

# Giving Credit Where It Is Due

## Spotlight on the G20

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## Introduction

A decade ago, ten G20 countries; Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa and Turkey, boasted some of the fastest growing economies in the world. Today, growth rates in many of these countries have fallen, hurt by factors including lower commodity prices and anemic global growth. One route to stimulate economic growth in these countries is to bolster the growth potential of female-owned small and medium sized enterprises (SMEs).<sup>1</sup>

Globally, SMEs contribute significantly to employment as well as innovation and productivity and, particularly in developing economies, SMEs are the biggest contributors to job creation. While SMEs face many challenges, a significant hurdle is often access to finance, especially for female-owned SMEs due to gender-related factors. We estimate the total amount of formal financing<sup>2</sup> needed but not available, the credit gap, amounts to more than \$160bn for female-owned SMEs in these ten G20 countries. Applying findings from our research paper “Giving Credit Where It Is Due”, we estimate that if these focus countries were to close the credit gap for female-owned SMEs,<sup>3</sup> real income per capita growth rates could be boosted by close to 90bps on average. If the credit gap is closed by 2025, incomes per capita could be on average nearly 15% higher by 2035 across this subset of countries, relative to our previous baseline scenario.

## Female-owned SMEs

Over one-third of the world’s formal female-owned SMEs are located in these ten focus countries, amounting to an estimated 3.6mn businesses, according to the International Finance Corporation (IFC). While the number is substantial, most of these countries lag their G20 peers in terms of per capita female SME ownership as Exhibit 1 demonstrates. Additionally, as shown in Exhibit 2, female SME ownership varies significantly across the ten studied countries. While there are more male than female SME owners on average, Brazil is an outlier with 56% of SMEs owned by women. In contrast, male ownership dominates the SME sector in India and Saudi Arabia, with over 80% male share. Given the breadth of the SME sector, we distinguish between types. Formal enterprises are those that are registered with government and tax authorities, informal enterprises are those that are not. While our study focuses on formal SMEs, it is notable that many women find employment through the informal sector. In India, the IFC estimates there are over 120 times more informal female-owned micro, small and medium enterprises than there are formal female-owned SMEs.

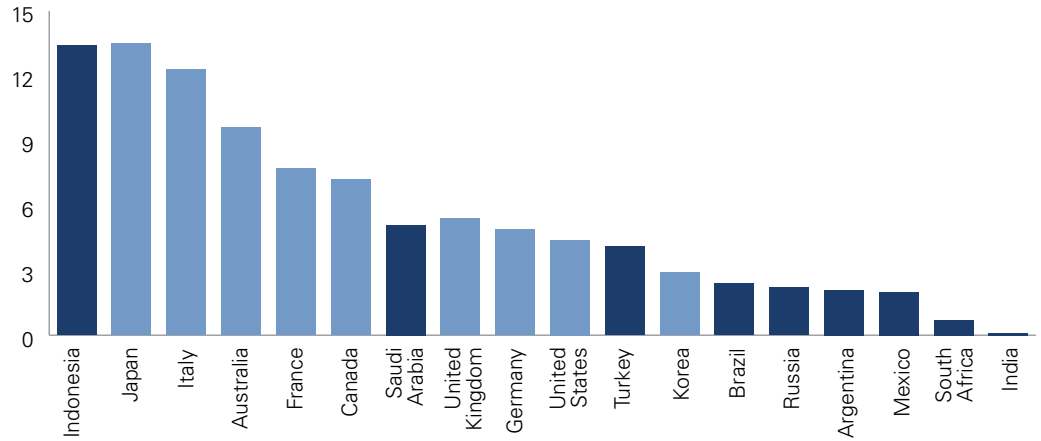
1. In line with the IFC, we categorize SMEs as “very small” (5-9 employees), “small” (10-49 employees) and “medium” (50-250 employees). We focus on formal SMEs, given that “micro” businesses (1-4 employees) and informal businesses are less likely to have access to a financial institution. Also consistent with IFC definitions, “formal” enterprises are those that are registered with government and tax authorities, while “informal” enterprises are those that are not, as well as non-employer firms (operated by their owners with no paid employees). An enterprise is considered female-owned if the sole proprietor, or at least one joint owner, is female.

2. Formal financing is assumed to be debt that would be included on a company’s balance sheet, such as loans, overdrafts, trade financing, leasing and factoring.

3. Female-owned SMEs are defined as formal enterprises with 10-250 employees and at least one female owner.

**Exhibit 1: The number of women-owned formal SMEs per capita is generally lower in the ten studied countries**

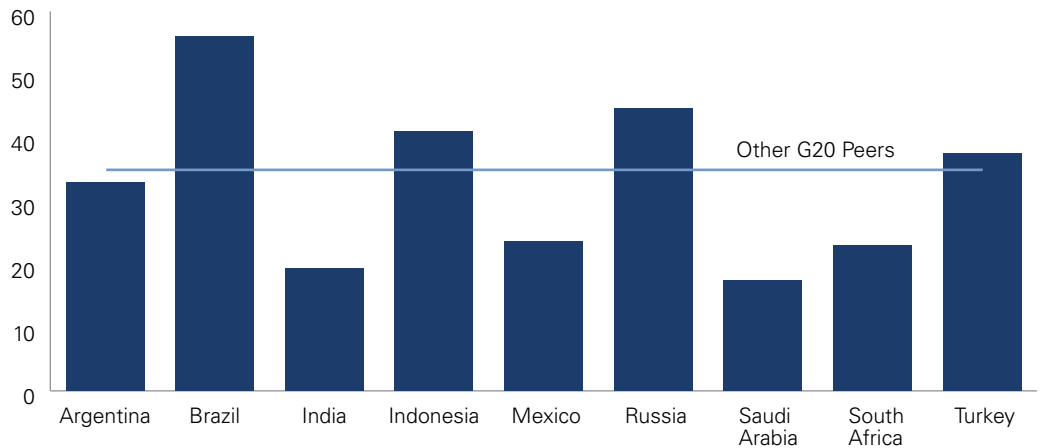
Women-owned formal SMEs per 1000 working age capita



Source: IFC Enterprise Finance Gap Database. Excludes China due to data availability. Ten studied countries in dark blue. Other G20 countries in light blue.

**Exhibit 2: Female SMEs ownership varies significantly across countries**

% of formal SMEs that are women-owned



Source: IFC Enterprise Finance Gap Database. Excludes China due to data availability.

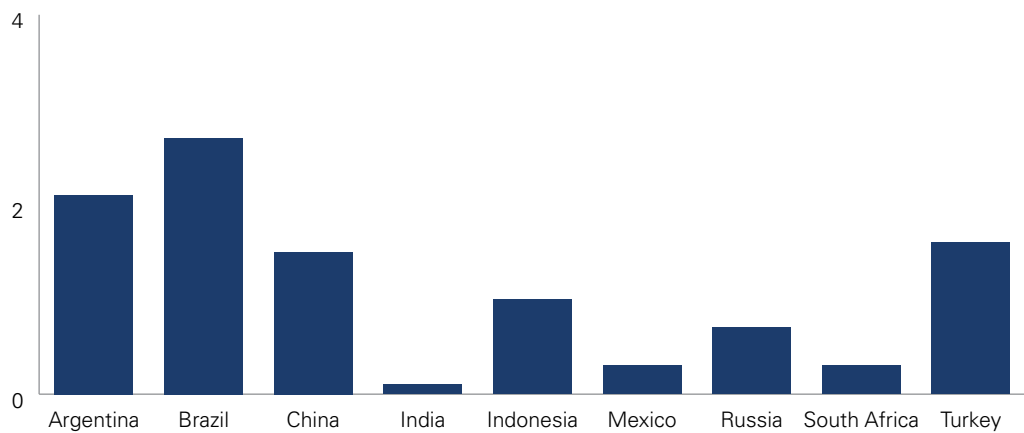
## The Credit Gap For Female-owned SMEs

Our research has highlighted that, while all SMEs face challenges, certain hurdles are more specific to female owners. These include aspects such as legal and cultural barriers, access to education and infrastructure-related challenges. Access to finance is often identified as a critical constraint. While financing barriers can be specific to each country, common gender-related barriers include women's lack of collateral, weak property rights and discriminatory laws and customs.

In order to quantify the demand for finance, we looked at the credit gap across countries. We estimated the size of the credit gap by using the IFC's classification system for credit need. It separates enterprises into four categories (no need, unserved, under-served, well-served) based on the availability of loans from formal financial institutions. Applying this methodology, we estimated a total credit gap of \$160bn for female-owned formal SMEs in the ten studied G20 countries. This corresponds to over half of the total female emerging markets credit gap of \$285bn, as estimated by the IFC. To compare the credit gap across countries, we looked at the credit gap as a percentage of GDP.<sup>4</sup> Argentina, Brazil and Turkey stand out for their large credit-gap-to-GDP ratios for female-owned SMEs, as Exhibit 3 shows.

### Exhibit 3: Argentina, Brazil and Turkey have the widest credit gap in GDP terms

Credit gap as % of GDP, formal women-owned SMEs



Excludes Saudi Arabia due to data availability.

4. Note that credit gap estimates in USD date back to different years across the countries, depending on the timing of the World Bank's Enterprise Surveys. The credit gap estimates for the ten focus countries are as of the following years: Argentina (2010), Brazil (2009), China (2003), India (2006), Indonesia (2009), Mexico (2006), Russia (2009), South Africa (2007), Turkey (2008). To calculate the credit gap-to-GDP ratio, we use each country's GDP as of the respective credit gap date. This assumes that credit gaps have been growing at the same rate as nominal GDP since the survey date. This, in our view, is a more plausible approach than using GDP in the same year across countries to calculate the ratio, which would introduce unnecessary distortions to the data.

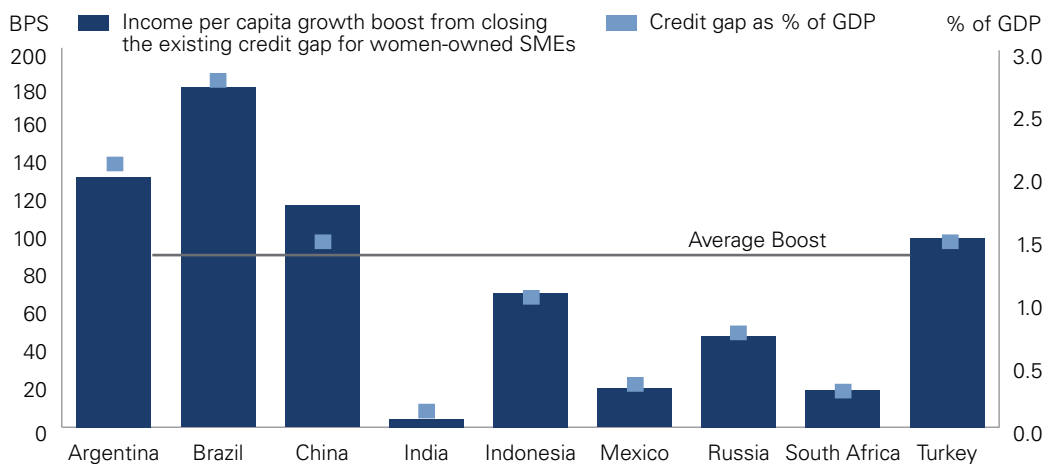
## Linking SMEs and Economic Growth

One critical link between SMEs and economic growth is the overall business environment and access to finance. In our previous report,<sup>5</sup> we estimated the macroeconomic link formally by looking at how SME credit affects income per capita growth across countries. To do this, we considered the overall level of development, proxied by initial income per capita, and the overall institutional environment, proxied by GS Growth Environment Scores (GES).<sup>6</sup> We found a strong relationship between SME credit and income per capita growth. The impact of increasing SME credit can be more dramatic for less developed countries and stronger for countries whose institutions are more robust. When applied to the ten focus countries, this analysis suggests that a 100bp increase in the SME loans-to-GDP ratio could boost income per capita by over 60bps on average.<sup>7</sup>

## Closing the Credit Gap

Taking this link, we focused on female-owned SMEs specifically and the existing credit gap across this subset of countries. As illustrated in Exhibit 4, results suggest that if these countries could close the credit gap for female-owned SMEs entirely, the resulting real income per capita growth rates could be almost 90bps higher on average, relative to our previous baseline scenario.<sup>8</sup> While closing the credit gap entirely presents many challenges, the economic benefit of targeting such a goal could be substantial. Stand out countries are Argentina, Brazil and China, reflecting the fact that these countries have both large credit gaps for female formal SMEs as a percentage of GDP and relatively high GS Growth Environment Scores (GES) representative of the overall institutional environment.

**Exhibit 4: Closing the existing credit gap for women-owned SMEs could boost income per capita growth by almost 90bps on average, relative to our previous baseline estimates**



Source: IFC Enterprise Finance Gap Database, World Bank, International Monetary Fund, Goldman Sachs calculations. Excludes Saudi Arabia due to data availability.

5. Goldman Sachs Global Markets Institute (2014). 'Giving credit where it is due: How closing the credit gap for female-owned SMEs can drive global growth'.

6. The Growth Environment Scores are Goldman Sachs proprietary indicators that are designed to capture important features of the economic, political and institutional environment that affect countries' growth potential. The GES components fall into six major areas: macroeconomic conditions, macroeconomic stability, political conditions, technology, human capital and microeconomic conditions.

7. All country averages are GDP-weighted, which, in our view, is a better gauge of the 'global impact' related to raising SME credit

8. Our long-term projections are based on several fundamental factors driving economic growth, namely labor, investment and productivity, and thus are meant to reflect potential long-term growth trends. These trend numbers can and do diverge from actual growth rates due to cyclical fluctuations.

## Recommendations

- **Increase training opportunities for female-owned SMEs to improve their access to capital:** Education to help women better understand risk/return trade-offs may encourage movement into more profitable sectors, increase risk tolerance for credit and improve decision-making. Training on credit application processes may help alleviate concerns about the application process and success rates. Additionally, business training may help women be more confident in their prospects for receiving credit as well as improve the likelihood that financial institutions will approve their loans.
- **Improve credit risk assessments and terms for female clients:** While the creditworthiness of female-owned SMEs is an under-researched area, traditional assessments of credit risk used by financial institutions relying on credit history, land ownership and availability of collateral place women at a significant disadvantage when applying for capital. By developing new credit scoring models as well as offering loans with more suitable credit terms, such as alternative options to fulfill collateral requirements and longer term loans, financial institutions can better serve female-owned SMEs and reap the benefits of fostering the growth of this market.
- **Create new offerings targeting female-owned SMEs:** New financial offerings targeted at the female market may prove useful in helping women grow their businesses and support loans. This may include contractual savings to help women accumulate capital to invest in their businesses, and tailored insurance, which would provide downside protection
- **Strengthen financial infrastructure:** Financial infrastructure encompasses the institutions, physical structures, technology and networks that allow for the effective exchange and holding of information and capital. It includes such things as collateral registries, credit bureaus, and payment and settlement systems. Enhancing financial infrastructure would not only make financial services more accessible to women, but also help to dispel some of the myths and misperceptions around women's creditworthiness.
- **Ease the process for female-owned SMEs to join the formal sector:** Encouraging women in the informal sector to bring their businesses into the formal sector would help them to access formal credit markets. Potential ways to do this include educating women on the benefits of entering the formal sector, making the government and tax registration processes simpler and more accommodating, and reducing the perceived burdens of transitioning to the formal sector.

## Conclusion

There are many headwinds facing the ten studied G20 countries: weak commodity prices, tepid global demand, and geopolitical uncertainty. Amidst this backdrop, domestic demand and job creation becomes increasingly important. Supporting female-owned SMEs should be a priority for countries seeking to stimulate their domestic economies. With a credit gap of \$160bn, access to finance is one of the critical factors hindering the growth of female-owned SMEs in these countries. Closing the credit gap entirely is undoubtedly an ambitious target and, as discussed in our recommendations, addressing it will require a multifaceted approach designed to improve access to finance and create a more conducive business environment for female entrepreneurs. However, if it can be achieved in our ten focus countries by 2025, our analysis suggests that income per capita could be boosted by nearly 15% on average above our previous baseline projections.

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