

Fintech and SME Finance: Expanding Responsible Access (SME Note)

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Small and medium enterprises (SMEs) represent the economic backbone of most developed and emerging countries. Globally, SMEs account for more than 90 percent of all businesses and more than 50 percent of employment. SMEs are also significant contributors of economic activity, representing on average 60 - 70 percent of the GDP of most countries worldwide.

SMEs play a major role in the economy, however their lack of access to finance in many cases is a critical barrier for them. There are many reasons preventing SMEs from obtaining adequate access to finance. These include, higher cost to reach and serve SMEs relative to the financial service revenue potential, information asymmetries that affect the availability of financial and credit data needed to assess their creditworthiness, the lack of collateral, the lack of financial literacy and difficulties in registration and verification.

Digital financial services (DFS) can help close the financing gap for SMEs, by providing access to alternative sources of funding and improving access to traditional players by enabling new digital products and process automation. Digitization and automation make the financing process more efficient, thereby lowering costs. The use of alternative data sources and Big Data analytics provides additional information sources to the credit risk-assessment process, allowing SMEs that were once unable to obtain finances to gain access. New business models, such as the sharing economy, e-commerce, digitization of SME-business processes, and open banking and APIs, provide rich data on SME activities and cashflows. This enables DFS and helps SMEs obtain access to financial products.

Globally, millions of small businesses are at risk of closing permanently and/or have suffered massive losses due to the COVID-19 pandemic. In a crisis, SMEs are more vulnerable in terms of access to finance when compared to large corporations. Speed of execution is critical for the provision of government relief funds to SMEs; digital financial products are essential to support SMEs during the COVID-19 pandemic.

However, there are obstacles and challenges which make it difficult for SMEs to fully adopt digital financial products. These are the main areas where challenges have been identified: digital financial literacy and awareness of DFS, digital infrastructure, financial supervision and regulation, identity, and data privacy and data protection. Some of the issues are more prevalent in emerging markets, which have less developed digital infrastructure, systems and processes.

Policy and regulatory approaches can facilitate access to finance for SMEs through DFS. Foundational elements where policy can have a positive impact include:

- Digital financial education programs for SMEs highlighting DFS awareness;
- Affordable digital infrastructure that fosters widespread internet access and usage, along with robust cybersecurity frameworks;
- Financial regulatory frameworks that encourage financial innovation while minimizing the risks created by digital financial products;
- Robust, secure and universally accepted company identification/registration frameworks for SMEs, and
- Adequate data protection and data privacy regulations.

In addition, policy and regulatory recommendations that are specific to digital financial products for SME financing can be classified around the following themes:

- a. Promote the digitalization of SMEs' operations, improve the availability of SME information, expand credit information sharing and support efficient and widely accessible digital payment systems;

- b. Develop modern credit infrastructure frameworks to support the introduction of Fintech asset-based lending products for SMEs;
- c. Support the growth and development of debt and equity capital platforms to improve SME access to finance through the establishment of regulatory frameworks that balance innovation with investor/consumer protection.