5. Conclusions and Recommendations

Motivation

A thriving SME sector is strongly associated with rapidly growing economies that have lifted citizens out of poverty. The World Bank Group promotes growth through both systemic and targeted interventions. TSME support has often been justified by the special contributions of SMEs in developing economies to growth, jobs productivity, or investment; or by the special challenges confronting SMEs that do not apply to other sizes of firms and the proposition that the delivery of targeted benefits to SMEs addresses and contributes to the resolution of systemic constraints.

The evidence on the first justification is not conclusive – it appears that firms of multiple sizes contribute to employment growth and that size may not be the most important factor. Enlarging the SME sector does not cause growth but may well accompany it. The second justification is consistent with notions of just and inclusive growth and a “level playing field,” but it relies on evidence that targeted approaches contribute to the sustained elimination of the special SME challenges – that is, that targeted growth eliminates systemic constraints. The objective is not to benefit SMEs as an end in itself, but to create economies that can employ more people and create more opportunity.

If projects differentiate SMEs as a group in need of special support because of their special needs or disadvantages or their special contribution to the economy, then it matters a great deal that they are accurately distinguished from other firms. How SMEs are defined establishes their relevance to World Bank Group development objectives of poverty alleviation and inclusion. For SMEs to be a meaningful category of enterprises, it should be a group of firms that is specifically differentiated from others by the way that it experiences particular policy, institutional, or market failures or the way it benefits the economy or the poor.

However, the definition that IFC and MIGA use is not adapted to the conditions of specific countries; the World Bank’s definition appears to accept local definitions without always determining if they relate to the underlying problems being addressed by their SME strategy. Both the upper and lower limits of IFC/MIGA’s definition look too high for some countries.

From a financing perspective, setting an appropriate line between microfinance and SME finance is important. Selectivity is required for both efficacy of targeting – to ensure both benefits reach those in need and efficiency of targeting – to avoid the
high cost of supporting those that don’t need it. Looking at enterprise survey data suggests that how firms are constrained depends not only on firm size, but on the interaction of size with country conditions, especially income level. Therefore, not only is an appropriate definition of SMEs contingent on but which size classes of firms to target is contingent on country conditions. One size classification does not fit all.

It is important to remember that that priority SME needs include many systemic challenges, including providing a reliable electric power supply, an honest and transparent public sector, moderate taxes, political stability, fair rules of the game so that informal firms cannot compete unfairly, and an educated workforce. It is also critical to ensure that the legal, regulatory, and institutional environment supports the growth of a deep, competitive, and stable financial sector, where banks seek SMEs as part of their client base. Reforms to establish the essential infrastructure underpinning well-functioning product and factor markets are central to the growth of the SME sector, but many are not be targeted -- they can benefit microenterprises and large enterprises as well. Finding the right combination of systemic and targeted interventions to address these constraints is central to addressing these challenges.

The Logic of Targeted Support for SMEs

SMEs exist and operate in the same environment as other firms, although they may experience it differently. For financing, IFC’s rough estimate of the magnitude of the “financing gap” for SMEs is large enough that the World Bank Group’s annual expenditures for on-lending are substantially less than one half of one percent. Therefore, it is simply not credible to argue that the Bank Group can play a significant global role just by channeling finance through intermediaries or directly to SMEs. This means that, except in special circumstances, such as response to a crisis or in extremely small economies, the only credible argument for channeling finance to SMEs is to build the capacity and sustained activity of the financial sector to supply SME credit demand. Financing projects, therefore, that form the bulk of the targeted SME portfolios, needs to demonstrate not only that they are meaningfully targeted but that they are strategically designed to fix market failures – whether by building capacity, creating a demonstration effect, or stimulating competition.

This also implies that the agenda is strongest where the financial sector is weakest – where the financial sector is developed and serving the SME sector, the Bank Group should be less active. Additionally, M&E needs to capture not only how SMEs benefited but how the financial system benefited. With regard to the other four
theories of change, when providing advisory services to financial intermediaries and government bodies, the Bank Group should clearly show how it will remediate institutional or government failures constraining SMEs and collect evidence of those changes.

Similarly, BDS, like financing, cannot be credibly justified unless a sustainable market for services is promoted through the activities. Otherwise, the scope of existing interventions is too tiny to make a global difference. Therefore, for BDS projects, the Bank Group needs to provide clear evidence not only of benefits to direct beneficiaries but of benefits to the market. Finally, value chain interventions should similarly create new dynamics within the sectors in which they are working that can be sustained beyond the project’s life.

Thus, the objective of this evaluation has been to determine how well the World Bank Group has promoted inclusive growth through targeted support to SMEs, which in turn requires addressing the market, institutional, and policy failures underpinning their constraints. To do this, IEG explored the relevance, efficacy, efficiency, and work quality of each institution’s TSME work, to develop an understanding of how the World Bank Group is doing and where experience can be applied to have a greater development impact. The limits to information to answer these questions form part of IEG’s findings - and have implications for how to proceed.

**IFC and Targeted Support to SMEs**

IFC regards SME support as a strategic objective based on these firms’ job creation potential. A nuanced analysis of the literature on job creation suggests that job creation is likely more evenly shared between SMEs and large firms and that factors other than size may be important to consider. The lack of strong evidence for favoring SMEs over other size classes of firms means that new evidence is needed to support a key rationale typically offered for TSME support.

IFC’s TSME portfolio is significant in its overall size. As TSME support is mainly provided through financial intermediaries, these projects are concentrated in the financial markets industry group. Most SME investment projects do not define SMEs, which brings into question the precision of targeting; nor do they specify that benefits be directed to SMEs. Most projects also do not clearly connect the SME support provided to the correction of an established market failure or as an appropriate response to an established SME constraint.
As seen in Chapter 1, IFC’s strongest contribution to SMEs takes place by developing markets and institutions that can then operate sustainably on their own. Given that most TSME support is through the financial sector, the most credible theory of change underpinning much of it lies in its contribution to developing sustainable private markets for SME finance, rather than the direct benefits it delivers to firms.

This means that IFC’s relevance is greatest where the financial sector (or other service markets) is weakest in serving SMEs. It is greater when it operates at or near the frontier, in countries where the financial sector has not yet developed to serve SMEs, regions within countries where SMEs are not served, and specific intermediaries without a firmly established SME practice. This is especially relevant in low-income and fragile and conflict-affected situations. To stay near the frontier would require IFC to enter some new markets earlier and exit some established ones earlier as well.

IFC’s TSME investment projects generally did not perform as well as the overall portfolio and the rest of the financial markets portfolio. However, TSME projects improved their performance over time after 2006. IFC often refers to the reach of its SME banking portfolio, but its reach data raise questions about the relative effectiveness of their targeted SME projects in growing the SME portfolio compared to projects in the general portfolio. Not only does this raise questions about the efficacy of the current model for service delivery, but it also points to IFC’s broader lack of sufficient M&E information on its TSME projects, which would enhance understanding of their development impact.

By contrast, IFC’s TSME advisory services, overall, have performed better than the rest of the advisory portfolio, except in low-income countries. Nearly half of IFC’s targeted advisory services portfolio took the form of technical assistance to financial institutions and governments. In general, advisory dollars were focused largely on poorer countries (IDA and IDA blend), and 40 percent of expenditures took place in Africa. Many advisory projects were linked with complementary investment projects. Where TSME investment projects were delivered in tandem with advisory services, IFC achieved superior development outcomes in its investment projects.

MIGA and Targeted Support for SMEs

MIGA’s support to SMEs takes two approaches: directly to foreign investors making small investments in SMEs or indirectly to foreign financial intermediaries for their investments in subsidiaries to on-lend to SMEs. MIGA’s support for SME projects
has been substantial during FY06-12, comprising 50 percent of projects and 30 percent of MIGA’s gross exposure. Of these, 57 percent of projects were underwritten under MIGA’s SIP, but these account for less than 8 percent of gross exposure in support of SMEs and 2 percent of overall gross exposure.

**Small Investment Program**

Although SIP has extended MIGA’s engagement in low-income and fragile countries and with types of investors it has not traditionally supported, the program has fallen short in meeting objectives of offering streamlined and efficient underwriting of SME projects, it has also had weak development outcomes and suffered from inconsistent work quality. As one of only three political risk insurers offering a special facility and underwriting procedures that support SME investments in developing countries, MIGA occupies a special place in the market. However, the extent of unmet demand for PRI from SME investors remains unclear. SIP projects are collectively relevant to three of MIGA’s operational priorities: (i) supporting investments in IDA countries; (ii) supporting investment in conflict-afflicted and/or fragile environments; and (iii) supporting South-South investments.

However, the viability of SIP projects is challenging because of the location of most SIP projects in high-risk countries. SIP projects have a high rate of early cancellation and experience a number of pre-claim situations. Further, IEG found indications that some projects raised questions about E&S standards. SIP’s streamlined processing of guarantees has not produced efficiency gains in terms of reduced processing time. Feedback from MIGA staff also indicates little savings in underwriting resources compared to regular guarantees, especially in light of new streamlined procedures for “plain vanilla” mainstream guarantees.

**REGULAR GUARANTEES**

MIGA’s regular guarantees offer a wholesale means to channel a large amount of political risk coverage to benefit SMEs. In theory, this could offer an efficient way to serve the needs of SMEs, analogous to IFC work with financial intermediaries. However, at present, there is no mechanism for targeting benefits to SMEs to ensure that funds will be used for the purpose stated in the Board document. The wholesale guarantees that target SMEs are highly concentrated with a few clients driven by regulatory provisions in their home countries.

Wholesale guarantees that target SMEs underperformed relative to a comparable group of financial market guarantees in terms of business performance, economic sustainability, and contribution to private sector development. In addition, there is
no evidence that the long-term tenor was passed on to end borrowers. Overall, the lack of systematic tracking of project performance makes it difficult to determine project results or whether the expected project objectives were achieved.

The World Bank and Targeted Support for SMEs

Lending Portfolio

World Bank targeted support for SMEs is broader than suggested by its formal strategic focus on access to finance; it also likely is more driven by country and regional strategies and demand than by any central guidance. By product line, lines of credit (financial intermediation loans), matching grants, and BDS projects dominate the lending portfolio. Although the Bank is substantially engaged in low-income and fragile and conflict-affected countries, the relatively low level of commitments in IDA countries and the high level of commitments in upper-middle-income countries—partly influenced by the response to the global financial crisis—raise questions looking to the future of the relevance of this portfolio to reaching the frontier and building markets and market institutions where they are weakest.

Another relevance concern arises from the 65 percent of Bank Group TSME lending projects that failed to define the term SME in any way. Further, although 75 percent of TSME lending projects state that they address market failure, only 34 percent say what it is and only 13 percent provide any evidence. Limited SME access to finance is by far the leading justification for intervention, yet as noted in Chapter 1, this is a universal feature of financial markets. It is often a symptom of market failure, but not a market failure in itself. Economic dynamism is the leading objective identified for projects, followed by job creation, economic growth, and economic inclusion. However, it is often difficult to trace the connection among the problem identified, the intervention selected, and the dynamism aimed for through a clear theory of change or logical framework. It is even more difficult to find good measures to validate these connections.

IEG evaluations of completed World Bank investment projects find the great majority achieved successful development outcomes, achieving a result better than the rest of the FPD SME-relevant portfolio and better than the World Bank portfolio average. However, efforts to judge the efficacy and efficiency of World Bank TSME support are inhibited by the lack of quantitative evaluation of the development impact of its leading product lines. Even though projects track indicators, not all are relevant to a project’s theory of change, and few include a serious quantitative assessment of what the project changed in the performance of beneficiary SMEs or the performance of the markets they were trying to enhance or create. Finally, even
projects that appear to be efficient from the point of view of administrative costs can be inefficient because of poor targeting.

TSME lending projects identified by IEG as having a more complex design have, on average, four more components or subcomponents than others. Projects with more elements are more prone to delays, cancellations, and restructuring and also to longer delays.

Work quality exhibits several strengths, including linkage to prior analytic work, a high rate of successful development outcomes, and a high rate of realism in self-evaluations. Weaknesses lie in overly complex designs, overly optimistic time frames for implementation, and the frequent need for delays, restructuring, and partial cancellation.

**Analytic Work**

Although only a small fraction of the analytic work underpinning TSME projects is itself targeted, AAA work is both relevant and important to SME challenges. Most AAA projects consisted of technical assistance, mainly to governments but also to financial institutions. Self-ratings (not validated by IEG) indicate a high and rising level of success for TSME technical assistance. Technical assistance in the context of lines of credit appears effective at strengthening institutional performance and therefore in producing positive outcomes. However, although economic and sector work appears effective in some dimensions, it has limited traction in influencing government policy. If it is yielding reforms through some other path, that is not documented, which raises important questions about efficacy and efficiency, as well as the lack of M&E.

**Conclusions and Recommendations**

In spite of its many achievements, the current portfolio does not consistently reflect a clear and strategic view of which firms should be targeted, why, and for which services, or of how serving them promotes market development to sustainably meet their demand. Targeted support for SMEs needs to be more firmly rooted in a clear, evidence-based understanding of what distinguishes an SME and how the proposed support will sustainably remove the problems that constrain the ability of SMEs to contribute to employment, growth, and economic opportunity in developing economies.

The lack of relevant information on portfolio performance makes it difficult to learn from experience or even to establish the existence of additionality of World Bank Group interventions. As noted in Chapter 4, current inconsistencies across
institutions result in missed opportunities for institutions to leverage each other’s strengths. The lack of institutional consensus on what constitutes an SME, when it is appropriate to support them, and how success is defined seems especially inappropriate as the Bank moves toward global practices that cross traditional institutional barriers. As One World Bank Group, the need for a common perspective has never been stronger. As a solutions Bank, it is vital that World Bank Group approaches be informed by the best evidence and learning, as well as well-tailored strategies that take full account of local conditions.

As the World Bank Group continues supporting SMEs, to help them realize their potential contribution to developing economies (based on portfolio and case study reviews, data analysis, field visits, and extensive literature review), IEG concludes that, to make TSME support more effective, the World Bank Group needs to do several things.

**Recommendation 1: Clarify the Approach to Targeted Support to SMEs**

IFC, MIGA, and the World Bank should harmonize their SME approaches to make clear the objectives and analytic justification for TSME support, how it relates to systemic reform, where it is appropriate, what main forms it will take and how it will be monitored and evaluated.

For countries where SME development is a priority, any targeted support should be firmly grounded in the Country Partnership Framework/Strategy, in the relevant parts of the Systematic Country Diagnostic based on country analytic work, and in other instruments that provide an analytic and strategic framework that identifies the sequence and mix of systemic and targeted interventions that will address systemic challenges to SMEs, building markets and access to services. The specification of the target for TSME projects should relate to country-specific conditions and in some cases address small and medium firms differently based on how they experience existing country conditions. Shared country strategies that leverage and sequence the expertise and comparative advantages of the World Bank Group institutions should ensure complementarity, maximize impact, and reduce the potential for redundancies and inconsistencies, despite the different institutions’ business models. Targeted support for SMEs needs to be firmly rooted in a clear, evidence-based understanding of how the proposed support will sustainably remove the problems that constrain SMEs’ ability to contribute to employment, growth, and economic opportunity.

The M&E framework should be designed to capture the effect of project interventions in these dimensions – at the beneficiary, client, and broader market
level. At both levels, information is needed to understand the counterfactual – what would have happened without the project. This means, where possible, a rigorous, fact-based approach that generates information on the baseline, the post-project period, and control group. A longer-term time frame may be required to collect data to evaluate sustainability of impact.

**Recommendation 2: Enhance Relevance and Additionality**

World Bank Group management should refine its SME approaches to shift benefits from better-served firms and markets to states with underdeveloped financial systems, especially low-income and fragile and conflict-affected states, frontier regions, and underserved segments.

A key indicator of whether such a shift is occurring would be the evolution of the distribution of the TSME portfolio as well as the composition of beneficiary institutions and firms. This also implies including in the M&E of targeted projects indicators of the impact of the project on the targeted population of firms as well as the impact on financial intermediaries.68

**Recommendation 3: Institute a Tailored Research Agenda**

World Bank Group management should institute a tailored research agenda to support and assist these clarifications and refinements of its SME support approach. Utilizing the best qualified researchers (for example, a great deal of qualified expertise focused on this agenda resides in the Development Economics Vice Presidency), this should produce more policy- and contextually relevant distinctions of the definition of SME; a better understanding of the dynamic contributions of SMEs to economic growth, employment, and poverty alleviation; deeper knowledge about how the design of interventions should vary contingent on country conditions; a project-relevant definition of the “frontier”; a clearer view of the correct sequencing and combinations of systemic and targeted; and more rigorous analysis of the actual performance and impact of key types, combinations and sequences of World Bank Group and other donor interventions. Enterprise surveys should be refined to better identify market failures and unmet demand for financial and other services; and to generate more panel data that better account for firm dynamics and allows more confident relating of explanatory factors to firm growth and employment.

**Recommendation 4: Strengthen Guidance and Quality Control**

Relevant World Bank Group management should provide guidance and quality control so that any project documents for Bank Group projects targeting SMEs will:
(i) Define the group of firms to benefit by measurable criteria such as number of employees and annual revenues.

(ii) Justify the definition of the beneficiary group targeted (which could be a subset of SMEs) based on country-specific evidence that this group suffers from size-specific market failures or constraints.

(iii) Specify and wherever appropriate embed in legal provisions the mechanism to reach the targeted group.

(iv) Include in its results framework and M&E framework indicators of the impact of the project on the targeted group and on the constraints or market failures justifying the project.

All projects that describe themselves as targeting benefits to SMEs should reflect this approach. In addition, these projects should be coded accurately with regard to whether or not their benefits are in fact predominantly or exclusively available to SMEs. Coding systems and practices should be reviewed and modified to assure that targeted SME projects are correctly coded, to reduce “false positives” and “false negatives.”

**Recommendation 5: Reform MIGA’s Small Investment Program**

MIGA should radically rethink its approach to providing guarantees for investments in SMEs through the SIP program, considering either a merger with its regular program or a fundamental redesign to improve performance.

If MIGA decides to eliminate SIP as a separate window, it can maintain its relevance to the frontier and continue to guarantee small investments under its regular procedures; processing qualifying projects under its expedited “no objection” procedure where eligible. MIGA could maintain its SIP brand by establishing an SIP trust fund or a MIGA-funded, SIP-branded transparent subsidy mechanism to reduce the cost for the premium and underwriting for high value-added SME projects that reflect highly additional new investments into small companies in frontier regions or markets.

If SIP is to be retained as a separate window, then the current weaknesses need to be squarely addressed, including through improved selectivity and screening, greater quality control of the preparation process, better targeting to SMEs rather than small investments, and improved M&E. Cost and revenue accounting should be improved to permit informed management decisions about SIP program resources in the context of overall MIGA strategic priorities.
To strengthen capacity of less-experienced SME guarantee holders, MIGA should provide stronger capacity-building and technical assistance to implement and manage E&S requirements for small projects.