

Josefina Stubbs

## FOCUS SECTION

### SMALL BUSINESS FINANCE

It is my great pleasure to introduce you to this focus section of *Law in transition*, on behalf of the International Fund for Agricultural Development (IFAD).

Rural areas in many developing countries are undergoing rapid transformation, driven by both global and country-specific developments. Reducing rural poverty by fostering inclusive agricultural value chains creates employment, generates income and contributes to national growth. As an institution that is deeply involved in shaping agricultural and rural development policies and programmes in many low or middle-income countries around the world, we understand farming, at whatever scale, as a business. We know that smallholder family farmers need more and better access to finance, financial products, markets and insurance to enhance their productivity, increase their income and contribute to local and national economies.

The substantial tightening of capital adequacy, which came as a regulatory response to the recent financial crisis, and the resulting contraction in bank lending to small businesses has made the subject of access to finance for small businesses, and ultimately small and medium-sized enterprise (SME) growth, a very prominent issue. Governments across the world have recognised the significance of this problem and we have seen numerous initiatives taking place with the aim of facilitating finance and enhancing the operational environment for small businesses. It has also long been recognised that one of the pieces of this puzzle is the establishment of a legislative framework, which could either promote or impede innovative financing solutions.

Small businesses are faced with various problems when trying to access finance. They may, for example, struggle to provide potential lenders with acceptable collateral. This may be due to limitations in existing collateral systems, which do not provide lenders with a reasonable level of risk mitigation (owing to inefficient laws or enforcement procedures), or due to the fact that existing legal rules do not enable certain types of assets to be used as collateral at all. As portrayed in Ivor Istuk and Ahmed Meziou's article on the status of collateral regulations in the region, the vast majority of the countries where the EBRD invests have introduced modern collateral laws and registries (both for movable and immovable assets). However, the article also shows that the success of these reforms has not been even and that there is more work to be done on fine-tuning the developed systems or reforming the under-performing ones.

The ways in which innovative legislative concepts can help to break this deadlock by creating new types of collateral are illustrated in Stefan AntoniĆ and Darko Jovanović's case study on crop receipts. The authors introduce us to the almost alchemic world of creating collateral value from thin air (future outputs of agricultural production) and show us that this is possible when adequate contractual frameworks, inspections and pledge enhancement mechanisms are put in place.

Small businesses may also struggle to provide evidence of a track record, which lenders generally seek. As such, many small business owners are turning to alternative asset-based lending methods, such as sale and leaseback arrangements or other types of operating and financial leases. The importance of a supportive

regulatory and legislative framework, as well as proper risk assessment techniques for leasing operations, are portrayed in Stewart K. Pirnie's article on leasing in Mongolia, where the government has committed to revising the current leasing law and further developing the leasing market.

In addition to the problem of securing long-term finance, SMEs suffer from inadequate cash flow caused by late payments, and the sale of accounts receivable (factoring services) may sometimes be the only way to give small businesses quick access to working capital. As Ivor Istuk and Mirosljub Labus show in their article on improving supply chain finance in the EBRD region, factoring is experiencing a marked revival in the current economic context, boosted by the development of more sophisticated legal and technical solutions. However, a suboptimal legal and regulatory environment can limit this development.

Modern times offer the excitement of new technologies, especially when such technologies enable millions of micro businesses and individuals in the world's unbanked regions to access various financial services and hence stimulate the development of local economies. Such is the motivation behind the EBRD's support for the development of mobile money services in Tajikistan, brought to us by Sibel Beadle and Aiaze Mitha. These reforms enable individuals and small businesses to manage their bank accounts, transfer money domestically or internationally from phone to phone or to make payments using their mobile phone, thus integrating them into the modern financial world. On the other hand it remains a fact that three-quarters of the world's poorest people live in the rural areas of developing countries. Most of them depend on agriculture for their livelihoods. In a very interesting article, IFAD staff explain how innovative contract farming structures facilitate vertical integration among producers, wholesalers and retailers and help increase agricultural production and productivity, as well as strengthen the food security of rural producers and the rural poor at large.



## FOREWORD

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Next to building supportive legal environments, SMEs also need know-how to improve their performance and growth. Charlotte Ruhe's article on the Small Business Support team's advisory services for small enterprises illustrates how the EBRD has been able to build expertise and experience by providing businesses with the advice they need when they need it, which could ultimately translate into growth and employment. Likewise, Lorenzo Ciari and Alan Colman's piece on the Legal Transition Team's assistance with judicial training in competition policy and its capacity-building work with competition authorities is a good reminder that SMEs also need an even playing field, which only strong regulatory institutions can guarantee.

Last but not least, the search for innovative finance mechanisms and reform support should not only focus on the end users of finance. Improving access to finance for financial intermediaries can yield even better results. For example, helping financial institutions find different solutions for refinancing their exposures to the small business sector could make them more confident and willing to invest further in the small business financing market. The viability and market appeal of one such new and innovative financial instrument is analysed by Bernd Volk in his very informative article on SME covered bonds.