FINANCIAL SERVICES FOR ENTREPRENEURS

An essential lever for job creation and socioeconomic development

CONTEXT

Around the world, micro- and small enterprises[1] are an essential driver of innovation, job creation and socioeconomic development. These enterprises make up the social fabric and generate sustainable development because they are firmly rooted in their communities. However, in developing and emerging countries, limited access to financing is often a barrier to the creation, growth and sustainability of these enterprises. The World Bank reports in this regard that, of the 400 million micro-, small and medium-sized enterprises catalogued in developing economies, over half, i.e., between 200 and 245 million, have poor access to credit[2].

The entrepreneurs running these businesses are often faced with a gap (the "missing middle") in financial services: they demand financial services more sophisticated than those typically offered by microfinance institutions but without entirely meeting the criteria imposed by traditional banks. This is particularly pronounced among women entrepreneurs.

Micro- and small enterprises support both production and local consumption. Furthermore, they sometimes provide their products and services to larger enterprises that contribute, in turn, to economic growth and community development. In doing so, they directly stimulate the development of the private sector and the creation of tens of thousands of jobs accessible to disadvantaged individuals, capable of helping to lift them out of poverty and isolation.

This positive impact is all the more important since not everyone has the skills or potential to become entrepreneurs: some of them need enterprises to be created and grow around them, capable of providing them with the jobs they need. It is, therefore, important to make financing and the other financial services needed by entrepreneurs accessible to them to enable them—both them and the employees they hire—to take their rightful place in the economy and thus develop their full potential as drivers of economic growth.

> *DID recognizes that the financing of micro- and small enterprises is essential to strengthening the private sector, the creation of jobs and the economic and social development of a region or a country.*

Adequate access to financial services for entrepreneurs enables living conditions to improve, not only for the individuals who benefit from them, but also for their families and their community as a whole. In general, stimulating the creation and growth of small job-creating enterprises contributes to expanding the ranks of the middle class, with all of the ensuing positive impacts: increased

[1] As defined by the World Bank, microenterprises are enterprises employing five or fewer persons with a turnover of less than US$100,000; small enterprises are those employing between 6 and 50 persons with a turnover of between US$100,000 and US$3 million and medium-sized enterprises are those employing between 50 and 300 persons with a turnover ranging from US$3 million to US$15 million.

[2] According to the *IFC Enterprise Finance Gap Database (2013)*: http://financegap.smefinanceforum.org/.

access to health care, education, housing and transportation, general economic progress, support for democracy and stabilization of society[3].

By making available to micro- and small enterprises a specialized offering of financial services tailored to their needs, financial cooperatives and other microfinance institutions make it possible, on the one hand, to include financially entrepreneurs with limited or no access to the services offered by banks and, on the other hand, the continuation of the support they offer to their members and clients whose business activities have developed over time. This continuity is essential for these entrepreneurs who, despite having progressed in the formalization of their activities and now being able to qualify with banks, wish to maintain the business link and the relationship of trust they have established with their microfinance institution. For the latter, by thus retaining the loyalty of a member or client it is able to increase its business volume, sustain its operations and thus pursue its efforts of financial inclusion with a larger number of individuals by introducing a form of intermediation between its various clientele groups.

FINANCIAL SERVICES FOR MICRO- AND SMALL ENTERPRISES: A GAP TO BE FILLED

The offering of financial services to entrepreneurs is most often concentrated between small microfinance institutions (or traditional MFIs) and traditional financial institutions. On the one side, small microfinance institutions offer loans whose characteristics are rarely appropriate to the realities of entrepreneurs: standardized group loans or microloans that target a less organized clientele with increased risk, capped loan amounts, financial products less well defined and less well adapted to the needs of entrepreneurs, more expensive loans to offset higher operating costs and the absence of the expertise required to adequately coach and advise entrepreneurs. At the other end of the continuum, traditional financial institutions impose requirements and significant delays—in particular because of the high risk of default posed by small enterprises—and the amount of the loans offered and the corresponding service fees are often prohibitive for such enterprises.

The gap observed between these two poles is enhanced by factors such as the absence or deficiency of a credit bureau, the mediocre quality of the available information and the lack of mechanisms for recording collateral and enforcing contracts.

This gap is also reinforced by the entry barriers that undermine both the confidence entrepreneurs need to carry out their entrepreneurial project (poor financial education, limited management skills) and the means at their disposal to access appropriate financing (little or no formalization, no credit history and few or no formal guarantees) in economic and political environments that amplify the risk and reinforce this shortcoming.

The polarization of the financial services offering combined with the barriers faced by entrepreneurs puts them in a situation in which they have no access to financial services tailored to their needs and offered under affordable terms that take into account their reality.

[3] According to the Organisation for Economic Cooperation and Development (OECD).

FIRST, PROMOTE FORMALIZATION AND EXPANSION OF ENTERPRISES WITH AN APPROPRIATE LEGAL FRAMEWORK

DID recognizes that implementation by the State of measures to foster the formalization and growth of micro- and small enterprises is a condition for success for a sustainable supply of financial services to these enterprises. However, given the very high number of enterprises operating informally or with very little formalization in the microfinance market, this lack of formalization should not be an obstacle to financing.

The State should protect the property rights of entrepreneurs and provide rules and mechanisms that will seek to render secure their production capacity and encourage them to be innovative and bold in the face of risk, including the use of investments capable of increasing their productivity.

However, for companies to be encouraged to operate formally, the State should avoid imposing a disproportionate or inequitable burden in the form of registration procedures, taxation and overly stringent compliance rules that might risk not only discouraging formalization, but also encouraging a form of underground economy. An overly constrictive legal framework would also risk creating a competitive advantage for entrepreneurs operating in the informal sector, which would create yet another barrier to the formalization of enterprises.

A SPECIFIC NICHE THAT CALLS FOR A SPECIFIC APPROACH

Inasmuch as financial services for entrepreneurs make up a specific niche, DID believes that these services require an appropriate expertise and should be offered by specialized resources, with a keen knowledge of financed activities.

Entrepreneurs operating micro- and small enterprises exhibit special characteristics that must be understood and mastered by financial institutions anxious to meet their needs:

- Unlike employees, whose financial flows are predictable, entrepreneurs have irregular cash flows the cycles of which are related to their activity sector and are often difficult to predict;
- The loans requested by entrepreneurs entail larger amounts with longer terms; managing these loans is more complex, which requires additional expertise;
- Most of the time, the process of assessing the repayment capacity cannot be done by analyzing formal financial statements; therefore, alternative mechanisms must be designed to clearly establish the financial position of entrepreneurs;
- Frequently, a combination of several business activities within the same company is observed, which complicates their analysis;
- Experience shows that entrepreneurs often have little accumulated savings to secure the loans they apply for; they prefer reinvesting their money in their business or in creating personal assets. So lending institutions have to identify alternative ways to guarantee the loans granted and, above all, enhance their risk management procedures;
- Each business line is associated with its own characteristics, risks and regulations; loan officers assigned to a clientele of entrepreneurs must, therefore, possess detailed knowledge of the business sectors in which their clients operate and the profitability of the borrower enterprises.

SPECIALIZED AND QUALIFIED HUMAN RESOURCES

Financial services for entrepreneurs include enough specificities to require specialized resources to engage in the analysis of the needs of the clientele, assessment of the risks incurred, loan approval and monitoring portfolios.

A good knowledge of the business sectors financed will avoid granting loans in excessively risky activities or that do not comply with the borrowers' repayment capacity, thus preventing over-indebtedness. This knowledge will also make it possible to discern which are true entrepreneurs—a factor essential to the success and viability of the ensuing financing activities.

In addition, specialized loan officers will be better able to offer sound advice and anticipate the needs of entrepreneurs, which are factors that contribute to developing a business relationship with the borrowers that will be profitable for both the latter and the institution.

The specialization of the loan officers requires adequate and regular training as well as coaching and close supervision. It also requires these agents to be engaged in the same sector long enough to master it. Finally, it is important to properly segment loan portfolios to ensure a good match between the number and complexity of the accounts assigned to a loan officer.

Incentive Compensation

DID recognizes the importance of putting in place for employees and managers an incentive program to foster both the growth and the quality of the loan portfolio.

We must not minimize the effort to invest in the definition of an adequate and strategic program of incentive compensation capable of rallying the interests of all stakeholders. When properly formulated, incentive compensation can act as a powerful performance vector for the employees and help retain top talent within the institution.

Any incentive program should be based on developing the portfolio, but also on maintaining its quality, so as to achieve the desired objectives.

To encourage good borrower behavior, some incentives can also target the financial institution's clientele.

The Example of Client and Employee Share Ownership Programs as Incentives

In the Entrepreneurs Financial Centers (EFC) established and operated by DID, where regulations allow it, borrowers who repay their loans as agreed receive, upon loan repayment, a return that represents a certain percentage of the interest paid. Part of this amount may be converted into shares of the institution, in different proportions. As an incentive, the institution can add a sum that changes according to the borrowers' commitment.

In the case of employees, the share ownership program is restricted to those with more than one year in service and satisfactory performance. These employees can then contribute to the program by deducting a certain amount from their salary, to which the institution can also add a corresponding amount.

Besides the fact that it enables the institution's clients and employees to become co-owners, this program also acts as an important development tool by:

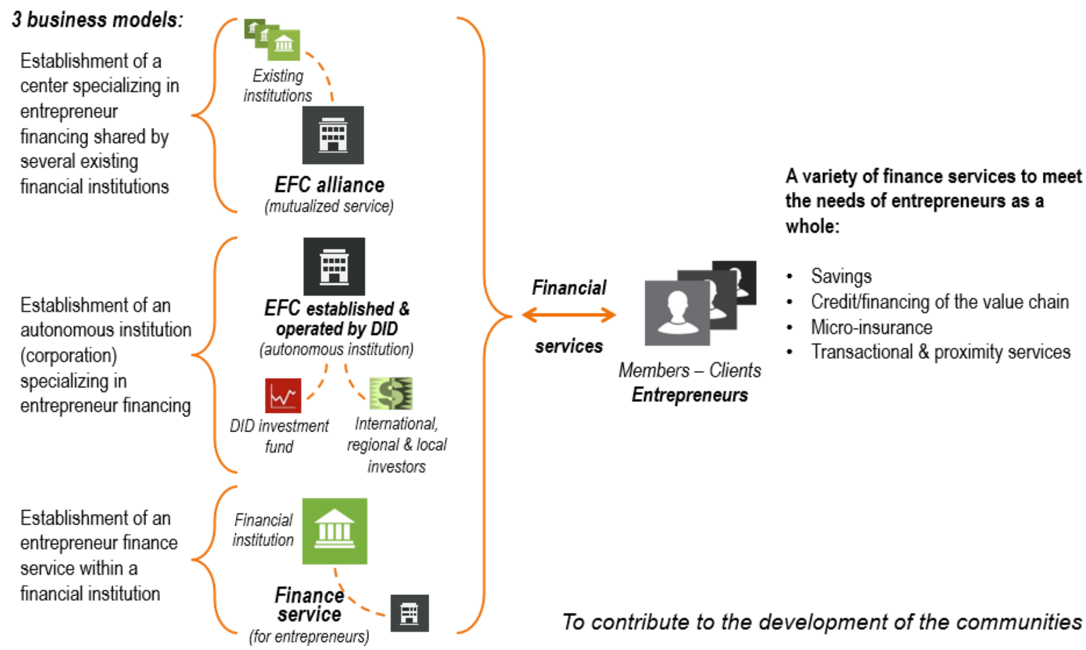
- *creating a sense of belonging for both clients and employees;*
- *fostering the establishment of long-term capital (to finance various projects or to serve as a retirement fund to which entrepreneurs would not otherwise have access);*
- *participating in the financial education of the clients and promoting good repayment habits among borrowers;*
- *encouraging good performance and staff retention.*

DIFFERENT POSSIBLE STRUCTURES, THE SAME METHODOLOGICAL APPROACH

Although various structures can be put in place to give entrepreneurs access to financial products and services tailored to their specific needs, DID believes that all of these structures, regardless of their form, should use methodologies focused on proximity, rigour and a keen understanding of the business lines financed.

While most first-tier financial institutions do not have, individually, a pool of experts or sufficient knowledge to adequately meet the needs of entrepreneurs, DID particularly recommends using three different types of specialized structures, each acting as a center of expertise devoted to improving the offer of financial services to entrepreneurs:

- A specialized department within a financial institution (whether a first-tier financial institution or an apex organization).
- A specialized center attached to an existing cooperative financial network and shared by multiple first-tier financial institutions. Among DID partners, these mutualized institutions are called Entrepreneurs Financial Centers (EFC) "alliance". These centers, which are not separate legal structures, have the advantage of concentrating and equipping staff in a center exclusively devoted to the management of financial services for enterprises on behalf of the participating financial institutions, while providing an accessible entryway and thus maintaining an outreach service for entrepreneurs.
- An autonomous Entrepreneurs Financial Center (EFC) devoted exclusively to an entrepreneur clientele: although it may target a particular niche, this type of institution should nevertheless have an inclusive approach and aim to increase real access to financial services for a heretofore poorly served clientele.



Although they take various legal forms, each model emphasizes the need to develop, centralize and professionalize the expertise related to financing entrepreneurs, while favoring a proximity relationship with the target clientele.

WHICH ENTERPRISES SHOULD BE FINANCED?

> *DID recognizes the importance of adequately segmenting and selecting target markets, so as to be able to properly manage the risks specific to each segment and better meet the needs of each one of them.*

The rigorous selection of entrepreneurs is a key factor in risk management. Financial institutions should therefore:

- select entrepreneurs who can demonstrate their commitment and sense of entrepreneurship (so as not to finance improvised enterprises or entrepreneurs with nothing to lose); from this perspective, DID believes that the risk associated with starting a business requires support mechanisms other than the provision of financial services alone and, therefore, startup enterprises should only be financed if these additional mechanisms are available;
- favor formalized enterprises[4] or promoters demonstrating a clear desire to be coached in this formalization;
- focus on enterprises that have a distinct advantage over the competition;
- exclude enterprises whose activities are of a speculative or illegal nature.

[4] Usually, the degree of formalization increases as the enterprise grows and ages. This formalization results in an increased separation between the entrepreneur's assets and the enterprise's assets by means of a more rigorous accounting, the availability of guarantees, resorting to financial services other than credit, the number of external staff and the fact that decisions are made on the basis of long-term business planning (Jasmina GLISOVIC and Meritxell MARTINEZ, *Financing Small Enterprises: What Role for Microfinance Institutions?* Focus Note No. 81 of the CGAP, July 2012).

Moreover, financial institutions should systematically refer to the notion of the "5 Cs"[5] when analyzing and deciding whether or not to grant a loan: **c**apacity for repayment (present and future), **c**apital (net worth), **c**haracter (integrity of the borrower), **c**onditions and **c**ollateral (guarantees).

INCLUSION OF WOMEN: A KEY TARGET

DID advocates the adoption and implementation of specific strategies to promote access by women entrepreneurs to financial services and the success of their business projects.

A very high proportion of entrepreneurs operating in the informal sector are women; they also account for a significant share of the formal sector entrepreneurs. Often, the creation of a business is the only way these women can earn an income they will use to ensure the wellbeing of their family[6].

The Global Entrepreneurship and Development Institute (GEDI) highlights the positive role that women play in the socioeconomic development of communities and the challenge for them to access to resources they need:

> *"Female entrepreneurship is a key driver of a country's prosperity; by creating the conditions for women entrepreneurs to flourish, countries are investing in their national well-being and competitiveness. Yet many women founders struggle to access the capital, technology, networks and knowledge that they need to start and grow their businesses."*[7]

Unfortunately, the literature clearly shows that women have more difficulty than men in obtaining the financing they need to start or grow their enterprise (especially since they often have fewer assets to offer as collateral) and when they do have access, they are often only entitled to loans for smaller amounts and at higher interest rates than those usually granted to men[8].

In this context, DID encourages financial institutions to take specific measures so that women fully benefit from the services offered, succeed in taking their rightful place in the local economy and improve their living conditions and those of their families.

Strategic planning of financial institutions should, therefore, clearly document the situation of women entrepreneurs in target markets, so as to adapt, in consequence, the financial services to be designed and offered for them, particularly with respect to delivery mechanisms, loan terms, guarantees required and the non-financial support that could benefit them.

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5 Consult in this regard DID's position paper entitled "Sound Credit Practices: A Key Element for Community Finance Institution Sustainability: http://www.did.qc.ca/media/documents/en/positionnements/DID-SoundCreditPractices-May2005.pdf.

6 Women typically spend a larger share of their earnings on their families and their community than men do. A study conducted in Brazil showed that the chances of survival of a child increased by 20% when it was his mother who managed household income (according to the speech by Robert Zoellick, President of the World Bank, at the Copenhagen Conference on MDG3, March 25, 2010).

7 According to the *Gender Global Entrepreneurship and Development Index*: http://i.dell.com/sites/doccontent/corporate/secure/en/Documents/Gender_GEDI_Executive_Report.pdf.

8 "*Strengthening Access to Finance for Women-Owned SMEs in Developing Countries",* International Finance Corporation (IFC): http://www.ifc.org/wps/wcm/connect/a4774a004a3f66539f0f9f8969adcc27/G20_Women_Report.pdf?MOD=AJPERES.

RIGOUR, AT THE HEART OF ENTREPRENEUR CREDIT MANAGEMENT

In entrepreneur financing, DID believes that a financial institution must adopt standardized practices and demonstrate exemplary rigour at every step of credit management, in particular when analyzing, granting and tracking loans.

Consistency, objectivity and standardization in lending practices are essential to enable the financial institution to grant quality loans, thereby building a sound loan portfolio.

The prevention of fraud, both internal and external, is a major issue in terms of credit management. So the credit management process must be structured to avoid any form of favoritism or fraud and be subjected to good internal control. In this context, finance-related practices should be depersonalized and rely on a proper selection of loan applications. This selection should, in turn, be based on a rigorous verification of the information received as well as on several counterchecks that will make it possible to validate and objectify the decisions made.

As mentioned above, the loans granted should meet the real needs of the enterprise. Indeed, financing that exceeds need exposes the entrepreneur to difficulties and thereby the institution to a risk of default. Similarly, a loan that does not cover the enterprise's needs may push the borrower to round out his financing from other institutions. Resorting to several lenders exposes the entrepreneur to a mismatch between cash flow and loan repayment, which may lead to default in making the payments and, even worse, over-indebtedness that endangers not only his enterprise project, but also his personal and family situation.

Financial institutions should also coach entrepreneurs by granting them loans the terms of which are tailored to the flows of their activities. In this connection, they should seek to establish with their clients a long-term relationship characterized by trust and transparency.

DID also recognizes the importance of laying down terms suited to the constraints and realities of the entrepreneurs and their business line:

- Promptness (at all steps of the application process);
- Adaptability (regarding the loan term, its repayment schedule, required collateral, etc.);
- User-friendliness and proximity (through an approach based on guidance, delivery mechanisms that foster greater accessibility and the use of technologies to facilitate loan disbursement, tracking and repayment).

With regard to credit management, in general, and credit to entrepreneurs, in particular, DID advocates observance of the seven client protection principles laid down by the Smart Campaign[9]:

1. Appropriate product design and delivery
2. Prevention of over-indebtedness
3. Transparency
4. Responsible pricing
5. Fair and respectful treatment of clients
6. Privacy of client data
7. Mechanisms for complaint resolution

[9] www.smartcampaign.org.

By specifically adhering to these principles, financial institutions contribute to building a strong and lasting relationship with their clients, reducing financial risk, strengthening the credibility of the inclusive finance sector and positioning themselves as leaders within this sector.

Credit Risk Management

In terms of credit risk management, DID advocates above all good diversification of the loan portfolio and business lines financed.

The risks associated with entrepreneur credit management[10], proportional to the variability of cash flows of entrepreneurs, are different from those associated with other forms of financing. Unlike employees, whose income is regular and predictable, entrepreneurs have both income and expenses that may vary over time depending on the demand for their products or services, the availability and cost of inputs and many other factors.

To better manage these risks, a financial institution must, therefore, diversify its loan portfolio by targeting entrepreneurs working in different business lines and having different financial flows, or through financial mechanisms such as portfolio-sharing with an apex organization or a financial institution located in another region. Not only does this practice protect the institution against an excessive variance in cash flows, but it will also avoid losses if one sector in particular experiences major difficulties. A financial institution should also seek to diversify its activities by covering several regions. It will also reduce the various risks it faces by:

- adequate matching of resources and good liquidity management;
- sustainable access to the funds it needs to lend;
- high financing standards;
- close and constant monitoring of the loan portfolio;
- creation of a reserve fund.

Interest Rates

DID believes that interest rates should be calculated using the declining balance method established so as to ensure the sustainability of the institution while promoting adequate and equitable access to credit for the target clientele. These rates should reflect the overall cost of credit and enable the institution to generate a reasonable return without, however, passing on to the clients the cost of the institution's inefficiencies.

The pricing and terms adopted by a financial institution need to be transparent and known to the clientele. They must make credit accessible to the borrowers while allowing the institution to ensure its own viability. This pricing should furthermore be competitive and reflect actual market conditions. DID advocates unsubsidized pricing, which does not create any market distortion, in order to avoid harming the borrowers by offering them terms advantageous in the short term, but not viable in the long term[11].

[10] See also DID's position paper entitled "Sound Credit Practices: A Key Element for Community Finance Institution Sustainability": http://www.did.qc.ca/media/documents/en/positionnements/DID-SoundCreditPractices-May2005.pdf.

[11] A principle also advocated by the CGAP: https://www.cgap.org/sites/default/files/CGAP-Consensus-Guidelines-Key-Principles-of-Microfinance-Jan-2004.pdf.

The interest rates charged by a financial institution may vary from one financial product to another, depending on the risk each one entails. They may also be modulated depending on the risk associated with each borrower or category of borrowers, insofar as this segmentation can be performed on the basis of reliable information obtained—for example from a credit bureau or a risk center.

Moreover, a borrower who is on his second loan could be offered a lower interest rate, to the extent he has complied with all of the terms associated with his first loan; this is one way of encouraging sound repayment practices while promoting client retention. The institution may also encourage good repayment of a loan by offering a financial incentive if the entrepreneur is meeting his repayment obligations.

Collateral

DID believes that collateral is needed for a reciprocal commitment between the financial institution and the enterprises it lends to.

Individuals operating micro- and small enterprises rarely have a solid credit history and often do not have personal or real property that can be validly used as collateral for a loan. This situation is explained by the fact that, when they own a house, a plot of land, a dwelling or a car, only rarely do they have a formal property title that confirms the ownership or even the value thereof.

In this context, and considering the importance of collateral, the financial institution must both expand the types of collateral that can secure loans and inform entrepreneurs about the steps to be taken to formalize ownership of these assets to secure their wealth.

In all cases, when the institution agrees to take as collateral assets, whatever they are, this must be done in compliance with the nation's laws. Institutions are advised to work in partnership with professionals such as valuators, notaries and lawyers to ensure that the practices of accepting collateral comply with the legal framework with regard to the process of assessment, recording and realizing collateral—which may entail significant costs. Mechanisms should furthermore be provided to limit or reduce the expenses associated with the renewal of these guarantees.

It is also important to recall that the decision to lend is not conditioned by the collateral and should first of all rely on the viability of the project to be financed as well as the borrower's character and repayment capacity. Criteria such as capital (net worth), terms and collateral should rather guide how the loan will be secured[12].

Loan Monitoring and Collection

DID believes that strict monitoring of loans facilitates collection and that all actors of the financial institution must be mobilized around the monitoring as required by their duties.

The chain of command of a microfinance institution takes on a particular importance in the loan collection process. It is indeed crucial that all of the persons who make up this chain i) share a common vision about the objectives pursued and the need for daily monitoring of results and ii) advocate coherent measures to achieve the objectives set.

[12] See DID's position paper entitled "Sound Credit Practices: A Key Element for Community Finance Institution Sustainability": http://www.did.qc.ca/media/documents/en/positionnements/DID-SoundCreditPractices-May2005.pdf.

It is also important not to entrust only to a small group of persons the responsibility for monitoring the loan portfolio and collection operations. Both loan officers and managers should have access at all times to information concerning the balances of the loan portfolios and consult this information on a daily basis to be able to quickly detect accounts with potential problems and take the necessary measures. So collection is everyone's business.

To avoid deterioration of the portfolio at risk (PAR), managers will do well to i) ensure the maintenance of an adequate ratio in the number of loan accounts per loan officer, taking into account the market segment served, and ii) establish incentive compensation measurements and targets to help maintain a balance between growth and risk of the loan portfolio.

RESPONDING TO A DIVERSITY OF NEEDS BY A DIVERSIFIED SERVICE OFFERING

DID recognizes that credit is just one of the multiple financial services needed by enterprises. An institution specializing in financing enterprises should, therefore, aim to meet all of these needs, whether by itself or by entering into collaborative arrangements with other actors.

Besides the fact that they need flexible conditions adapted to their reality, entrepreneurs also need a variety of financial services targeting both the development of their enterprise and the satisfaction of the needs of their family: commercial credit, agricultural credit, housing loans, insurance and savings.

Offering effective and secure transactional services also meets a growing need proportional to the development of an enterprise. So a financial institution needs to integrate effective payment systems, funds transfer or currency exchange services. The absence of such services often forces enterprises to do business in more than one place, which does not foster client retention and indirectly encourages paying off one loan with another.

In all cases, the financial institution should take into account the special characteristics and constraints related to its market when developing its service offering or entering into partnerships with other providers of financial services.

BUSINESS CREDIT

Business credit seeks to improve the production activities and the operations of an enterprise (regardless of how small it is), for example, by purchasing equipment, inputs or inventory, which usually helps consolidate or increase the enterprise's profits. This feature implies that the repayment of a commercial loan is usually done based on revenues generated by the activity or the acquisition that this same loan has made possible.

This type of credit is quite different from consumer credit as its repayment is more related to the enterprise's revenues, the size and frequency whereof depends on the performance of the business, and not a regular salary. So the repayment of a business loan depends on several variables that must be evaluated regularly such as repayment capacity (based on the income statement), the capacity of injecting capital (based on the enterprise's balance sheet), the performance and the potential for the growth of the enterprise, as well as the liquidity at its disposal.

The main commercial credit products offered by a financial institution may be supplemented by more specific products that target, for example, micro-enterprises or women merchants working in markets, which will make it possible to increase the contribution of the institution to the financial inclusion of a greater proportion of the community in which it is rooted.

AGRICULTURAL CREDIT

Farmers are also entrepreneurs and, therefore, need specialized financial services, especially as they are a class of entrepreneurs particularly vulnerable to usurious lenders.

The design and management of an agricultural financing service offering necessitates taking into account a large number of factors, such as cash flows and the risks linked to the management of an agricultural activity[13]. The management of finance risks associated with this type of enterprise should, therefore, be adapted to these different factors.

HOUSING LOANS

DID's experience shows that the housing finance offering meets a very strong demand, especially from entrepreneurs. These products can help entrepreneurs acquire, renovate or expand commercial premises, houses or apartments that they can then rent out or even private schools managed by them. They can also help them build their personal assets, which can be all the more significant since it is often very difficult for these individuals to get a mortgage unless they have a regular salary. Experience shows in addition that these products contribute to the good financial results of the institutions that offer them[14].

More generally, a housing finance offering tailored to local realities may contribute to increasing the availability of quality housing for the disadvantaged; the financial institution offering this type of financing thus contributes not only to improving the financial inclusion of the population, but also its quality of life and local economic growth[15].

INSURANCE

A financial institution should offer borrowers a loan insurance product to protect family wealth, in addition to the institution itself. Additional life, property, casualty or crop insurance should be offered when available on the market. Furthermore, since entrepreneurs rarely have access to a pension plan, the financial institution can fill in an important gap by offering its clients a micro-pension product.

All of these insurance products should be offered by a formal insurance company owned or associated with the financial institution[16].

[13] See to this end DID's position paper entitled "Agricultural Financing: A Powerful Tool for Contributing to the Food Security of the Populations": http://www.did.qc.ca/media/documents/en/positionnements/DID-AgriculturalFinancing-November2010.pdf.

[14] See in this regard the assessment of the impact of EFC Zambia, the Entrepreneurs Financial Centre set up and operated by DID in Zambia: http://www.did.qc.ca/media/documents/en/autres-publications/impact-efc-zambia.pdf.

[15] See in this regard DID's position paper entitled "Housing Finance: Facilitate Access for Families to Healthy and Secure Housing": http://www.did.qc.ca/media/documents/en/positionnements/DID-HousingFinance-September2010.pdf.

[16] For more details, readers may refer to DID's position paper entitled "Microinsurance: Reduce the Vulnerability of Families in the Event of Unexpected Situations": http://www.did.qc.ca/media/documents/en/positionnements/DID-Microinsurance-September2010.pdf.

SAVINGS

DID's experience shows that, while voluntary savings meet a need, most entrepreneurs prefer to reinvest their savings in their business or simply use them to fuel their working capital and their inventory, perform their current operations or fund their personal needs. In general, it is more profitable for them to reinvest their surpluses in their business to support its growth.

Nevertheless, by offering savings products tailored to the needs of its different clientele groups, the financial institution encourages its clients to adopt sound financial habits, while acquiring an additional source of financing that reduces their vulnerability to external shocks[17].

The savings products offered may include sight savings accounts (current accounts), term deposits (which will increase the availability of long-term resources for the institution) and proximity products for the regular collection of small savings, with few transaction costs and ideally requiring no minimum balance.

This last type of product meets the needs of entrepreneurs in the process of formalization who want to deposit their daily income and thus have receipts confirming this income.

Compulsory or pledged savings, although it contributes to the creation of wealth and secures the loans granted, should be kept at a minimum threshold. It should vary according to the type of financing requested by the borrower and decrease according to the degree of risk attached to this financing and other available collateral.

TRANSACTIONAL SERVICES

Experience shows that, after lending, transactional services are the ones most requested by entrepreneurs. They should indeed be able to easily access their funds, make payments or collect amounts owed. Designing services meeting these needs and the use of effective technologies to make these services user-friendly and efficient is, therefore, imperative.

The impact of transactional services on the quality of the loan portfolio is not negligible, especially in the case of micro- and small enterprises. For example, the mere fact of not offering entrepreneurs the ability to make remote deposits may cause delays in loan payments, which might instantaneously affect the portfolio at risk (PAR) 1 day. Also, the lack of payment services (such as checks) pushes growing businesses to turn to banks to meet their transactional needs, which promotes the dispersal of borrowers and reduces the transparency of operations. Cash management is also part of the transactional services required by entrepreneurs. This management remains a challenge for microfinance institutions, which should increase the flexibility of withdrawal services for entrepreneurs so they are not forced to keep large sums with them because they don't have quick access to funds.

[17] See in this regard DID's position paper entitled "Savings: Building the Future": http://www.did.qc.ca/media/documents/en/positionnements/DID-Savings-September2005.pdf.

Business Development Services

DID recognizes that business development services targeting financial education and the enhancement of entrepreneurs' skills are factors that formalize businesses and mitigate risks. They contribute directly to both the success of the enterprises and the financial institutions that serve them. These services should be offered in partnership with external providers.

Experience shows that one of the main factors hindering the development of enterprises is the lack of the entrepreneurs' financial education and technical skills, especially in planning, accounting and management. So microfinance institutions would do well to remedy these shortcomings. Indeed, by strengthening these entrepreneurial skills, the institution will thereby enhance the repayment capacity of its clients.

Although the financial institution's credit counselors and loan officers are able to play an advisory role by relying on the special relationship they establish with financed entrepreneurs, this role should be limited to the sphere of financial education and finance.

To help entrepreneurs strengthen their entrepreneurial skills, prepare their business plan or formalize their accounting, financial institutions should rather refer them to the appropriate resources or develop partnerships with external organizations specializing in the offering of such support services. These services should not be funded from the financial intermediation spread, but rather be paid for according to a different price schedule.

However, writing a business plan should not be a condition essential to financing a project, but rather be encouraged on a voluntary basis. Experience shows indeed that business plans, although they are an important step in an entrepreneur's progress by helping him to ask the right questions and validate how realistic his project is, are sometimes drawn up by third parties and are, therefore, not fully mastered by the entrepreneurs who file them. The business plan alone is, therefore, not a guarantee of success for a given business project. From this viewpoint, more emphasis should be placed on providing technical coaching to the entrepreneur.

Using Technologies

DID recognizes the importance of technology as a factor for outreach, user-friendliness, speed, security and efficiency—all key factors for an entrepreneur's success. Technology facilitates the management of operations by the financial institution and makes financial services more accessible to entrepreneurs.

For a financial institution, technology solutions ensure better monitoring of operations, improving the delivery of products and services, enhancing the security of transactions and data and promoting good governance and enlightened decision-making.

DID, therefore, advocates when possible[18] the use of technology to support all systems of a financial institution:

- Support systems (financial management and accounting, marketing, office automation, telecommunications, workflows, etc.)
- Operational systems (savings, credit, insurance, transactions)
- Governance systems (decision-making support and accountability)

[18] See DID's position paper entitled "Technological Solutions: Increase the Outreach of Financial Services Through Expanded and Secure Access": http://www.did.qc.ca/media/documents/en/positionnements/technological-solutions.pdf.

Considering the importance, for a financial institution dedicated to the financing of entrepreneurs, to ensure close monitoring of loans granted, it is imperative to make use of technological systems that will make it possible to collect and effectively share data. The processes of analyzing and granting, taking collateral, disbursements, monitoring and collections should all be organized and, to the extent possible, automated, so that the entire financing operation will be standardized and treated uniformly. The use of real-time databases is also essential for the management and monitoring of the loan portfolio since it will make it possible to quickly detect any late payment in addition to facilitating and standardizing risk management.

Financial institutions should also put technology at the service of user-friendliness and the proximity of services for the entrepreneurs served: mobile transactional applications, loan payments by cellphone, texting payment reminders, smart cards, biometrics, prepaid credit cards, etc.

Protecting the Environment

DID encourages financial institutions to adopt awareness-raising measures in order to protect the environment, but nevertheless believes that these institutions have limited power with respect to environmental protection, in particular, including the absence of frequently observed clear and enforced rules to enable them to introduce the principle of eco-conditionality in the granting of loans.

A microfinance institution has to comply with the regulatory requirements in force in the region or country concerned with regard to the environment. It should also adopt an environmental policy, establish a list of exclusions specifying which practices or business sectors are to be avoided and identify mitigation measures to be advocated in cases where risks to the environment appear.

Loan officers should also be aware of environmental issues and the potential impact on the environment of certain industrial practices, for example, by attending topical training sessions, in order to orient, as needed, entrepreneurs to more environmentally sound and respectful practices.

Lastly, financial institutions should themselves adopt best practices with respect to their own use and recovery of resources.

It should nevertheless be recognized that the commitment of a financial institution in this regard is limited by the environmental regulations in force in the region or the country concerned.

CONCLUSION

By offering to micro- and small enterprises financial services tailored to their needs and their reality, financial institutions are making a major contribution to the creation of jobs and the socioeconomic development of their communities.

To do this, they must treat this clientele as a particular niche, which requires distinct practices and expertise. They must offer a diversified range of products and services to meet all the specific needs of the entrepreneurs. These products and services must also be provided on terms that recognize the reality of the entrepreneurs. In all cases, the provision of specialized services to entrepreneurs should be marked by proximity—a condition essential to a good understanding of the persons and sectors financed, as well as adequate coaching that will contribute both to fostering formalization and the proper development of enterprises and to encouraging proper behavior on the part of the borrowers. Rigour should be practiced at all stages of the analysis, granting and monitoring of loans, as it is at this price that the financial institution can ensure its sustainability and continue its contribution to the development of the private sector.

The numerous testimonies received from financed entrepreneurs well reflect the enormous impact provided to them by a greater access to financial services, at several levels: personal and entrepreneurial development, self-fulfillment, pride, financial education, asset-building and independence.

Making the financial services needed by micro- and small enterprises more accessible and offering these financial services in a rigorous and viable manner is also an engine of development that is economic as well as personal and developmental for both individuals and the communities they live in.

GROWTH

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for microfinance
and its cooperative institutions

For 45 years, Développement international Desjardins (DID) has worked to improve access by communities in developing countries to quality financial services that meet their needs. In order to do this DID supports the creation, development and strengthening of sustainable financial institutions that are rooted in the community. DID's activities are backed by the 115 years of experience of Desjardins Group, the largest cooperative financial group in Canada and the fifth largest in the world.

To consult DID's other position papers, or for any other information about our organization, you may visit our website at www.did.qc.ca/en.

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