Editorial

IT IS ABOUT ten years since our journal last devoted an edition to small and medium enterprise lending. Since then, microfinance has continued its rapid rise, and reflecting this every other edition of the journal has been devoted to some aspect of microfinance.

Are SME lending and microfinance the same thing? They are often enough referred to together as MSME lending. But the answer must be a resounding 'No'. Just as a small business however defined is a very different entity from a microenterprise or self-employment, so is SME lending very different from microfinance. Running a garment manufacturing business that employs 50 and is trying to enter international markets is much more complex than working as a roadside tailor. So also, lending $50,000 to the garment manufacturer, without collateral or guarantee and using past credit history and other information to assess risk is a different business from lending $50 to the tailor to buy fabrics via a self-help group in which the other members offer a group guarantee.

So why are these different categories lumped together? The articles in this edition, and the banks and other financial institutions they describe make a clear distinction between the two and use different approaches, and often different staff, to serve them. Donors and development agencies in their promotional materials aimed at a 'northern' public tend to conflate the two, bringing to the fore the most favourable or photogenic of the two groups. As Tom Gibson puts it in Crossfire: which appears in the publicity brochures – a poor man with a hoe bought with a microloan, or the eight-foot high wheel of a combine harvester? The man with the hoe may be a more heart-warming sight, but it is the small businessman with the combine who can employ labourers and stimulate jobs in food processing down the chain. Microloans are said to enable people to 'work their way out of poverty'; yet in reality microloans are often used to pay medical bills or school fees, rather than for investment. In fact, microfinance may be an important tool to help poor people to survive, but some would argue that it usually consigns them to just that – surviving in petty trading in over-crowded markets with no hope of growth.

Confusing microenterprises and SMEs has meant that while the development community congratulates itself on the rise of microfinance, the small and medium businesses that might have a better chance than microenterprise of boosting the economy still languish without finance, because the ceiling of most microloans is well below the amount needed to develop a small business which can create jobs.

Fortunately, as these articles demonstrate, banks are themselves increasingly interested in lending to SMEs, even without the incentives such as loan guarantees that used to be employed, with little success, to

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entice them to lend to this risky sector. The IFC (International Finance Corporation) has experience in lending and technical assistance to banks entering this field, and this edition of *EDM*, assembled with the help of Matt Gamser of the IFC and others, includes some of their experience. Berryman et al.'s article on banks' SME lending practice highlights common features: such as the use of credit scoring and rating as against group guaranteed loans, and the use of separate small business units.

If banks get it right, Berryman's article reveals, they often find the small business sector profitable – at least as profitable as the rest of their operations. Frank Nieder's article about SMEs in Peru also points to the fact that SME lending can be profitable – though not as profitable as micro-lending which involves much higher interest rate spreads. The move from micro-lending to small has often been seen in terms of mission drift, with implied easier profits; it is interesting that in one country at least the lower interest rate on a small business loan makes profitability harder.

In one respect SME and micro banking are similar: in both cases there is more to banking than loans. Although SME loans may be the way to attract customers, banks have found that services such as payroll, money transfer and deposits often bring in the greater profits.

Chen and Weiss report on a number of mature microfinance institutions in South Asia which are adding SME finance to their microfinance operations. These MFIs have also found the two sectors quite distinct: fewer than 10 per cent of one MFI's customers were expected to 'graduate' to SME loans. Microfinance loans go mainly to women, often constrained by culture to running businesses from home; SME loans go to men.

More needs to be done to understand the contribution of small enterprises to economic growth and poverty reduction, and to help them access finance. The first step is recognizing that they are very different from microenterprises.

Finally, Jim Tanburn, who served on our Editorial Committee, keeping us abreast with happenings on the Donor Committee for Enterprise Development, has moved on, and is now replaced by Linda Jones, retiring Chair of the Board of the SEEP network. Thank you, Jim; welcome, Linda.

Clare Tawney, Editor