad Jabre

IFC has discovered that its efforts to assist SMEs are much more effective when organized through local financial intermediaries than when carried out through direct investments. IFC is therefore moving to cut back its program of direct investment in SMEs and will focus instead on intensive efforts to help local banks, equity funds, leasing companies, and other financial intermediaries provide finance for SMEs. Assaad Jabre, IFC's vice president for operations, discussed the evolving strategy with SME Focus.

Q. When seeking to help small enterprises, how does IFC balance bottom-line business considerations with development impact or poverty-reduction issues?

A. Basically, I see no contradiction between profitability and development impact. I don't know of any loss-making project that has a strong development impact. Indeed, I strongly believe that loss-making projects are a drain on the economy of the country concerned and are not a solution to poverty.

Q. In October 2000 you visited China. What was your sense of the SME sector there?

A. I was impressed by the emergence of the domestic private sector in general. IFC recently released a study on the growth of the private sector in China, done with the help of Australian and Chinese academics and financed by the Australian government. It shows that the private sector represents 33 percent of GDP—over 50 percent...
if we include agriculture—and that it is mostly made up of SMEs. This is a remarkable achievement given that the private sector was only declared constitutional in 1999.

Q. What role do you see those Chinese SMEs playing?

A. The emergence of the domestic private sector, primarily SMEs, is going to be crucial to alleviating the negative effects of the transformation of state-owned enterprises. It can create new jobs and help mitigate the impact of unemployment. We need to nurture the development of this sector and help it grow even faster and better. This is especially the case in the western provinces, which lag in terms of GDP per capita and other criteria.

We’re proceeding with an equity investment in the Sichuan SME Investment Fund, a $30 million fund aimed at providing equity to SMEs in Sichuan, one of the largest western provinces. Our partners in this fund include New York Life, DEG of Germany, and Norfund of Norway. It is run by a U.S.-based manager specializing in small business, Small Enterprise Assistance Funds. We think we have the right combination: good market potential, private participation, and an experienced manager. While the amount of money is small, this project can show other investors that the local SME sector is viable and that good investment opportunities exist in Sichuan. We’re also working with donors to develop an SME business support facility in Sichuan that will build local business capacity, provide technical assistance to entrepreneurs, and strengthen financial intermediaries.

Q. IFC has long made direct investments in SMEs. How successful have those been?

A. We have not done as well on direct SME lending and equity investment as we would have liked. IFC does not have retail operations set up around the world, and we don’t have many services and products to offer our clients such as deposit accounts, overdrafts, or wire transfers. Consequently, our ability to engage with those clients is limited. Plus, we approached them much the same as we do larger businesses: by providing long-term loans of relatively substantial amounts in relation to their size. This was not always the appropriate way of doing things.

Q. When IFC wholesales its SME investments, working instead through financial intermediaries, is that more effective?

A. One of the criticisms was that in the past, the money we channeled through intermediaries didn’t really go to SMEs, but to larger enterprises instead. This was the case in some projects where we tried, unsuccessfully, to force intermediaries lacking interest or experience in SMEs to become involved in this sector. On the other hand, many of the lines of credit we set up to help SMEs have

See CHANGING COURSE, page 7
MeetVietnam.com

E-marketplace to increase business for Vietnamese SMEs

For Vietnamese entrepreneurs, opportunities for exporting have never been better. A new bilateral trade agreement is expected to double trade flows with the United States over the next two years. A long-planned stock exchange is finally in place, and the Vietnamese government is increasingly acknowledging the key role of small businesses in economic growth. Even so, exporting seems a distant prospect to many of Vietnam’s emerging entrepreneurs. Most are cut off from prime markets, lacking access to all-important trade facilitation services.

Ready to fill this void is a new Internet portal, MeetVietnam.com. Based on a successful model from China, it provides a “discovery to delivery” e-marketplace connecting Vietnamese SMEs with potential buyers overseas. Pioneered by the Mekong Project Development Facility (MPDF), MeetVietnam will let Vietnamese SMEs display their goods and services online through virtual “storefronts,” while overseas buyers search for products and procure online.

NEW FACILITY SEEKS INNOVATIVE PROJECTS

The World Bank Group’s SME Capacity Building Facility (CBF) supports pilot projects and partnerships that foster SME development worldwide. Launched in September 2000 with $7.1 million in funding from IFC, the facility expects to fund 20 to 40 projects in its first year. Projects must address the key needs of SMEs: capacity building, information and technology, access to capital, and improved business environments. In addition, they must be:

INNOVATIVE: having novel features and starting on a pilot basis

PARTNERSHIPS: engaging external partners

CAPACITY BUILDERS: developing local-level capacity to support SMEs

REPLICABLE AND SCALEABLE: adaptable and expandable to multiple applications

SUSTAINABLE: possessing long-term potential

STRATEGIC: aligned with the World Bank Group’s SME pillars and carrying other benefits.

At its second meeting on December 7, 2000 the CBF approved support for several new projects. Acción International, a microfinance pioneer in Latin America, will expand its proven service model to Africa. BASIX, one of the first private sector financial institutions targeting India’s rural poor, will receive technical assistance funding for its institution-building needs. A project with world-class firms like Pricewaterhouse Coopers and Computer Associates will help underserved South African communities and entrepreneurs gain access to new communications technologies.

CBF reviews project submissions quarterly.

For more information, visit www.ifc.org/sme or contact Katia Macedo (kmacedo@ifc.org).
The SME facilities that IFC manages in partnership with bilateral donors are taking an increasingly active role in helping local financial sectors work with micro, small, and medium enterprises. In Cambodia, for example, the Mekong Project Development Facility provided crucial support for the launching of ACLEDA Bank. In Kosovo, the newly formed SEED (Southeast Europe Enterprise Development) is working to steer finance to firms that can assist the country’s recovery. And in South Africa, the Africa Project Development Facility is helping a local financial intermediary reach many more small businesses through three new SME equity funds. Three reports from the field:

Microfinance in Cambodia

ACLEDA Bank Ltd. opened its doors just recently, on October 7, 2000. But its name is already well known among Cambodia’s small-scale entrepreneurs.

Established in 1993 as the Association of Cambodian Local Economic Development Agencies, ACLEDA began as a nonprofit, nongovernmental organization funded by international development organizations. Today it has evolved into a regulated for-profit institution with $22 million in assets that is Cambodia’s leading provider of microcredit, holding more than half the national market. Its 45 branches have lent $15.5 million to nearly 60,000 emerging entrepreneurs—80 percent of them women, and most living in Cambodia’s poverty-stricken countryside. Average loan size is $273, with a nonperforming rate of only 4.8 percent that compares favorably to many larger commercial banks in Cambodia.

ACLEDA’s decision to transform itself into a commercial bank was the direct result of its success. Its first five years, in which ACLEDA rapidly expanded to cover 13 of Cambodia’s 21 provinces, showed that loans could be provided to the country’s small business owners and farmers at a profit. General Manager In Channy and his colleagues realized that if ACLEDA could wean itself from dependence on donors and operate as an independent commercial entity, that would not only ensure its long-term sustainability but also increase growth potential by diversifying funding sources to include equity injections, commercial interbank loans, and public deposits.

IFC’s Mekong Project Development Facility and the United Nations Development Programme provided financial and technical support for the transformation. The technical assistance enabled ACLEDA to bring its policies and procedures in line with international accounting standards and its internal structure in line with international commercial banking standards, making it attractive to new investors. IFC has since joined KfW of Germany and FMO and Triodos Bank of the Netherlands in buying a 49 percent stake in the new bank. These new capital resources are allowing ACLEDA Bank to scale up its microcredit operations by more than 40 percent over the next two years.

ACLEDA Bank will also offer savings and fixed deposit-taking, business services long needed but out of reach for Cambodia’s rural small-scale entrepreneurs. Other services will include cash management, wire transfers, and—down the road—specially designed insurance products, said ACLEDA’s vice chairman, John Brinsden. A former senior executive at Standard Chartered, he was sent to the bank with financial support from IFC’s Japanese trust fund.

With significant additions to its staff over the past six months and further expansion planned, ACLEDA will be able to open four new offices and extend its services to another 25,000 entrepreneurs.

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**SEED in Kosovo**

As part of their efforts to rebuild Kosovo's battered postwar economy, the World Bank and the European Union (EU) are jointly funding a $10 million project that will provide credits for small and medium enterprises. As the only available source of substantial long-term loans to SMEs, this project can spur growth in a region that traditionally has had a thriving small business sector but now faces unemployment rates of 50 percent or more.

The lack of a commercial legal framework and reliable financial and market information, however, makes it difficult for the institutions to find creditworthy entrepreneurs and channel money to them rapidly. Help is coming from Southeast Europe Enterprise Development (SEED), an IFC-managed multidonor SME initiative that opened as the Balkans Enterprise Facility in September 2000.

**New Equity Funds in South Africa**

Most small businesses in South Africa do not attract investment from that country's venture capital industry. Local fund managers generally see them as high-risk and lacking the growth profile and investment potential that would make them worthwhile targets.

Research by the Johannesburg office of the Africa Project Development Facility (APDF), however, challenges those perceptions. Many local SMEs could indeed thrive and produce above-average returns for investors, especially if given access to minority risk capital backed up by management assistance and training. For this reason, APDF has been working to strengthen Khula Enterprise Finance Ltd., a government-funded initiative for micro, small, and medium enterprises in South Africa's disadvantaged population groups. Since Khula works only with companies having annual revenues of R10 million ($1.4 million) or less, the assignment gives APDF a good way to scale up its impact and reach more companies at the lower end of its target range.

Since 1997 Khula has helped almost 91,000 small businesses obtain more than R234 million ($33.4 million) in loans from local financial institutions. In 1999 it contracted APDF for assistance in helping its clients raise equity as well. The outcome was strong APDF support for Khula (the Zulu and Xhosa word for “growth”) in developing, structuring, and launching three new regional SME equity funds.

APDF reviewed the market and need for equity funds, advised on the concept, structure, location, and management of the funds, and helped locate and select their managers. It also planned to work closely with the new funds in providing business advisory services and technical assistance directly to enterprises seeking or securing financing.

The three new privately managed regional funds are capitalized at R50 million ($7.1 million) each, with Khula investing about 40 percent in each case and raising the rest from other investors. Two were started in 2000: the New Cape Equity Fund, based in Cape Town, and the MKN Equity Fund, based in Johannesburg. A third, targeting Gauteng and North West provinces, is to be launched soon. Between them the three funds are expected to invest in up to 200 firms over the next five years, scaling up APDF's impact on the local small business sector considerably.

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Partner Profile: FUNDES Internacional

It's been 17 years since the late Archbishop Marcos McGrath of Panama challenged Swiss industrialist Stephan Schmidheiny to use his business acumen to bring more widespread economic benefits to Latin America.

Today, the nonprofit organization they jointly founded is a cutting-edge player in small business development in the region. FUNDES, the Foundation for Sustainable Development in Latin America, offers a unique service model with a strong track record of cost recovery and replicability.

FUNDES initially managed a regional loan guarantee program. But by 1996 it had realized the limitations of this approach and instead began offering an integrated service package. A consulting arm was set up to diagnose SME problems and recommend solutions. FUNDES put programs through the "acid test of the market," providing only those that business owners would find useful enough to pay for.

The response has been overwhelming. Annual consulting revenues have grown from $474,000 in 1997 to $1.7 million today and are on target to rise by another 50 percent in 2001. Charging average fees of $35 per hour, FUNDES reaches 33,000 SMEs a year in Bolivia, Chile, Colombia, Costa Rica, Mexico, and Venezuela. Each of the 10 country affiliates is run as a 50/50 joint venture with the local private sector, and they address the same issues major consulting firms tackle for big business clients: strategic planning, sales and marketing, business processes, supply and distribution management, e-business.

Clients are encouraged to measure FUNDES's recommendations against rigorous performance indicators. Professor James Heckman of the University of Chicago, the 2000 Nobel laureate in economics, found that a recent FUNDES impact study "sets the standard for evaluating an important class of programs in an important sector of the Latin American economy."

FUNDES also uses funds from the Inter-American Development Bank, Switzerland, Germany, and others to develop new initiatives. For example, FUNDES runs a weekly entrepreneurship show on Chilean television and has radio programs in Colombia, Guatemala, and Panama. With a view to promoting environmental sustainability, it operates a consulting arm that helps SMEs adopt the newest clean technologies.

But for all its success, FUNDES currently reaches only a tiny percentage of its target market, and has begun working with the World Bank Group on ways to scale up. The SME Department is supporting its entry into new markets in Latin America and joint efforts with the Africa Project Development Facility in South Africa and Nigeria. "FUNDES has a unique and very effective model," said SME Department Director Harold Rosen. "We're anxious to do whatever we can to help extend their reach, and we want to pick up some of their approaches and lessons in order to improve some of World Bank Group's own advisory services. We expect a growing partnership between our two organizations this year."

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achieved their objectives. For example, in a study of Turkish banks we found that the money designated for SMEs did reach them, and that those banks would not have lent to SMEs without our support. So this kind of work has to continue, with careful selection of the financial intermediaries we are seeking to bolster. Indeed, it is increasingly becoming our primary tool in reaching this crucial element of local economies.

**Q.** In sum, when it comes to investing in SMEs, what should IFC’s role be?

**A.** We have decided to shift our concentration from direct investment to investment through intermediaries. Recognizing that our resources can be leveraged better through indirect investment, we will help our member countries build financial intermediaries that serve SMEs.

We’ll still make some direct investments in SMEs, but only where we have a very clear role to play: for example, in areas where there are no suitable intermediaries or where IFC’s financing can have a high demonstration impact.

We will also provide more technical assistance to SMEs. We’ll extend the reach of our SME project development facilities by using Internet technology and contacting a much bigger audience. In the past, these facilities helped a relatively small number of larger SMEs each year. While this is commendable, the needs out there are far greater. Our SME Department is working hard on reaching out to this wider audience. We are encouraging linkages between foreign direct investment and SMEs, for example in Russia, where we’re helping set up local supply chains to foreign companies like IKEA and Campina. We are also working with similar large investors in other countries to help finance their local SME suppliers.
CALENDAR

Seminars

NEW FOCUS FOR CAPITAL MARKET DEVELOPMENT IN LATIN AMERICA AND THE CARIBBEAN.
February 5–6, 2001, in Washington, D.C.
Sponsor: Inter-American Development Bank.
E-mail: vaniaa@iadb.org (Vania Altenburg-Lorenzo)

12th INTERNATIONAL CONFERENCE ON SMALL AND MEDIUM ENTERPRISES.
April 15–18, 2001, in Antalya, Turkey.
Sponsors: World Association for Small and Medium Enterprises and Confederation of Turkish Craftsmen and Tradesmen.
E-mail: arun@wasmeinfo.org (Arun Agrawal)

In the World Bank Group

RURAL AND MICROFINANCE BEST PRACTICES: HOW TO DESIGN OPERATIONS CONSISTENT WITH BANK POLICY.
Spring 2001 (dates to be announced), in Washington, D.C.
Sponsors: Private Sector Development; Financial Sector Development; Rural and Microfinance Thematic Group.

MAINSTREAMING MICRO AND SME FINANCE INTO COMMERCIAL BANKING.
March 2001 (dates to be announced), in Pretoria, South Africa.
Sponsors: Africa Region Private Sector Finance; SME Department; World Bank Institute; Private Sector and Infrastructure.
E-mail: aamuah@worldbank.org (Alex Amuah)

NEW PRODUCTS IN MICRO AND SME FINANCE.
March 2001 (dates to be announced), in Washington, D.C.
Sponsors: Financial Sector Development; SME Department; World Bank Institute; Private Sector and Infrastructure.
E-mail: aamuah@worldbank.org (Alex Amuah)

Training

BDS TRAINING PROGRAM 2001.
August 5–23, 2001, in Glasgow, U.K.
Sponsor: Springfield Centre.
E-mail: bds@springfieldcentre.com

BUSINESS DEVELOPMENT SERVICES.
April 2001 (dates to be announced), in Washington, D.C.
Sponsors: Europe and Central Asia Region; SME Department; World Bank Institute; Private Sector and Infrastructure.
E-mail: aamuah@worldbank.org (Alex Amuah)

WORLD BANK GROUP/INTERNATIONAL MONETARY FUND SPRING MEETING.