

## **Caleb M Fundanga: Access to finance – corporate governance and sustainability**

Opening remarks by Dr Caleb M Fundanga, Governor of the Bank of Zambia, at the official opening of the Microfinance and Small to Medium Enterprises Conference on “Access to Finance: Corporate Governance and Sustainability”, Lusaka, 17 June 2008.

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- Honourable Felix Mutati, MP – Minister of Commerce, Trade and Industry;
- Mr Michael Mundashi – Non-Executive Director Standard Chartered Bank;
- Mrs Mizinga Melu – Managing Director Standard Chartered Bank
- Mr Prashant Thakker – Global Head of Microfinance Institutions of Standard Chartered Bank
- Distinguished Guests, Ladies and Gentlemen

I am honoured to have this opportunity to make keynote remarks at this conference on Microfinance Institutions and Small to Medium Enterprises organised by Standard Chartered Bank, whose theme is “Access to Finance: Corporate Governance and Sustainability”.

I wish to extend a warm welcome to all participants, particularly those that have travelled from outside the country. I hope that you will find time to see some of the tourist spots of Lusaka and experience the warm hospitality that Zambia has to offer.

Distinguished Guests, following the liberalisation of the Zambian economy in the early 1990’s, the number of small- and medium-scale enterprises (SMEs) has increased significantly as the Government divested from running business in the economy to pave way for increased participation of the private sector. For instance, in the mining sector, the supply of goods and services has been taken up by private companies including those that can be classified as SMEs.

Similarly, the transport sector, which was dominated by Government through the United Bus Company of Zambia (UBZ), Zambia Railways and Zambia Airways, etc, is now largely run by the private sector, consisting mostly of small and medium entrepreneurs. One can go on to mention the tourism, manufacturing, real estate, construction and others.

This development is of great benefit to the economy in general and individual entrepreneurs in particular. Therefore, small- and medium-scale enterprises have the potential to make a significant contribution to the growth of the economy, thereby improving the economic welfare of the population.

As you may know, SMEs in Zambia often have a direct impact on community development. Since they are usually based in places where the owners live, they draw upon the community for their workforce and rely on it to do business. They provide employment, particularly for low-skilled workers, as well as women and the youth, who usually make up the greatest proportion of the unemployed.

However, this sector has faced difficulties in accessing credit for working capital and expansion of their investments. Mr Chairman, even if more SMEs wished to modernise their plant and equipment, they would find it hard to do so because of the difficulty of obtaining financing. Many banks choose not to provide credit to SMEs as they are perceived to be more risky and yet less profitable. Some banks that might want to make such loans may lack the knowledge of how to make small loans and package them appropriately.

The other challenge lenders have to work with in assessing SMEs for them to access credit is the lack of reliable data. For example, data on the share of bank credit to SMEs are almost non-existent in Zambia. Even in banks where credit data are available from credit registries, in most cases they do not include information about the size of firms. Any estimates regarding the share of credit to SMEs have to rely on proxies, such as the size of loans.

Mr Chairman, it is clear that lending to SMEs is different from lending to large firms. In the case of young firms, it is more difficult to acquire information. Moreover, given the small size of the loans, it does not pay for the bank to undertake a detailed review of the creditworthiness of SMEs. Thus, for SME lending to be profitable, banks must experiment with new approaches and technologies for risk assessment and loan management. Such experimentation produces positive externalities by generating knowledge that is difficult for the bank to keep for itself, since trained agents can leave the bank to work with competitors. The other benefit we get from SMEs is that when there are adverse shocks in the market, their small size and flexibility allow them to speedily adjust to market changes.

Ladies and Gentlemen, it is encouraging to note that, in the recent past, banks and non-bank financial institutions have expanded their provision of finance to SMEs, although there is still a lot of room for further improvement.

We have recognised that a long-term strategy for SMEs calls for action across a wide range of policy domains, including education, research and development, financial sector regulations, competitive policies and a sound banking sector. These actions should address the need to create a healthier overall economic environment in which the business sector, SMEs in particular, operate. All key stakeholders should therefore strive to put in place SME-specific policies and programmes that provide the sector with the support it needs to prosper. The banks are not an exception in this regard.

The most recent statement of policies for SMEs are outlined in the Fifth National Development Plan, and they are in line with the country's long-term economic programme as enunciate in the Vision 2030. The primary stated objective of this policy is to create conditions conducive to sustainable growth in a structural context of private sector participation, openness and enhancing efficiency within a competitive environment.

In order to enhance their contribution to economic growth, the Government during the Fifth National Development Plan (FNDP) period is focusing on addressing constraints that have negatively impacted on the performance of the manufacturing sector. One of the specific interventions in assisting enterprises, particularly the SMEs, is to access affordable finance. As major players in credit provision, Banks have an urgent challenge to provide products that are suitable to SMEs and within their reach.

Honourable Minister, at current levels, interest rates are too high for the SMEs to access credit. We urge banks and other financial institutions to continue reviewing the cost of borrowing as part of the process to improve SMEs access to the much needed finances to expand their operations, employ more people, and thereby provide impetus to significantly reduce poverty rates in the country.

Honourable Minister, distinguished ladies and gentlemen, in view of the financing gap for the SMEs, the microfinance sector in Zambia has taken a leading role to fill this vacuum. However, the services provided by the microfinance institutions fall short of meeting the demands of SMEs. The sector can be said to be relatively young with the pioneers being established in the early 1990's.

Distinguished ladies and gentlemen, I am glad to note that the conference will also focus on the very important aspect of corporate governance.

Corporate governance is vital to building a solid, efficient and sustainable financial system and growth of businesses. Without these sound foundations, the institutions capable of reaching out to the poorest in society will never be encouraged. It is generally agreed that there is a strong link between corporate governance and access to finance. The following are some of the attributes of an enterprise with good corporate governance:

- (i) A well managed and coordinated company;
- (ii) Role and duties are clarified;
- (iii) Easier access to finance;
- (iv) Financial awareness and the ability to respond quickly;
- (v) Significant reduction in business risk and corporate failure; and
- (vi) Increase in monetary value of the firm.

In the case of Zambia, a BoZ Microfinance Survey of 1999 highlighted that most of the MFIs were inadequately capitalised and had weak corporate governance structures. The survey also pointed out that there were about 98 MFIs operating across the country in an unregulated environment.

The study further revealed that the nature of microfinance business in Zambia was generally targeted at the lower income group which have limited or no access to financial institutions offering financial services such as credit or savings.

Following the study, broad consultations were held with various stakeholders, including Government, commercial banks and other financial institutions, and the general public. The purpose of the consultations was to ensure that the development of legislation relating to the microfinance sector was as comprehensive and appropriate as possible. The consultations by the Bank of Zambia were extended to various countries to obtain international best practice that could be of benefit to our local environment.

Therefore, in order to ensure that the MFI sector grows in a sustainable manner and to protect public deposits, the BoZ developed the Banking and Financial Services “Microfinance Regulations” which came into effect on 31 January 2006.

The Regulations were aimed at strengthening the sector and ensuring accountability and transparency in operations and providing effective smooth integration of the sector into the mainstream financial sector.

Honourable Minister, distinguished ladies and gentlemen, at the time of the coming into effect of the Microfinance Regulations, there were only three microfinance institutions licensed by the Bank of Zambia. Today, the number of licensed microfinance institutions has increased to thirteen. This number is expected to increase further in light of the additional applications that are currently being considered.

Ladies and Gentlemen, it is pleasing to see the extent to which commercial banks are working at providing financial services to the medium and small scale entrepreneurs. This is so because such financial inclusion is bound to lead to wealth creation.

It is imperative that commercial banks, in providing financial services, ensure that the projects they are supporting are financially viable. The role of the commercial bank, in this regard, goes beyond sifting out unviable projects and providing finance for the best projects.

As Bank of Zambia, we are pleased to see that the private sector, especially banks, are now taking steps to partner with Government in working towards reduction of poverty through increased provision of financial services to a wider clientele.

We are also pleased to witness the unique partnership between Banks and MFIs and SMEs on sharing skills and experiences in areas of common interest. This is key to creation of common understanding.

I wish to conclude by urging participants, to actively participate in the deliberations of this conference. I am certain that this conference will benefit both the local institutions and our visitors from abroad.

Once again, I would like to thank Standard Chartered Bank Zambia Plc, for organising such an important workshop for MFIs and SMEs.

Honourable Minister, distinguished ladies and gentlemen, I thank you.