Plenary 3: Growing micro clients’ business

Session Synopsis
Enhancing opportunity for micro and small entrepreneurs through diversification, new markets and other pathways is important to achieving financial inclusion in the Pacific. To successfully enhance these opportunities, a conducive environment must be provided, with financial service providers and agents having a key role.

**The needs of microfinance clients**

Many microfinance entrepreneurs need training to help them develop their business to become sustainable. Being sustainable impacts their ability to not only repay their micro credit loans but also can flow through to supporting themselves and their families. The provision of financial training and access to savings services are crucial for most microfinance entrepreneurs to provide them with the basic skills necessary to make their business successful while also providing the means for them to store, manage and grow their financial assets. Training and education is an opportunity for financial services providers, government and development partners to work together on delivery, as training and education needs are not necessarily product specific and benefit the community generally.

Due to the relatively small population base in the Pacific, microfinance clients must consider a range of strategies to grow, beyond selling more of the same. Diversification is one way that a small enterprise can maximize their income. If a microfinance client has a successful business selling fruit, that microentrepreneur may not be able to expand by selling more fruit, as they may run out of people to sell to. An alternative is for that microentrepreneur to secure a micro loan, and expand into other areas, such as sewing or baking. Microfinance can help whole households. For example, if a woman takes a loan to expand her business, a positive credit history developed as a result can enable her to later take a second loan for her husband to start a taxi business. Diversification is not just about one person doing more jobs, but about creating new jobs for more people.
Even if a start-up business fails, a client may still have developed a good credit history. In this case, they may take a second loan to try another business – and the second attempt may be more successful as the client will have learned from previous mistakes.

**Savings and Alternative Loan Structures**

A micro businesses requires savings to grow and expand. Having access to savings enables access to loans which can be used to support the development of their business. A bank account can provide a safe place for an individual to grow their savings, and accounts can be established in a way that limits access by family members and friends - giving the business owner direct control over the funds. While savings accounts can be very useful in this regard, many people prefer to put their savings into tangible assets such as livestock or jewelry, rather than into a bank account.

If a client does not have enough savings available to make a deposit, a financial institution may still grant a loan which might include a ‘forced savings’ requirement. Under such an agreement an agreed portion of income will be deposited into a savings account only to be withdrawn if it becomes necessary in order to expand or diversify the business. Setting aside some profit into savings enables microentrepreneurs to think about other business opportunities to pursue.

Moveable assets are an increasingly popular source of collateral for security over a loan where a client does not own land. The use of such assets as collateral is very important for micro and small enterprises to be able to access credit and many developing countries are exploring formal ways by which such services can be provided and regulated.

Informal lending in the Pacific remains culturally popular and significant, but as financial institutions develop and diversify their savings and loan products, and the community becomes more aware of the security and opportunities an account offers, the problems with informal lending can be reduced.
Challenges

One of the biggest barriers for financial institutions to support micro and small enterprises is the cost of maintaining a loan program on a regular basis. For example, if a rural customer defaults, the cost of sending bank officers to these remote settings is very large. In order to be viable, financial institutions need to look to solutions that minimize their costs. Remoteness is a time cost for microentrepreneurs also, and time taken to travel to and from a bank is time that could have been spent on the business. Mobile and agent banking help address this challenge for both the financial institution and clients.

Another challenge is how to manage the (moral hazard) risk of clients using their business loan funds for non-business purposes. This risk can be mitigated through the provision of financial education to help customers make more informed decisions about how to use their loan and maximize the benefits and opportunity that having access to finance provides.

A challenge for development-oriented financial institutions working with people with a desire to build a small business but little education is how far to go with assistance and the client relationship. Is a bank account or mobile wallet enough? Maybe information about how to save and how to borrow. Perhaps explaining how different types of financial products can be used for different situations. Discussing the management of cash flow and other ways to grow a small business. The approach is influenced by the institution’s mandate – it may be minimalist or holistic.

Institutions providing microfinance regularly monitor the number and types of enterprises operating in their areas through surveys and maintaining databases. This allows the institution to monitor the types of businesses and various product offerings available in any particular area so that when considering new business loans financial institutions are not inadvertently contributing to an oversupply of any one type of business. Where they can, microfinance lenders develop a portfolio of business types across different geographic areas as a means to reduce sector or portfolio risk and underpin the sustainability of the financial institution.

Key Points:

- Financial institutions supporting micro and small enterprises need to consider the level of engagement with clients in helping make their business sustainable and grow over time. Providing opportunities to develop the skills of clients can increase the success rate of their businesses, in turn enabling clients to repay their loans as well as support their families. Financial institutions can also help their clients understand the importance of diversifying their products as a key business strategy, and importance of developing a positive credit history.
which is beneficial should their business struggle or fail, or apply for additional funding to expand the business.

- Financial institutions can also encourage good savings habits with their clients, which can help micro and small businesses to grow and expand. This can include “forced savings” to help clients realize the importance and value of saving and how it can impact the success of their business. Financial institutions can also look at ways clients’ can use their non-land assets as collateral to provide more opportunities to access credit.

- Financial institutions face several challenges in supporting micro and small businesses. Included among these is the often high cost involved to support these clients (and how to lower these costs to an acceptable level that makes lending a viable option for the bank), and helping clients understand how they can use their loan and the types of business decisions involved. Such challenges can be addressed through financial education programs offered as part of a loan program, and augmented with support of government and development partners. Lastly, the ability of financial institutions to help grow micro clients’ businesses depends on the sustainability of the institution itself, which requires a balanced loan portfolio and attention to broader market conditions and competition within the sectors their clients operate.