



# Responding to COVID-19: Lessons from Previous Support to Micro, Small, and Medium- Sized Enterprises

Synthesis Note No. 3 (COVID Series-1) | June 2020



Independent  
Evaluation 

*Raising development impact through evaluation*



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## ABBREVIATIONS

ADB	–	Asian Development Bank
DMC	–	developing member country
DMF	–	design and monitoring framework
EBRD	–	European Bank for Reconstruction and Development
GDP	–	gross domestic product
ICT	–	Information and communications technology
IMF	–	International Monetary Fund
MDB	–	multilateral development bank
MSMEs	–	micro, small, and medium-sized enterprises
NPL	–	nonperforming loan
PCG	–	partial credit guarantee
PFI	–	participating financial institution
SCFP	–	Supply Chain Finance Program
SIDS	–	small island developing economies
SMEs	–	small and medium-sized enterprises
TFP	–	Trade Finance Program

## NOTE

In this report, “\$” refers to US dollars.

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## I. INTRODUCTION

1. **The current coronavirus disease (COVID-19) pandemic is causing a global economic slowdown and reversing previous reductions in poverty.**<sup>1</sup> The International Monetary Fund (IMF)<sup>2</sup> projects that the global economy could contract by 3% in 2020. Based on the latest Asian Development Bank (ADB) estimates,<sup>3</sup> the global economic impact of the current pandemic could reach \$5.8 trillion (about 6.4% of world's gross domestic product [GDP]) under a 3-month containment scenario, and \$8.8 trillion (9.7% of global GDP), under a 6-month scenario. COVID-19 heightens the problems faced by the poorest and most vulnerable groups. The International Labour Organization (ILO) has estimated that, as of 22 April 2020, global working hours for the second quarter (Q2) of 2020 will be 10.5% lower than the pre-crisis baseline of Q4 2019 (equivalent to the loss of about 305 million full-time jobs, assuming a 48-hour working week). For Asia and the Pacific, ILO estimates the Q2 figure will be 10% lower than the baseline.<sup>4</sup> The World Bank has estimated that the pandemic will result in an increase in the number of extremely poor people by 49 million in 2020, about 16 million of whom will be in South Asia.<sup>5</sup>

2. **Among the hardest hit vulnerable groups will be micro, small, and medium-sized enterprises (MSMEs), which are vital to achieving inclusive growth and poverty reduction.** According to the ADB Institute,<sup>6</sup> in 20 economies in the five ADB regions SMEs made up 96% of all the enterprises, employing 62% of workers and contributing 42% of GDP. The disruption in supply chains and reductions in consumption due to quarantine measures have so far caused massive shutdowns, layoffs, defaults, and bankruptcies among MSMEs. Most of these enterprises have limited technological expertise and have financing constraints (e.g. stringent documentary or collateral requirements), making them less resilient and less flexible in responding to the situation. The interplay of these various constraints has resulted in massive unemployment and production disruptions, especially in food manufacturing, transport, and retail, which are key MSME sectors.

3. **While the current crisis may be more severe than and different from previous financial crises, responses to help MSMEs cope with and recover from this crisis can still learn from the past.** The key difficulties with this crisis are the health implications of the pandemic and the uncertainty associated with the timeframe for return to normality. There is also a possibility of a resurgence of the disease, which could lead to the closure of businesses that had just begun to operate again. While a typical financial crisis mainly results in liquidity issues, a pandemic such as COVID-19 also involves the well-being of consumers and disruptions to payment processing and supply chains. This synthesis note aims to extract lessons from the previous MSME operations of ADB and its development partners (including nonbank and private sector financial institutions) to help guide the design of future ADB operations in relation to the COVID-19 crisis. Lessons from past financing support provided to MSMEs to cope with the 1997–1998 Asian financial crisis and the 2008–2009 global financial crisis have a continuing relevance for the ADB support that may have to be considered both during the crisis and afterwards.

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<sup>1</sup> COVID-19 is the short term for severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2). At the time of writing, more than 3 million people have been infected and over 300,000 deaths have occurred as a result.

<sup>2</sup> International Monetary Fund. 2020. *World Economic Outlook*. Washington D.C. Accessed on 27 April 2020 from <https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020>.

<sup>3</sup> ADB. 2020. *An Updated Assessment of the Economic Impact of COVID-19*. ADB Briefs No. 133, May 2020. Manila. Accessed on 19 May 2020 from <https://www.adb.org/sites/default/files/publication/604206/adb-brief-133-updated-economic-impact-covid-19.pdf>.

<sup>4</sup> ILO. 2020. *ILO Monitor: Covid-19 and the World of Work*. Third Edition. 29 April 2020. Accessed on 20 May 2020 from [https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/briefingnote/wcms\\_743146.pdf](https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/briefingnote/wcms_743146.pdf).

<sup>5</sup> *The Impact of Covid-19 on Global Poverty: Why Sub-Saharan Africa Might be the Region Hardest Hit*. World Bank Blogs. 20 April 2020. Accessed on 27 April 2020 from: <https://blogs.worldbank.org/opendata/impact-covid-19-coronavirus-global-poverty-why-sub-saharan-africa-might-be-region-hardest>.

<sup>6</sup> N. Yoshino and F. Taghizadeh-Hesary. 2018. *The Role of SMEs in Asia and Their Difficulties in Accessing Finance*. ADBI Working Paper 911. Tokyo: Asian Development Bank Institute. Accessed on 24 April 2020 from <https://www.adb.org/publications/role-smes-asia-and-theirdifficulties-accessing-finance>.

## II. LESSONS LEARNED FROM ADB SOVEREIGN MSME OPERATIONS

### A. Crisis Support

4. **Financing support for ADB’s countercyclical and emergency measures that factor in the country and local context minimizes the fiscal burden imposed on countries during crisis.**<sup>7</sup> The pricing, maturity and denominated currency of the loans that ADB provides to its developing member countries (DMCs), especially the poorer countries, are crucial elements in designing financial support. While such support can provide immediate fiscal space to enable countries to respond to a crisis, they also have to mitigate potential repayment risks for borrowers through provision of carefully targeted longer tenor local currency loans.<sup>8</sup>

5. **Adapting ongoing projects in a timely manner ensures that ADB’s interventions will remain relevant during the crisis.** The COVID-19 crisis is affecting credit demand, lending, profitability, and repayment performance. In response to the Asian financial crisis, the Thailand Rural Enterprise Credit Project moved quickly to offer short-term and working capital subloans, shifting its focus away from its original purpose of providing medium and long-term loans to rural enterprises.<sup>9</sup> In the case of the Philippines Small and Medium Enterprise Development Support Project, IED considered that the growth target should have been adjusted more rapidly during implementation to align the project more closely with developments in the overall macroeconomic environment.<sup>10</sup>

6. **Providing immediate support to microfinance operations leads to a rapid recovery of livelihoods.** Vision Fund International’s experience in supporting microfinance operations in the central Philippines hit by the super typhoon Haiyan in November 2013 showed that livelihoods can be restored by providing needed capital.<sup>11</sup> This approach showed that recovery lending can be affordable and need not lead to over-indebtedness; the speed and effectiveness of recovery lending is optimized when there is preparation before the event. In the medium to long term, liquidity problems can be addressed through insurance schemes that provide financial support to microfinance institutions in the case of a disaster.

7. **Targeting the underserved MSME subsector is critical for broadening the impact of MSME development support during crisis.** Inclusion of other participating financial institutions (PFIs) beyond commercial banks can extend ADB’s reach and cater to the lower market segment, including SMEs. ADB’s Kazakhstan SME investment program is an example of a program where the targeting was less than optimal; the levels of small and medium enterprise (SME) lending were not achieved, mainly because PFIs focused on larger SMEs that required larger loan amounts and had the collateral needed for security.<sup>12</sup>

<sup>7</sup> ADB. 2012. *Completion Report: Public Expenditure Support Facility Program and Countercyclical Support Facility Support Program in Bangladesh*. Manila. In providing additional financial support, governments need to also take account of the country’s fiscal stance and the independence of its central bank in managing fiscal risks. See Independent Evaluation Department (IED). 2018. *Validation Report: Improving Domestic Resource Mobilization for Inclusive Growth Program for Georgia*. Manila: ADB.

<sup>8</sup> Independent Evaluation Department. 2016. *Validation Report: Small and Medium Enterprise Investment Program Tranche 1 in Kazakhstan*. Manila: ADB; IED. 2019. *Validation Report: Small and Medium Enterprise Investment Program Tranche 2 in Kazakhstan*. Manila: ADB.

<sup>9</sup> The Rural Enterprise Credit Project identified a need for higher loan-loss provisioning for nonperforming loans and safeguards against unanticipated financial crises. Other lessons were that an appropriate credit appraisal system for all loans and competent staff are needed to ensure a high-quality loan portfolio and more sustainable lending. A predominance of short-term lending can increase volatility. A balanced asset structure, with a larger share of medium- to long-term lending, is needed to reduce volatility. This will require careful monitoring to avoid a maturity mismatch. See ADB. 2004. *Project Performance Audit Report on the Rural Enterprise Credit Project in Thailand*. Manila.

<sup>10</sup> IED. 2011. *Validation Report: Small and Medium Enterprise Development Support Project in the Philippines*. Manila: ADB. The intervention was combined with a nonsovereign investment, providing additional capital, and technical assistance for improving the policy environment and institutional arrangements for SME lending operations.

<sup>11</sup> Vision Fund’s Community Economic Ventures Incorporated, made available Bangon Kabuhayan or “recover your livelihood” loans to its clients who had been affected by the typhoon and who had viable business plans and required loan financing. While ADB did not provide seed money, ADB funded the study that led to this publication. See ADB and Vision Fund International. 2016. *Disaster-Resilient Microfinance: Learning from Communities Affected by Typhoon Haiyan*. Manila.

<sup>12</sup> IED. 2016. *Validation Report: Small and Medium Enterprise Investment Program Tranche 1 in Kazakhstan*. Manila: ADB; IED. 2019. *Validation Report: Small and Medium Enterprise Investment Program Tranche 2 in Kazakhstan*. Manila: ADB.

An India MSME development project showed the value of developing, at the design stage, clear targets for the recipients of the project, which improved the monitoring of the project.<sup>13</sup> Proper targeting of SMEs requires a clear definition of SMEs and a good SME database and management system. This was highlighted in the Small and Medium-sized Enterprise Development Project in Bangladesh after the global financial crisis.<sup>14</sup> For effective policy support, identifying the critical sectors during the crisis and assessing the damage they have suffered are necessary. This can only be done if high-quality data are available; for example, if the objective is to provide support to women entrepreneurs, a central, sex-disaggregated, SME database significantly improves the ability to analyze and reach such targeted groups.<sup>15</sup>

## B. Post-Crisis Support

8. **Using a program cluster approach has worked well in the period after a crisis as it encourages ownership and engages countries that are committed to change.** A series of single-tranche loans will provide ADB with the flexibility to support medium-term reforms and enable it to promote a wide spectrum of essential policy reforms with relatively modest financing.<sup>16</sup> The links between various policy actions and high-level outcomes need to be made clear to the line agencies and ministries that are accountable for the outcomes. Sensible intermediate indicators can clarify how policy actions are linked to each other and how they work toward a specific outcome over time. For budgetary support involving various sectors and stakeholders, a series of single-tranche loans can be considered, which would allow it to provide support to a country's long-term economic plan, provided there are clear links between agency performance and direct budgetary benefits; and between various policy actions and high-level outcomes relevant to MSMEs, as in the case of Viet Nam.<sup>17</sup>

9. **Accompanying interventions that support increased SME access to finance over the long-term with complementary policy and regulatory measures contributes to sustained and optimal SME development.** In ADB's Kazakhstan SME investment program, providing credit lines to SMEs was not enough to achieve the objective of SME development; financial infrastructure deficiencies, supervisory weaknesses, and the overall health of the finance sector also required attention.<sup>18</sup> In a program loan for SME development in Viet Nam, the decrees and resolutions that were issued to improve the business environment for the SME sector and to enhance SME access to finance were accompanied by training programs to ensure effective implementation and sustainability. Given that the reforms under the program involved a number of agencies, attention also needed to be paid to ensuring continuous coordination among them.<sup>19</sup> A program grant provided to Lao PDR for SME development included trade policy measures to reduce transaction costs. It also incorporated an outreach strategy to increase SME

<sup>13</sup> IED. 2020. *Validation Report: Micro, Small and Medium Enterprise Development Project in India*. Manila: ADB.

<sup>14</sup> IED. 2016. *Validation Report: Small and Medium-sized Enterprise Development Project in Bangladesh*. Manila: ADB.

<sup>15</sup> IED. 2019. *Validation Report: Women's Entrepreneurship Support Sector Development Program in Armenia*. Manila: ADB.

<sup>16</sup> IED. 2014. *Validation Report: Support the Implementation of the Poverty Reduction Programs IV and V in Viet Nam*. Manila: ADB.

<sup>17</sup> IED. 2014. *Validation Report: Support the Implementation of the Poverty Reduction Programs IV and V in Viet Nam*. Manila: ADB.

<sup>18</sup> IED. 2016. *Validation Report: Small and Medium Enterprise Investment Program Tranche 1 in Kazakhstan*. Manila: ADB; IED. 2019. *Validation Report: Small and Medium Enterprise Investment Program Tranche 2 in Kazakhstan*. Manila: ADB.

<sup>19</sup> ADB. 2016. *Completion Report: Second Small and Medium-sized Enterprises Development Program in Viet Nam*. Manila: ADB; IED. 2017. *Validation Report: Second Small and Medium-sized Enterprises Development Program in Viet Nam*. Manila: ADB. This program was approved in 2010 and 2013. ADB also provided budgetary support from 2007 to 2011. One of the components of the policy-based loans was private sector development. Policy reforms, such as the revision and adoption of the legal framework and policies to promote SMEs and to establish mechanisms to reduce the transaction costs of SMEs, were implemented. On reducing transaction costs, a consultative mechanism to streamline licenses; a single-window system for businesses to cover registration, tax and seal formalities; and a national business registry were established. At the policy level, the incentives under the enterprise income tax were rationalized; guidelines to govern the operation of the Viet Nam Competition Council were adopted; commercial-scale infringements of patents, trademark rights, and rights of design became a crime; and a legal framework for logistics services, including multi-modal transport, was completed. See ADB. 2013. *Completion Report: Support the Implementation of the Poverty Reduction Programs IV and V*. Manila; and IED. 2013. *Validation Report: Support the Implementation of the Poverty Reduction Programs IV and V in Viet Nam*. Manila: ADB.

participation in trade, particularly for those SMEs involved in the supply chain.<sup>20</sup> The program in Viet Nam included a legal framework for logistics services, including multi-modal transport.<sup>21</sup> A program in the Kyrgyz Republic learned that, to support SMEs engaged in trade, access to the pre-custom single electronic window needed to be extended beyond the capital.<sup>22</sup>

### III. LESSONS LEARNED FROM ADB NONSOVEREIGN MSME OPERATIONS

#### A. Crisis Support

10. **Ensuring financing support is provided wherever possible in local currencies reduce foreign currency exposure for financial intermediaries and microfinance institutions that on lend financing to MSMEs.** Financing in local currency significantly mitigates funding risks for ADB clients. Foreign exchange rates are affected by a range of factors, including government debt, political stability, and economic recessions. For example, ADB loans to financial intermediaries in Azerbaijan were materially impacted by the economic impact of the oil price shock in 2014 and the subsequent currency depreciation. The capital adequacy of the borrowers was severely affected, requiring the outstanding ADB loans to be restructured. In other markets, such as Sri Lanka, foreign exchange rates have had extended periods of volatility. Because currency hedging markets are very limited, financial intermediaries seeking to work with ADB have expressed concerns about the currency risks involved in onlending ADB's funds to MSME borrowers.

11. **Utilizing a clear design and monitoring frameworks (DMF) and compliance with ADB's safeguard policies for financial intermediaries and microfinance institutions supports effective program targeting.** DMFs must provide a clear definition of qualifying MSMEs, as well as clear lending targets for each intended beneficiary group.<sup>23</sup> The financial intermediary must be able to identify the MSME borrowers and sectors to be supported. ADB's safeguard policies require that, for projects involving investment of ADB funds to or through financial intermediaries, ADB should conduct safeguard due diligence to assess potential environmental and social impacts and risks associated with the financial intermediary's existing and likely future portfolio, and its commitment and capacity for social and environmental management. It is anticipated that there will be high demand for support for agribusiness MSMEs during the COVID-19 response period. These operations raise specific concerns for safeguards compliance because of their potential exposure to the use of illegal fertilizers, child labor, and tobacco crops, among others. Financial intermediaries must be able to demonstrate they have appropriate safeguard screening and monitoring in place.<sup>24</sup>

12. **Providing short-term trade facilitation support to MSMEs is crucial during a crisis to prevent interruptions to trade flows, especially in ADB Pacific small island developing economies (SIDS).** If the Supply Chain Finance Program (SCFP), which was established in 2012, is targeted at MSMEs, which are typically outside multinational supply chains, it can add significant value and provide much needed credit support. The SCFP has not been evaluated by IED, but its mandate to enhance access to working capital for SMEs through payments by banks to SME suppliers upon the buyers' acceptance of goods appears

<sup>20</sup> IED. 2013. *Validation Report: Private Sector and Small and Medium-sized Enterprises Development Program Cluster (Subprogram I and II) in Lao PDR*. Manila: ADB.

<sup>21</sup> ADB. 2013. *Completion Report: Support the Implementation of the Poverty Reduction Programs IV and V in Viet Nam*. Manila; IED. 2013. *Validation Report: Support the Implementation of the Poverty Reduction Programs IV and V in Viet Nam*. Manila: ADB.

<sup>22</sup> ADB. 2015. *Completion Report: Investment Climate Improvement Program in Kyrgyz Republic*. Manila; IED. 2015. *Validation Report: Investment Climate Improvement Program in Kyrgyz Republic*. Manila: ADB.

<sup>23</sup> These may be defined as geographic areas where banking services are limited, by the size of the MSME borrowing the funds (using MSME revenues or number of employees or other definitions), by the ownership of the MSME (groups of women, single women, women-led), or by the type of business (agribusiness, manufacturing).

<sup>24</sup> ADB. 2009. *Safeguard Policy Statement*. Manila; IED. 2019. *Safeguard Assessment of Nonsovereign Operations Synthesis Note No. 1*. Manila: ADB; ADB. 2020. *ADB's Comprehensive Response to the COVID-19 Pandemic*. Manila. IED. 2020. *Effectiveness of the 2009 Safeguard Policy Statement*. Manila.

to make it relevant to SMEs in ADB's Pacific SIDS.<sup>25</sup> In March 2020, ADB made available another \$200 million under the SCFP for companies manufacturing and distributing medicines and other items needed to combat COVID-19.<sup>26</sup> The ADB Trade Finance Program (TFP) also has an important role to play. Approximately 68% of TFP transactions by number support SMEs. The TFP's response to the global financial crisis identified 85 issuing banks from 16 ADB DMCs for inclusion in the TFP, although none of the issuing banks that were added in response to the global financial crisis were in ADB Pacific SIDS. The current TFP list of issuing banks includes only three from the Pacific, one each in Fiji, Papua New Guinea, and Samoa.<sup>27</sup> Access to finance continues to be a concern for ADB's Pacific SIDS, which have meaningful exports of agricultural and mineral resources. The urgent nature of ADB's response to the COVID-19 pandemic suggests that rapid deployment of increased TFP support will take place through the TFP's existing network of issuing and confirming banks, with a program expansion to include domestic trade and local currency financing.

## B. Post-Crisis Support

**13. Providing medium-term contingency planning through two stage disbursements allows increased monitoring of the creditworthiness of financial intermediaries.** If disbursement of funds is in two or more tranches, this will help the monitoring of financial intermediaries' credit metrics and the progress of onlending to MSMEs and assist ADB to plan its technical assistance. After the crisis, financial intermediaries are likely to be affected by high non-performing loan (NPL) ratios, impacting their ability to meet scheduled repayments or maintain their operations. In Mongolia, for example, the economy contracted significantly in 2015, and, while all loan repayments were met, not all targets for MSME lending were achieved, either because there was insufficient demand for loans or because management priorities shifted to non-MSME sectors such as retail lending.<sup>28</sup> In 2015, ADB approved loans to financial intermediaries in Azerbaijan to increase their MSME lending and to instill confidence in the banking sector during the country's ongoing economic difficulties. However, the situation deteriorated very quickly, leading to loan restructuring and government interventions to rationalize the banking sector.<sup>29</sup> In the same year, financial intermediaries in Sri Lanka received loans with accompanying TA to support increased MSME lending during the post-conflict recovery period. While the MSME lending met all its targets, TA implementation suffered from divergent views on project plans and limited monitoring of TA progress.<sup>30</sup> In many of these circumstances, if ADB's loans had been deployed in two stages this may have helped to ensure that planned programs continued to align with the financial intermediaries' business strategies and their financial positions during evolving situations.

**14. Extending medium to long-term partial credit guarantees (PCGs) for financial intermediaries can help leverage additional resources to support MSMEs, however high-quality ADB work at entry and ongoing capacity building support are required to ensure that facilities meet their development targets.**

<sup>25</sup> ADB. 2018. *Proposed Guarantees, Loans, and Risk Participation Products for Additional Financing Trade Finance Program*. Manila; ADB. 2018. *Proposed Supply Chain Financing: Additional Financing*. Manila; ADB. 2020. *ADB's Comprehensive Response to the COVID-19 Pandemic*. Manila. IED. 2011. *Special Evaluation Study on Real-Time Evaluation of Asian Development Bank's Response to the Global Economic Crisis of 2008–2009*. Manila: ADB. The new issuing banks added in response to the global financial crisis were in Afghanistan, Armenia, Azerbaijan, Bangladesh, Bhutan, Cambodia, Georgia, Indonesia, Mongolia, Nepal, Pakistan, Philippines, Sri Lanka, Tajikistan, Uzbekistan, and Viet Nam. The TFP expanded its program in stages, with the Armenia, Bhutan, Georgia, and Tajikistan banks added in late 2010 or 2011. TFP website: <https://www.adb.org/site/trade-finance-program> accessed 27 April 2020. ADB. 2018. *Performance Evaluation Report Pacific Private Sector Development Initiative*. Manila; ADB. 2019. *Pacific Private Sector Development Initiative Phase IV*. Manila; ADB. 2019. *Pacific Economic Monitor December 2019*. Manila.

<sup>26</sup> ADB. 2020. *News Release: ADB to Provide \$200 million to Support Strained Supply Chains in Fight Against COVID 19*. Manila.

<sup>27</sup> Four DMCs received about 87% of the TFP in 2010 (Bangladesh, Indonesia, Pakistan, Viet Nam), suggesting that small program limits for other DMCs can provide useful support for trade.

<sup>28</sup> ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Senior Loans to XacBank and TenGer Financial Group Supporting Micro, Small, Medium-Sized Enterprises and Leasing Finance (Mongolia)*. Manila; ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Senior Loan to Khan Bank Supporting Micro, Small, Medium-Sized Enterprises (Mongolia)*. Manila.

<sup>29</sup> IED. 2019. *Country Assistance Program Evaluation Azerbaijan, 2011–2017*. Manila: ADB

<sup>30</sup> ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Senior Loans to LOLC Finance and LOLC Microcredit in Sri Lanka*. Manila.

Efforts to use PCGs in this manner have had very limited success.<sup>31</sup> For example, in Pakistan, a PCG program was developed in the late 1990s following a financial crisis. PFIs were provided with PCGs for 50% of their MSME portfolio exposure up to an agreed lending limit. [Confidential information deleted.] Only one PFI participated. [Confidential information deleted.]<sup>32</sup> In the Philippines, ADB responded to a government request for support for its SME development program in 2004–2010. ADB provided a local currency revolving PCG facility for PFIs which would guarantee 50% of the agreed portfolio lending limit. In 3 years, only one PFI joined the program, and it used only 20% of the portfolio limit allocated to it, due to its insufficient SME client base. For PCG projects to succeed, the market demand for the product must be present and the program should be designed so it is attractive for financial intermediaries.<sup>33</sup>

#### IV. LESSONS FROM OTHER MULTILATERAL DEVELOPMENT BANK MSME OPERATIONS

##### A. Crisis Support

15. **Recognizing and leveraging comparative advantages of financial intermediaries, including local knowledge, local currency finance, product cross-selling, and lower transaction costs help better target MSMEs.**<sup>34</sup> MDBs have focused almost exclusively on providing support to MSMEs indirectly through financial intermediaries, because this is both efficient and effective. In Bolivia and Uruguay, for example, where Inter-American Investment Corporation has provided loans mostly in US dollar denomination, companies have identified the lack of loans in local currency as a disadvantage, compared to loans from local financial intermediaries. In addition, if MSME support becomes a profitable business line for a local financial intermediary, this can have sustainable, long-term impacts well beyond the life of an individual operation.

16. **Prioritizing a clear MSME definition and a strong results framework ensures effective MSME program reach.** Multiple MDB studies have shown that key contributing factors to the success of MSME support include clear definitions and eligibility criteria to ensure that MSMEs are reached effectively.<sup>35</sup> A strong DMF will lead to the production of credible performance data, allowing timely progress monitoring and midcourse adjustments if necessary. A strong DMF is especially important for attributing the funding of specific beneficiaries to a particular intervention. This in turn affects the additionality of the operations targeting SMEs.

17. **Ensuring robust sector analysis for proper risk identification and mitigation is fundamental to structure effective guarantees and risk-sharing facilities for encouraging financial intermediaries to lend to MSMEs.** The Multilateral Investment Guarantee Agency has found that guarantees perform better when there is “consistency between the project and government’s strategies, correct identification of environment and social risks and, in times of crisis, commitment of a parent financial institutions to support and maintain the overall exposure levels of their subsidiaries.”<sup>36</sup>

18. **Partnering with state-owned banks can be highly productive to support MSMEs in a country that an MDB is unfamiliar with.**<sup>37</sup> Although engagement with a private bank is preferred, in certain circumstances a partnership with a state-owned bank can be the best available option, as demonstrated

<sup>31</sup> These PCGs are distinct from those of TFP, SCFP, and Micro Finance Risk Participation and Guarantee Program, all of which have expanded in response to market demand for their guarantees and which have reported zero or near-zero rates of default.

<sup>32</sup> ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loans, Guarantee, and Technical Assistance Grant to the Islamic Republic of Pakistan for the Small Medium Enterprise Sector Development Program*. Manila.

<sup>33</sup> ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Loan, Partial Credit Guarantee, and Equity Investment to the Republic of the Philippines for the Small and Medium Enterprise Development Support Project*. Manila.

<sup>34</sup> <https://publications.iadb.org/publications/english/document/Evaluation-of-Direct-Support-to-SMEs-by-the-IIC.pdf>

<sup>35</sup> [https://ieg.worldbankgroup.org/sites/default/files/Data/Evaluation/files/SME\\_Synthesis.pdf](https://ieg.worldbankgroup.org/sites/default/files/Data/Evaluation/files/SME_Synthesis.pdf)

<sup>36</sup> [https://ieg.worldbankgroup.org/sites/default/files/Data/Evaluation/files/SME\\_Synthesis.pdf](https://ieg.worldbankgroup.org/sites/default/files/Data/Evaluation/files/SME_Synthesis.pdf), p.20

<sup>37</sup> EBRD (Operation Evaluation). 2018. *Lending for SMEs, Women in Business, and Energy Efficiency in SMEs*. London; EBRD. 2010. *Operation Performance Evaluation Review: EU/EBRD SME Facility (Regional)*. London.

by the European Bank for Reconstruction and Development (EBRD) operations in Egypt. EBRD sees the need for the adoption of the logical framework approach in its operations with programs involving substantial grant funds.

## B. Post-Crisis Support

19. **Supporting fintech companies and digital finance can help sustain MSMEs' access to lending.** New fintech companies and digital platforms grew rapidly after the 2008–2009 global financial crisis. New technologies such as cloud computing, artificial intelligence, and digital payment systems are lowering the costs for financial intermediaries to obtain information and data about MSME clients. Digital data can be used to supplement more traditional information sources on MSMEs and to determine their creditworthiness. Digital payment systems, via mobile apps or online banking, can also make it easier to disburse funds. However, these innovations come with their own risks, such as fraud or misuse of client data; appropriate regulatory frameworks for digital finance need to be developed as well.<sup>38</sup>

20. **Modernizing regulations and policies can promote competition and innovation in lending technologies leading to improved performance for microfinance institutions.**<sup>39</sup> Regulations and policies promoting competition between microfinance institutions and innovation in lending technologies can help reduce lending rates. If the policy objective is to reduce interest rates, regulations should, in principle, aim to create a market structure in which microfinance institutions can operate, test their lending technology, introduce innovations that increase productivity and efficiency, and exert competitive pressures. A good understanding of lending rate fundamentals and recent changes in financial technology is essential for informed policy decisions. This should result in better regulations, and therefore in an improvement in microfinance institutions' sustainability prospects.

## V. CONCLUSIONS

21. **Redesigning existing facilities and carefully taking in consideration local country context to design new interventions, strengthens ADB's relevance during the COVID-19 crisis.** Support to DMCs is optimized when the financing and payment terms of its loans are tailored to the specific needs of locally impacted communities. For ongoing investment projects, ADB's response may include the requirement to reconsider lending tenors, repayment terms, and other credit risk mitigation measures. For programmatic interventions, a review of the MSME sector's immediate, medium-term and long-term needs may be required. The COVID-19 pandemic highlights the urgent need for countries to have a readily available centralized MSME database for proper targeting and immediate distribution of support during crises. Countries also need an efficient information and communication technology (ICT) infrastructure to support supply chain management. The programmatic approach, for both sovereign and nonsovereign operations, can allow succeeding tranches and any TA projects to be modified. During the current crisis, support for MSMEs in agribusiness is likely to be crucial, highlighting the need for safeguard compliance in this area. In designing new investment programs, assessing the appropriate financing and payment terms helps mitigate currency risks. It may be possible for ADB to play an important role in the recovery of bond markets by issuing local currency bonds with a view to lending in local currency to financial intermediaries for onlending to MSMEs. Grace periods for repayments may need to be for 12 months rather than 6 months as is the general ADB practice. Within the immediate context of the COVID-19 crisis but not compromising the financial soundness of ADB's long-term operations, eligibility requirements for both financial intermediaries and microfinance institutions to rapidly access ADB funding should be regularly reviewed to optimize loan targeting and reach,

<sup>38</sup> [https://content.centerforfinancialinclusion.org/wp-content/uploads/sites/2/1970/01/Responsible\\_Digital\\_Credit\\_FINAL\\_2018.07.18.pdf](https://content.centerforfinancialinclusion.org/wp-content/uploads/sites/2/1970/01/Responsible_Digital_Credit_FINAL_2018.07.18.pdf)

<sup>39</sup> IMF. 2011. *The Impact of the Global Financial Crisis on Microfinance and Policy Implications*. Washington, DC.

22. **Focusing on investments in information technologies and support for updates in regulatory and policy frameworks to better incorporate ICT and other technological innovations will provide medium- to long-term support for FIs and MSMEs and help address operational challenges.** An immediate problem for FIs and MSMEs during the COVID-19 pandemic is that such businesses often rely on face-to-face customer interaction. One way to address this will be to provide additional support for investments in information management systems, finance ICT, and sovereign investments in related regulatory frameworks and policies. Awareness of national support for financial intermediaries as well as for MSMEs will help ADB to better carry out contingency planning. ADB already maintains a database of government policies to support crisis recovery which will prove a useful resource.<sup>40</sup>

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<sup>40</sup> ADB. 2015. *Proposed Senior Loans LOLC Finance and LOLC Microcredit (Sri Lanka)*. Manila and ADB. 2020. ADB COVID-19 Policy Database. <https://data.adb.org/dataset/adb-covid-19-policy-database>