

MSME Finance in Rwanda – Status and Opportunities for Financial Institutions

Anup Singh

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Key Points:

1. *MSMEs in Rwanda account for approximately 97% of businesses, contribute to 55% of the total GDP, and employ around 41% of the population.*
2. *A significant 79% of the enterprises mentioned that financial institutions do not meet all their financial needs.*
3. *To adequately support MSMEs, financial institutions need to enhance efficiency, design and implement customer centric products/services, focus on cash flow lending.*

Context¹

Rwanda, with a per capita GDP of US\$ 701, growth rate of 4.7% in 2014-15 and inflation rate at 5.5%, aspires to progress from a low-income, agriculture-based economy to a middle-income, knowledge-based service economy by 2020². Rwanda is perhaps the best example of a country's progress from post-conflict reconstruction to economic development. In its economic development, as per the vision 2020 document, Rwanda sees an important role of MSMEs and hence significant efforts are centred around easy formalisation, privatisation and banking reforms to enable their access to finance.

MSMEs account for approximately 97% of businesses in Rwanda, contribute to 55% of the total GDP, and employ around 41% of the population. With the importance accorded to the MSME sector by the government and the role they play in Rwandan economy, it is imperative to understand their situation in terms of access to finance and role of private sector in enhancing their growth. This note features MSMEs' access to finance in Rwanda and charts a potential roadmap for financial institutions in Rwanda as they expand to MSME markets.

Research Framework

MicroSave conducted research to assess the state of finance to MSMEs in Rwanda. The research centred on evaluating three main areas, namely, current functioning of MSMEs; role in economy; and financial needs of the MSMEs in Rwanda. The analysis revealed unique patterns and issues of MSMEs in Rwanda. The following sections detail the status of MSME finance in Rwanda and highlight the areas where financial institutions can strengthen the finance delivery to tap the opportunities.

MSMEs Adequately Served by Financial Institutions

There are over 12 commercial and micro-finance banks having presence across the country. Intense competition among these banks has ensured deep penetration of formal finance (in terms of

savings/current accounts) among the MSMEs. 90% of the enterprises surveyed had accounts with formal financial institutions, while 6% of the respondents, most of which are of micro category, used semi-formal institutions to save money and expressed their comfort to deal with such institutions. 4% of the sample population has never used banks or any semi-formal institution for any purpose. Most of such unbanked enterprises belonged to micro categories and had a recent (less than 2 years) vintage.

Tough Access to Finance for Start-ups

Only 21% of the surveyed start-ups received some form of bank borrowings. The supply of finance however is inadequate since the banks finance a maximum of 30% of the total project size. Entrepreneurs further observed that the loans to start-up are costly as they are based on collaterals (at times 3-5 times of borrowing). They also expressed their dissatisfaction with time taken to process loans – in cases it was as long as 6 months.

Financial Needs of MSMEs are Rarely Met

A significant 79% of the surveyed enterprises mentioned that financial institutions do not meet all their financial needs. MSMEs find it very hard to convince the financial institutions to provide finance as they lack reliable financial statements and collateral to cover the business and financial risks. Most of the MSMEs meet their total requirement of funds using the entrepreneur's own capital and borrowings from friends and family. However, often they miss or underestimate the fund planning, which usually results in a fund crunch situation if in case the enterprise underperforms in short run.

MSMEs Demand Multiple Financial Products and Banking Services

The financial needs of MSMEs ranged from working capital loans to leasing and factoring. 53% of the respondents demanded working capital loans to finance their businesses while 37% expressed the need for investment, assets and vehicle finance to expand their businesses. 10% of the respondents expressed need for other higher

¹Statistics source: National Institute of Statistics, Rwanda 2015.

²"Rwanda Vision 2020". Ministry of Finance and Economic Planning, Government of Rwanda

order products such as cash management and collection, payroll services and such as leasing and factoring. A general observation from the respondents was that the financial institutions and banks are not progressive, they do not have suitable product range, are slow in processing compared to Kenyan banks and do not look beyond collateral to determine the loan amount.

Suggestions by MSMEs for the Banks and FIs

MSMEs were asked on suggestions that they can offer to banks and FIs in Rwanda to suit their needs and meet expectations. The top three suggestions were:

- **Speedy and Simple Processes:** A whopping 47% of the sampled MSMEs suggested enhancing efficiency in processing as the first task the banks must do. Most of the respondents opined that the banking services are very slow and it takes a lot of time. While banks take an average 2 months to process loans, in instances it gets delayed by more than 4 months. Respondents who had access to banks in Kenya termed Rwandan banking system as “old school”. Most of the respondents also found the loan processes of the banks very cumbersome and repetitive.
- **Customised Products for MSMEs:** Entrepreneurs surveyed expressed that the Rwandan banks are not inclined to innovate or design new products to meet the emerging needs of MSMEs. Among the respondents, all the enterprises that had bank borrowing, had generic business loans. For most of the enterprises, these loans neither suit their cash cycles, nor meet their needs completely.
- **Focus on Cash Flow and Not Collateral:** SMEs recounted unfavourable experiences at banks while applying for loans mainly due to collateral requirements and lack of client-centric processes. Collateral requirements become major impediment at times to grow the businesses. Entrepreneurs do understand the importance of collateral to secure loans. However, they expressed that bank lending should be based on assets, cash flow and credit history, rather than only on collaterals. Another key worry of the entrepreneurs is the requirement for property (land and house) as the collateral for many banks. They expressed their discontentment at having to pledge their personal property for the business. Some of the respondents expressed that in not so rare instances, banks have forced them to have 8-10 times collateral for loans. It is worth noting that the financial institution may benefit from the collateral registry for movable assets as the institutions may lend against leverage movable assets such as inventory, chattels etc.

Way Forward for Banks and FIs

MSMEs have huge potential for the banks, as profitability of the segment is considerably higher than other industrial sectors. This high profitability compensates for the relatively high costs associated with servicing MSMEs. Also, as economic participation of MSMEs in Rwanda is increasing, the banks have the unique opportunity to zero-in on this strategic and niche segment. However, to tap the MSME markets in Rwanda, the banks and FIs - as a first step - will necessarily have to:

- **Enhance Efficiency through Process Reengineering:** Efficiency, or rather lack of it figures at the top of the priority list for the MSMEs. The banks should review their operational systems, document the workflows and map their processes to identify the processing bottlenecks that cause the delays. Financial institutions should also strengthen their risk management practice, reduce turnaround time through efficient loan processing and achieve operational excellence for MSME finance. To ensure operational efficiency with delivery and costs optimisation, the banks should review the delivery channels and current distribution arrangement look at various non-branch delivery channels such as relationship manager, agent, electronic and mobile banking.
- **Expand offerings, Design and Rollout Customised Products:** There is an immediate need to design and implement new products based on the market needs. Financial institutions should profile the SMEs on various parameters such as industry/clusters they operate in, financial needs, geographies, regions, employment provided, assets size, turnover etc. and determine which are the key segments for them. Accordingly, financial institutions should develop SME products concept and prototype for both assets and liabilities offerings as demanded by the entrepreneurs from the key segments.
- **Re-Engineer Processes to Focus on Cash Flow Lending:** The banks should develop robust credit scoring tools focussed on assessing the entrepreneurs’ character, business, financials, cash flow and operations to determine the loan and not resort to the collateral-based lending, which is often misleading and risky.

