

# Training Manual: The Basics of Financing Agriculture

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Module 5.1 | Micro Lending and SME Lending- A  
Comparative Review

# Acknowledgement

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*The Agriculture Finance Training Manual is part of AgriFin's Agriculture Finance Training Tools. The Manual was developed by [IPC](#) - Internationale Projekt Consult GmbH as part of AgriFin's technical advisory project for Cameroon Cooperative Credit Union League ([CamCCUL](#)).*

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# Session Overview

<b>LEARNING OBJECTIVE</b>	<b>SME financing is typically for longer duration and involves larger investment and therefore more risk. Therefore, lending to small and medium scale enterprises demands a unique set of analytical and management skills. In dealing with SMEs, therefore, an ALO needs to be versant with the analytical and qualitative factors that would influence the lending decision</b>
<b>SCOPE</b>	<p>This session provides the trainee a comprehensive understanding of the steps in evaluating an SME client's business proposal, managing potential risks of large investments and evaluating the business' ability to service debt.</p> <p>At the end of the session, the trainee will have an understanding of the following key areas:</p> <ul style="list-style-type: none"><li>Key features of a micro and SME business proposal</li><li>Success factors for managing micro and SME client relationships</li><li>Evaluating the financing needs of a micro and SME</li><li>Analyzing financial statements of Micro and SMEs</li></ul>
<b>TARGET</b>	Agriculture loan officers, financial analysts, trainers, and other professionals interested in agriculture financing
<b>DURATION</b>	2 hours

# Content

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1. Introduction
2. Micro-enterprises and SMEs
3. Micro-enterprises and SMEs: consequences for lending
4. Distinguishing between micro-lending and SMEs
  - a) Business characterizes
  - b) Client relationship
  - c) Financing needs
  - d) Financial analysis
5. Summary

# 1. Introduction

**Small and medium enterprises (SMEs) differ from microenterprises. This difference requires a different approach to lending.**

- This does not mean that the analysis technology will be totally different, or the approach will have to be changed radically.
- Changes are rather gradual, as the importance of certain aspects of the client and the analysis are altered.
- It important to understand these changes to ensure the optimal approach to the clients.

**After an overview of key differences, the implications for four areas are explored in detail:**

- the business
- the client relationship
- the financing needs
- the financial analysis

# 1a. What are SMEs?

	No. of employees	Revenue	Assets
<b>WB</b>	300	15,000,000 USD	15,000,000 USD
<b>IDB</b>	100	3,000,000 USD	None
<b>AF.D.B</b>	50	None	None
<b>ADB</b>	No official definition; use definitions of respective countries		
<b>UNDP</b>	200	None	None
<b>EU</b>	Micro < 10	≤2 million EUR	≤2 million EUR
	Small < 50	≤10 million EUR	≤10 million EUR
	Medium < 250	≤50 million EUR	≤43 million EUR
<b>Japan</b>	Small ≤ 20		≤300 million Yen (manufacturing) ≤100 million Yen (wholesale) ≤50 million Yen (retail, services)
	≤300 (manufacturing) ≤100 (wholesale) ≤50 (retail) ≤100 (services)		
<b>USA</b>	No clear definition		

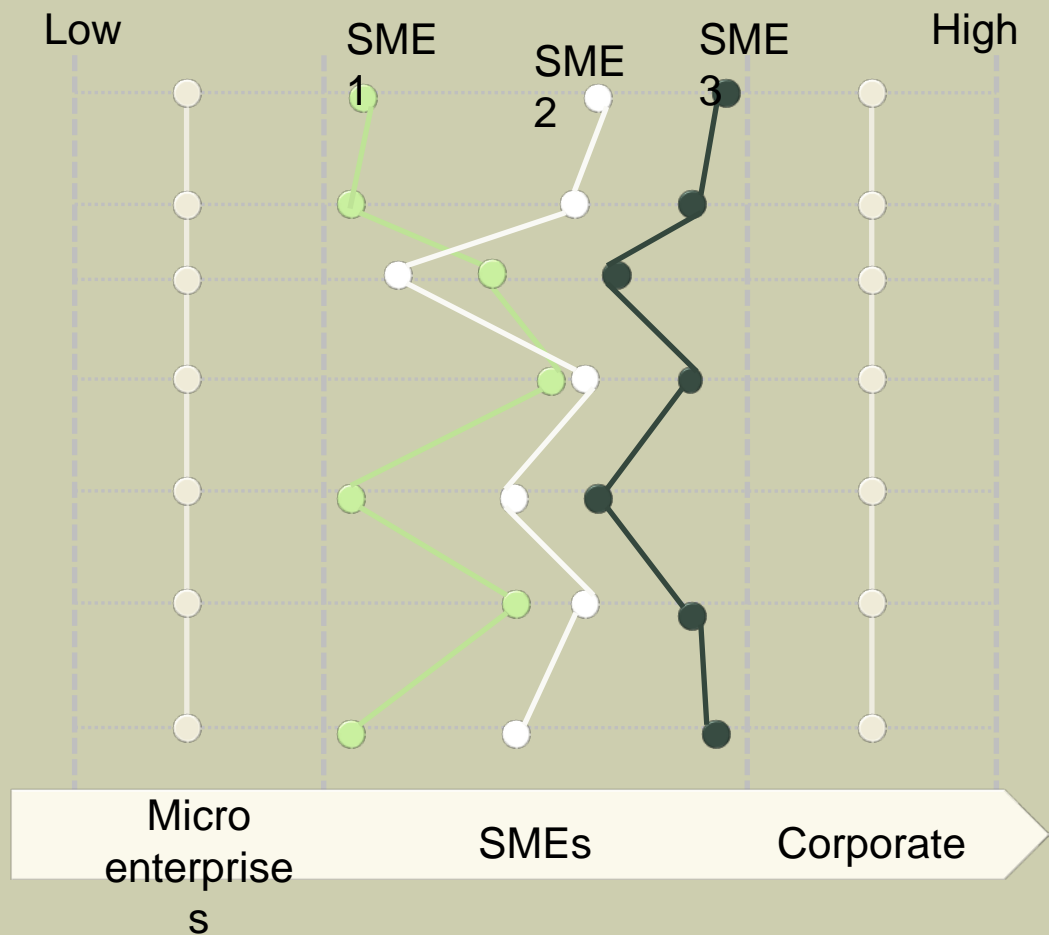
## 2. Micro-enterprises and SMEs: key features

	<b>MSE</b>	<b>SME</b>
Separation between private and company assets	Usually not	Sometimes yes / sometimes no
Formal accounting	Extremely limited	Usually at least some
Availability of collateral	Extremely limited	Sometimes yes / sometimes no
Demand for flexible, tailor-made loans	Low	Can be low / can be high
Usage of bank services other than loans	Low	Sometimes yes / sometimes no
Number of external, registered employees	Low	Usually higher than at MSEs
Decision-making based on long-term business planning	Usually not	Sometimes yes / sometimes no

**SMEs are a heterogeneous group!**

# 2a. Micro-enterprises and SMEs: comparison by size

- Separation between private and company assets
- Formal accounting
- Availability of collateral
- Demand for flexible, tailor-made loans
- Usage of bank services other than loans
- Number of external, registered employees
- Decision-making based on long-term business planning





# 3. Micro-enterprises and SMEs: consequences for lending

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The lending institution has to take the following into account when lending to SMEs:

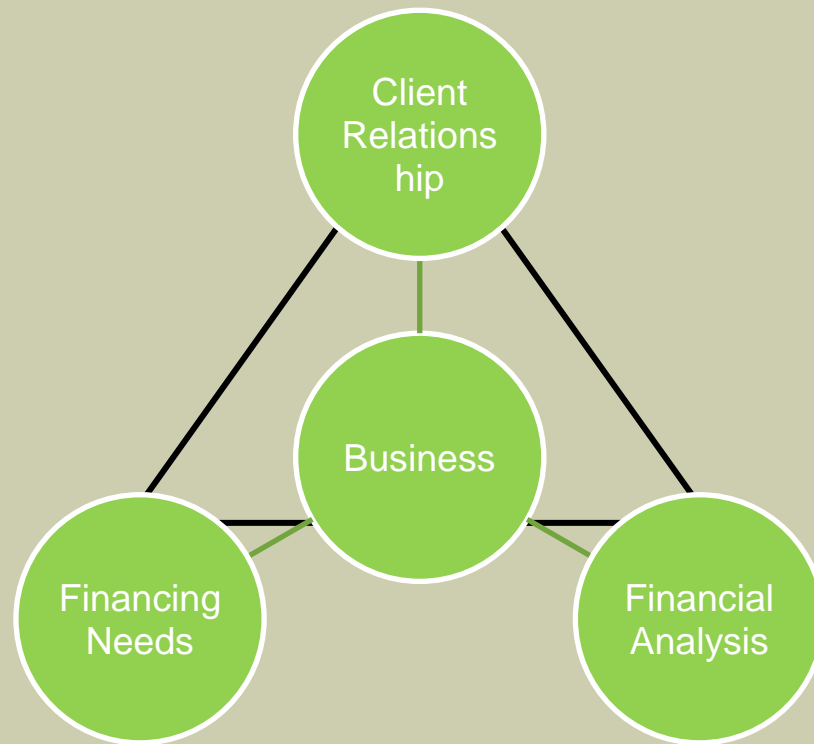
- Bigger loan amounts mean bigger potential risks
- Formality:
  - “Official” financials become important (even if they do not reflect the entire real situation) as source for repayment, as source for enterprise assets and their value
- The Financial needs of SMEs can be beyond standard installment or bullet repayment loans
  - Loan product design needs more variety and flexibility
  - Availability of other services ties the client to the CU and generates income

# 3a. Micro-enterprises and SMEs: consequences for lending (contd.)

Analysis approach	MSE	SME
On-site visit	Business and home	Business(es)
Compilation of financials	Balance Sheet Cash flow-based Income statement	Balance Sheet Income Statement Cash Flow
Industry and environment	Usually not relevant	Industry, market position, competition and regulatory environment need to be analysed
Ownership structure/management	Usually simple as owners usually also managers; registration form typically “individual entrepreneur”	Ownership and management structure has to be analysed in detail; registration usually as legal entity
Assets	Legal proof of ownership and reliable valuation usually not important	Legal proof of ownership and reliable valuation of key importance
Formal financial statements	Usually not available or not meaningful	Usually available and meaningful (even if not 100% reflection of reality)
Products	Simple, standardised instalment loans; (bullet repayment loans); Current account, money transfers	Credit facilities at call; individually tailored solutions, current accounts, money transfers, POS, etc.

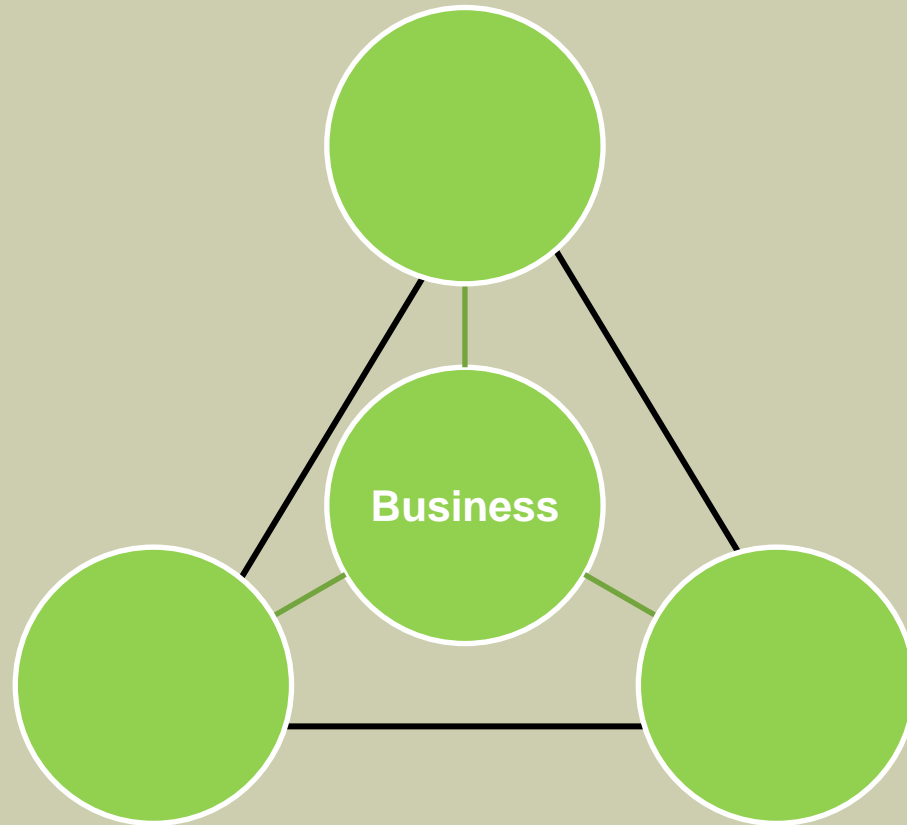
# 4. Categories for distinguishing between micro-lending and SMEs

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# 4a. Business characteristics

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# 4a. Business characteristics: Micro clients (I)

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## Micro clients:

- Micro-business and family household are not separated
- Ownership and management of the business are not separated
- Organizational structure is rather simple
- Only one business activity (mostly trade or unsophisticated service)
- Assets are mostly current assets
- Almost no documentation of business activities
- Business is largely cash-based
- Flexibility of the business model, due to small scale
- Short planning horizon
- Self-employed Individual or even unregistered entity

# 4a. Business characteristics: Small/medium clients (I)

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Small/medium clients:

- Not a family-centered business
- Often more than one owner
- Separation between ownership and management of the business
- Organizational structure more complex
  - Several business lines
  - Several departments
  - More products
  - Higher business activity

# 4a. Business characteristics: Small/medium clients(II)

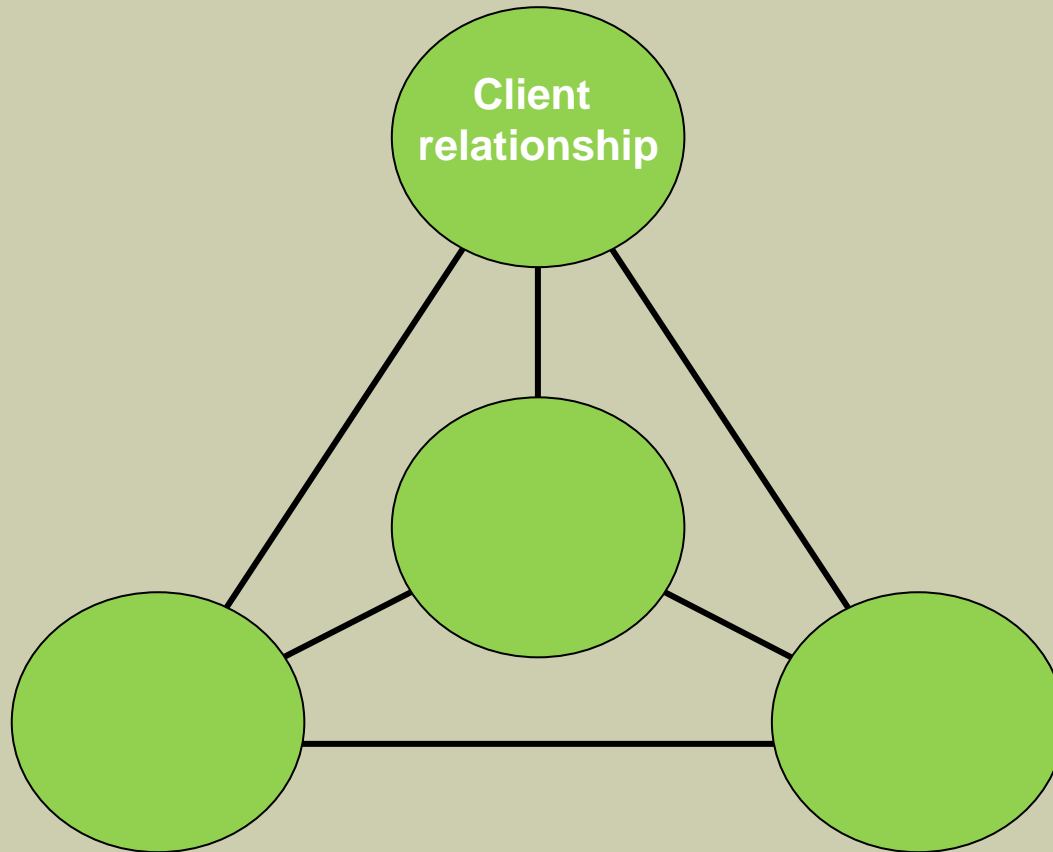
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## Small/medium clients:

- Business not mainly cash based (bank account statements and written contracts should at least partially reflect the business)
- Accounting and documentation (long-term contracts with suppliers, customers etc.) of business activities
- Relatively higher equity, more fixed assets
- More likely to be a production businesses or providing specialized, sophisticated services
- Mostly legal person (company, partnership etc.)

## 4b. Client relationship

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## 4b. Client relationship: Micro clients

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### Micro Clients:

- Little experience with formal financial institutions, especially for financing needs
- Mass, standardized approach
- Limited scope for cross-selling
- Easy to understand products (offering one product at a time)
- Informal communication style (rather not use too many banking terms)

# 4b. Client relationship: Small/medium clients

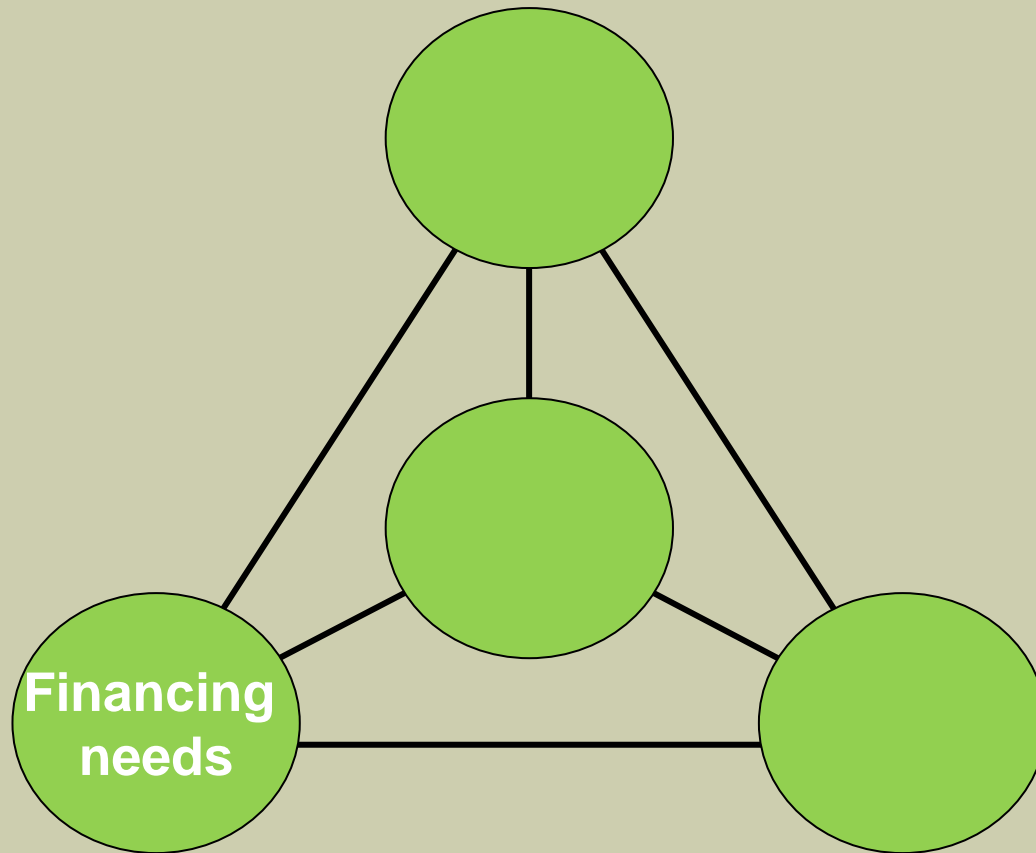
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## Small/medium clients:

- Experience with formal financial institution for financing needs
- More scope for cross-selling (e.g. deposit product for the clients' employees), more banking products on offer
- Tailor-made solutions for financing needs expected
- More than one loan product on offer
- More banking terms may be used in communication

# 4c. Financing needs

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## 4c. Financing needs: Micro clients

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- Need loans fast
- Relatively low amounts
- Short-term working capital
- Average maturities one year

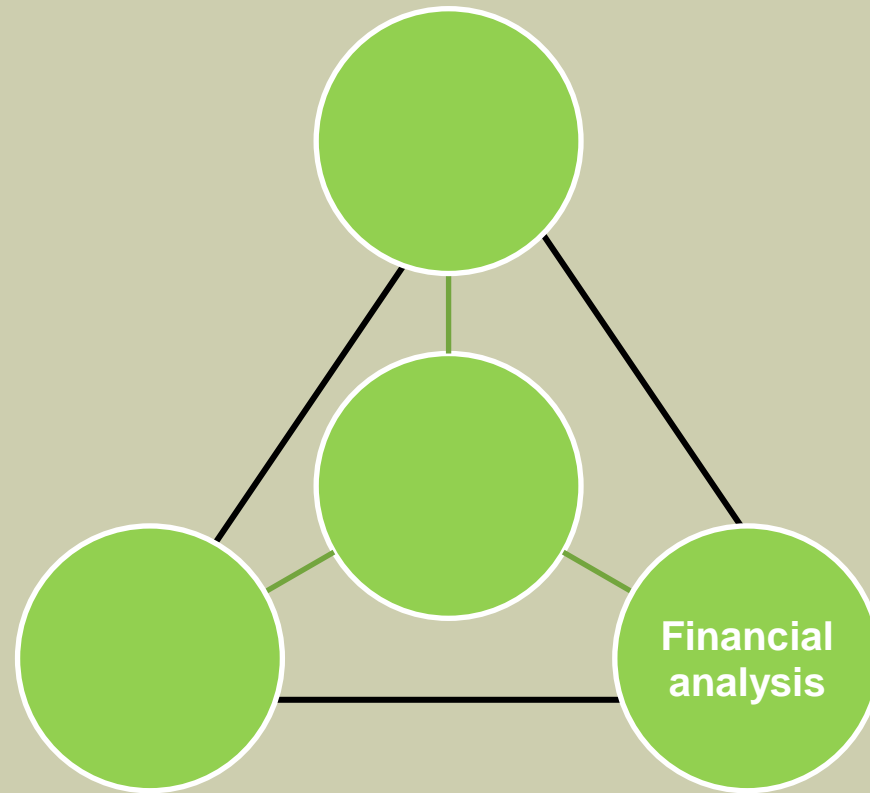
## 4c. Financing needs: Small/medium clients

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- Relatively larger loan amounts
- More often long-term investments, fixed asset investment
- In some cases, client has an “investment plan”
- Loan purpose maybe financed by several sources

# 4d. Financial analysis

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# 4d. Financial analysis: Micro clients

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## Micro clients:

- Analysis of the whole economic unit (household and business)
- Simple and fast analysis
  - Normally no cash flow projection
  - Based on the figures of the last 12 months, compilation of past profits and cash flow
- Based on oral information and “what meets the eye”
- Based on the personality of the manager/owner and his entrepreneurial skills
  - What does the client know about the market of his/her business?
  - What does the client know about his business model?

# 4d. Financial analysis: Small/medium clients (I)

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## Small/medium clients:

- Past, present and future must be analyzed (standard with cash flow projection)
- Analysis based on multiple sources of information
  - Documents
  - Accounting
  - Oral information
- More time for analyzing a loan
  - Client will have a plan, not a “next day” financing need)
  - Maybe more than one visit and interview partner (owner, manager, accountant etc.)
- Industry risk is more important for the investment decision
  - Rather specialized product/service, hard to change, once invested



# 4d. Financial analysis: Small/medium clients (II)

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## Small/medium clients:

- Legal risks must be evaluated as well
- Choice and evaluation of collateral
- More tailor-made solutions, not one size fits all approach
- Impact of the investment/loan needs to be thoroughly analyzed
  - How does the business change with this investment / new product / market, clients / cost structure etc.
- Soft factors still important
  - Organization of the business
  - Ability of the management)

# 5. Summary

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While the tools used to lend to micro and small/medium enterprises are the same, the level of detail differs!

- Cash flows for small/medium enterprises
- Past and future flows for small/medium enterprises

The market/industry in which small/medium enterprises operate is more important

- Impact on the assessment of risks and investment decisions
- Products offered to small/medium enterprises are more specific to the enterprise situation

This in turn means, that the CU and its Loan Officers must have more specific knowledge.

It also means that the internal structures in a bank lending mostly to small/medium enterprises may differ from one lending mostly to micro enterprises

**For more resources, please visit AgriFin's website**

**[www.AgriFin.org](http://www.AgriFin.org)**

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We welcome your feedback to help us further refine these training materials. Please write to us at [agrifin@worldbank.org](mailto:agrifin@worldbank.org) with your detailed inputs and suggestions.