Article 13 / 06.05.2024 /CO_IMCI+ Alliance
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WHAT ARE THE CAUSES OF SME DEFAULTS IN SUB-SAHARAN AFRICA?

At the heart of the economic fabric of sub-Saharan Africa, very small, small and medium-sized enterprises (VSE/SME) often face a lack of access to financing. The latter constitutes one of the main obstacles to their development. In order to better understand the default mechanisms of African VSEs/SMEs, the French Development Agency (AFD) produced a study in 2019, of which here are some of the lessons learned.

In sub-Saharan Africa, as in the rest of the world, national economies are generally characterized by a large number of very small, small and medium-sized enterprises (VSE/SMEs) which constitute the majority of employment opportunities. However, the accelerated economic growth experienced by many sub-Saharan African countries over the last decade has not been accompanied by job creation or a more equitable distribution of wealth in society. Thus, African governments are now seeking to rethink how to stimulate inclusive economic growth, and meet the demands of rapidly urbanizing communities and the growing number of young people in the population. The creation and growth of SMEs is a strong focus, because they are a fundamental element of the economic fabric. However, the creation and development of SMEs in Africa are strongly restricted, in particular because of a lack of access to financing.

Removing the barrier to access to financing

Indeed, faced with problems of governance, insufficient infrastructure or abusive taxation, access to financing is the primary obstacle to the growth of small businesses in sub-Saharan Africa. SMEs often find themselves restricted in accessing the capital they need to grow and develop. The supply of capital (debt, equity) is therefore inadequate and SMEs are perceived negatively by financing stakeholders. However, the legal status of an SME is of little importance to banks, who have difficulty granting them loans based on the risk they represent. The ability of many businesses to access financing is strongly linked to interest rates. T**he French Development Agency (AFD) has been working for 15 years in developing countries to support access to financing for SMEs via a guarantee product: ARIZ. Having at its disposal diversified data on nearly 7,400 guaranteed loan lines in its area of intervention, AFD wanted to produce an unprecedented analysis of the causes of default of SMEs in sub-Saharan Africa. Published in 2019, this study revealed several findings.**

One study, several findings

The first of these is that the defect is caused in half of the cases by a single cause and in the other half by a multitude of combined factors (from 2 to 10 factors cited). The ten most cited causes of loan default — in at least 10% of cases — being:

1. Problems related to the company's suppliers, subcontractors or customers (36% of cases);
2. Bad managerial choices having an impact on the management, organization, efficiency and profits of the company (29% of cases);
3. Modification of market characteristics during the project – evolution of market potential: competition, consumers, demand shocks, drop in sales, etc. (23% of cases);
4. Financial choices and financing systems (18% of cases);
5. The financial environment;
6. The skills gap of the company manager;
7. Problems linked to local infrastructure or difficulties in the functioning of the local ecosystem;
8. Knowledge by the final beneficiary of the existence of a guarantee system;
9. The level of risk taken by the bank;
10. The political and social environment.

SMEs are primarily sensitive to problems linked to late payments by customers (State included), and suffer from a lack of structuring and a lack of managerial skills which lead to bad managerial choices (excessive diversification) or financial (loan amount too high, cost of debt too high).

They are also sensitive to problems linked to local infrastructure (road and energy, occasionally or chronically failing), but also to political crises. Environmental crises are rarely mentioned today.

Policies to support SMEs (from the acceleration of business registration procedures to the establishment of guarantee registers) are decisive for the smooth running of businesses but they are lacking in the countries studied. Likewise, communication from governments to SMEs on the support actions pursued is often insufficient.

All loans combined, the first default by companies in default occurred after 40% of the total duration of the loan. The guaranteed percentage is not discriminating nor is the ratio of security amount/loan amount. “Small” loans (less than 300,000 euros) and more “large” loans (greater than 300,000 euros) are affected very differently. Larger loans are more sensitive to market changes. **The risk of being involved is very high in the case of companies which are not already clients of the bank: this risk amounts to 64%. However, this risk is significantly reduced when the loan term is between 12 and 24 months.**

When a company is already a client of the lending bank, the size of the company has a discriminatory impact on the risk of exposure: companies with fewer than 5 employees (9% of the overall sample) have a higher rate of default (27%) than those with more than 5 employees (88% of the overall sample, 5% default rate).

To a lesser extent, the client's knowledge of an ARIZ guarantee and the level of risk taken by the bank are two recurring default factors. Finally, a certain number of factors have no effect on the company's default risk: amount of the loan in euros, nature of the loan, type of rate, percentage of the guaranteed loan, type of investment, age of the company, turnover of the company.

It is also interesting to note that a divergence was observed between the discourse of our interlocutors and the results of the statistical study: if we consider the total population of companies covered by the ARIZ guarantee, there is no statistically no greater risk of default depending on the sector in all of the four countries studied. This study therefore allowed the AFD Group to better understand the causes of default of SMEs in sub-Saharan Africa, thus enabling it to develop its product offering to support their access to financing.

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Swiss Company ID CHE-274.653.816