Plenary 4

Capital Markets and Economic Development - New Avenues for the Financing of Small and Medium Enterprises (SMEs)

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Capital Markets and Economic Development
New Avenues for the Financing of Small and Medium Size Enterprises

Japheth Katto
CEO, Capital Markets Authority-Uganda
Presentation Outline

• Common SME Financing Options
• Sources of Financing for New Investments
• Limitations of SME Financing in Capital Markets
• Common Features
• Is there a Muhammad Yunus Solution?
• Conclusion
Common SME Financing Options

• Retained Earnings/Internal Finance
• Family and Friends
• Money Lenders
• Banks and Other financial Institutions
• Trade Credit
• Equity
• Bonds/Commercial Paper
## Sources of Financing for New Investments - Small Enterprises (1-19 employees)

<table>
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<tr>
<td>Internal Finance</td>
<td>75</td>
<td>57.14</td>
<td>74.18</td>
<td>90.05</td>
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<td>Bank Finance</td>
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<td>3.9</td>
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<td>1.02</td>
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<td>0.61</td>
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<td>2</td>
<td>1.29</td>
<td>0.02</td>
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<tr>
<td>Credit Card Finance</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>1</td>
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<tr>
<td>Equity, Sale of Stock</td>
<td>4.49</td>
<td>-</td>
<td>-</td>
<td>2.23</td>
<td>0.74</td>
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<tr>
<td>Other Financing</td>
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<td>10.2</td>
<td>4.16</td>
<td>0.61</td>
<td>0.97</td>
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<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
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</table>

*Source: www.enterprisesurveys.org*
Sources of Financing for Investment - Small Enterprises (1-19 Employees)

- Uganda
- South Africa
- Senegal
- Egypt
- India

- Internal Finance
- Bank Finance
- Supplier Credit Finance
- Leasing Finance
- Development Finance
- Credit Card Finance
- Equity, Sale of Stock Finance
- Other Financing
- Informal Finance

Graph showing sources of financing percentages for different countries.
## Sources of Financing for New Investments - Medium Enterprises (20-99 employees)

<table>
<thead>
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<td>0.69</td>
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<td>4.00</td>
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<td>Development Finance</td>
<td>2.56</td>
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<td>-</td>
<td>0.36</td>
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<td>Credit Card Finance</td>
<td>-</td>
<td>0.10</td>
<td>-</td>
<td>-</td>
<td>0.60</td>
</tr>
<tr>
<td>Equity, Sale of Stock</td>
<td>-</td>
<td>0.18</td>
<td>-</td>
<td>3.27</td>
<td>0.90</td>
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<tr>
<td>Other Financing</td>
<td>4.70</td>
<td>4.80</td>
<td>2.25</td>
<td>0.27</td>
<td>1.00</td>
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<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
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</tbody>
</table>

Source: www.enterprisesurveys.org
Sources of Financing for New Investments - Medium Enterprises
(20-99 Employees)

- Internal Finance
- Bank Finance
- Supplier Credit Finance
- Leasing Finance
- Credit Card Finance
- Equity, Sale of Stock Finance
- Informal Finance
- Development Finance
- Other Financing

Countries: Uganda, South Africa, Senegal, Egypt, India
Limitations of SME financing in Capital Markets

- Capital, net assets and shareholders’ requirements
- Lack of sound financial and accounting practices and difficulties in applying IFRS
- Lack of sound management standards
- Lack of good corporate governance standards
- Fear of loss of control of ownership
- Inappropriate legal and regulatory frameworks for SMEs
- General fear for disclosure
- Lack of venture capital finance suitable for SMEs
Experiences of “AIMS” & “OTC” markets in Emerging Economies

• **AIMS Markets**
  - Malaysia (MESDAQ)
  - Thailand (MAI)
  - Kenya (NSE-AIM)
  - South Africa (AltX)
  - Zambia (LSE-AIM)

• **OTC Markets**
  - Taiwan (GTSM)
  - Pakistan (KSE-OTC)
  - Mauritius (SEM-OTC)
Common Features
(Eligibility Criteria & Listing Requirements)

- Paid up capital and/or asset size

- Track record range from 0 to a maximum of 5 years

- With the exception of MESDAQ a profit requirement is common.

- With the exception of MESDAQ continuity of management is a requirement at least for one year

- Share spread to the public is also an important requirement for all the markets
Common Features
(Eligibility Criteria & Listing Requirements)

• A moratorium on the promoters is a common requirement.

• Sponsor requirements are prevalent in OTC markets but they are also applied in for example MESDAQ and GEM.

• Companies listed on AIMS and OTCs are all required to meet high standards of corporate governance.
Is there a Muhammad Yunus Solution?

- If Junk Bond and Sub-Prime Mortgage Markets Can thrive then “Micro Capital Markets are a possibility”.
- The stiff requirements of past financial performance, capital and assets adequacy need to be relaxed.
- However prospective companies should have:
  - Atleast a five (5) year business plan
  - Feasibility study report
  - Moratorium on shareholders
  - Special professional/advisory services throughout listing. (Sponsorship)
Conclusion

• Being small with no track record does not mean weakness or failure. Potential for growth is key.

• The Capital markets should make provision for start-up companies with no track record but with high growth potential.

• We need to review the regulatory frameworks we have adopted from developed markets and be prepared to take measured risks.
Thank You