Finance to SMEs in Japan and Asia

The views expressed in this presentation are those of the author and do not necessarily represent those of the IMF or IMF policy.

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Outline

- Contribution of SMEs to an economy
- Challenges to SME financing
- Credit Information Issues
- Design of Risk Sharing
  - Debt Financing: Public Credit Guarantees and Collateral
  - Equity Financing: Risk Capital
SMEs’ contribution to an economy in Asia: GDP and employment

**Contribution to GDP of SMEs**
(In percent; and in year of latest available data)

**Number of Employees of SMEs**
(In percent of total employees; year of latest available data)

**Job creation shares by firm size and country income**
(In percent of total job creation; out of 85 countries)

Sources: Asian Development Bank (Shinozaki, 2012)

Sources: World Bank (2011, Ayyagari et al.)
1/ average of lower-middle income and upper-middle income countries
Challenges to SMEs: low profitability

Estimated Coefficients of Impact on Adjusted Net Profit by Firm Size
(after accounting for time trend based on coefficients of yearly dummy variables)

- Firms with large capital base
- Firms with small and medium capital base

Cross-country Comparison of Return on Assets, by Firms’ Assets Size (in percent)

Source: W. R. Lam and J. Shin (2012)
Challenges to SME: SME financing gap

Obstacles to growth of SMEs
(In percent of respondents per region, percent)

- Access to Finance
- Electricity
- Practices of competitors in the informal sector
- Tax rates
- Courts

Portion of under-served or unserved SMEs
(In percent of total SMEs)

Sources: IFC/Worldbank Enterprise Survey 2006-10; and McKinsey (2012)
1/ median value of estimated portion
Challenges to SME financing

- **Risk:**
  - Higher credit risks
  - Lack of reliable risk measures and records (financial statements)
  - Little credit history

- **Collateral**
  - Lack of or inadequate collateral
  - Burden of personal guarantees

- **Costs**
  - Lower debt service capability
  - Higher monitoring costs
  - Higher transaction costs for small loans

Credit bureau and credit availability

- Provide information to estimate repayment capacity
- Reduce asymmetric information
- Help set interest rates based on risk
- Positive correlation between credit information sharing and credit availability

Source: Mckinsey (2012)
Credit bureaus in Asia

- Japan: CRD
- Korea: KCB and NICE
- Malaysia: mandatory participation
- Thailand: two credit agencies.
- Indonesia: The CIB was created by the BI. Plans to create a private one.
- China: The central bank established the PCIC.
- India: Many credit bureaus, but the CIBIL is the most important.

Source: Standard Chartered (2013)
Policy implications for credit bureaus

- Comprehensive and timely data coverage
- Non-financial information
  - e.g. utility payments, rental payments, and phone bills
- Coordination among authorities and institutions
SME Finance: Risk Sharing

- Debt Financing
  - Public credit guarantees
  - Collateral

- Equity Financing
  - Risk capital
Credit guarantees

Outstanding Credit Guarantees in Japan
(In billions of yen otherwise noted)

Sources: Credit Guarantee Corporation and IMF staff estimates
1/ Fiscal Year

Source: OECD (2013)
Outstanding credit guarantees in Asia

Outstanding Credit Guarantees 1/
(In percent of GDP)

Credit guarantee outstanding
(In percent of GDP)

Sources: OECD (2013), Japan CGC, Thailand SBCG, Taiwan POC SMEG, and IMF staff calculations
1/US (2010), Thailand (Q3 2013), and the other countries (2011)

Sources: World Bank (2008, Beck at el.)
According to a study into 70 guarantee schemes,

- 17 guarantee schemes cover 50% of credit risk
- 8 schemes cover 100% of credit risk
- The remaining 45 schemes cover between 60-80% of credit risk

Source: KPMG (2011)
Impact of generous supportive measures: performance of Japanese SMEs

Source: W. R. Lam and J. Shin (2012)
Impact of generous supportive measures: favorable borrowing rates

Demand and Supply of loanable funds (in percent)

Operating Performance and Debt Repayment Capacity among SMEs with and without Credit Guarantees (in percent)

Source: CRD.
1/ Repayment capacity is measured in terms of number of years, which is the ratio of all long- and short-term debts divided by the sum of net income and depreciation expenses. SMEs in operating losses or longer years have weaker repayment capacity on debts.
Public credit support measures may entail economic costs

- Weaken credit risk assessment of lenders
- Understate credit risk
- Crowd out non-guaranteed loans and limit incentives to restructure SMEs

➤ Guarantees could lead to misallocation of resources and undermine the healthy dynamics of SMEs.
A broader range of collateral and registry reforms

- **Challenges in collateral**
  - Intangible Assets
  - A fair value of collateral
  - Personal guarantees

- **Registry reforms**
  - Establish property registers
  - Enhance bankruptcy procedures and court systems for recovery

![Effect of Collateral Registry Reforms on Access to Finance](sources.png)

(Firms with access to finance, in percent)

Sources: Global Financial Development Report 2014
Equity Finance: Risk Capital

**Risk of loss for different stages at which investments are made (In percent)**

- Seed stage: 65%
- Start-up stage: 50%
- Second stage: 35%
- Third stage: 20%
- Bridge or pre-public stage: 10%

Sources: The Entrepreneurial State (Mazzucato, 2013)

**Sources of startup funds (In percent except as noted)**

- Own funds: 45%
- Spouse/relatives: 30%
- Public agencies: 15%
- Friends/acquaintances: 10%
- Regional banks: 5%
- Individuals/corporations: 5%
- Credit cooperatives: 5%
- City banks: 5%
- Venture capital funds: 5%

**Venture Capital Investment in 2012 (In percent of GDP)**

- Later stage: 0.4%
- Seed/start-up/early stage: 0.35%

Countries: Israel, US, Canada, Korea, UK, Norway, France, Japan, Germany

Sources: OECD (2013)
Policy Implications

- Develop credit information and market infrastructure.
- Limit excessive interventions in credit guarantees to avoid distortions.
- Broaden the range of collateral
  - Enhance property rights and contract enforceability.
- Promote risk capital
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Thank you!

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