Promoting Access to Credit for MSMEs through Effective Government Interventions

Richard Ketley

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2. The financing gap in the MSME market in Nigeria
3. A history of interventions that affect MSMEs in Nigeria
4. Evaluation of interventions
5. Recommendations
EFInA commissioned Genesis Analytics to conduct an evaluation of public interventions in Nigeria that promote MSME development

- MSMEs play a pivotal role in emerging economies, driving equitable development and employment.
- They often face a number of challenges, one of which is access to credit.
- The Nigerian government has launched a number of interventions to support MSME’s access to credit.

- The study focused on constraints in the supply of services from financial institutions and effectiveness of public interventions to address these constraints.
- Research was gathered through interviews with an array of the key stakeholders* and an analysis of international best practice.
- The findings are presented here and the full report will be available on EFInA’s website.

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In Nigeria, 98% of the MSME sector is made up of micro businesses...

### Split of MSMEs in Nigeria

<table>
<thead>
<tr>
<th>Type</th>
<th>Employees</th>
<th>Turnover (annual N)</th>
<th>Turnover (annual USD**)</th>
<th>Asset Value (N)</th>
<th>Asset Value (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>0-10</td>
<td>0 – 10 million</td>
<td>0 – 65 000</td>
<td>5 million</td>
<td>32 000</td>
</tr>
<tr>
<td>Small</td>
<td>10-49</td>
<td>10 - 100 million</td>
<td>65 000 – 650 000</td>
<td>5-50 million</td>
<td>32 000 – 320 000</td>
</tr>
<tr>
<td>Medium</td>
<td>50-199</td>
<td>100 - 500 million</td>
<td>650 000 – 3.2 million</td>
<td>50 – 500 million</td>
<td>320 000 – 3.2 million</td>
</tr>
</tbody>
</table>

The number of MSMEs in Nigeria is estimated between 10-50 million*

* The nature of the MSME sector makes an exact number hard to quantify

** An average exchange rate of 155N to 1USD has been used.

... and although the lending portfolios of financial institutions are sizeable, MSMEs have access to very little

Total lending portfolios to MSME
2010, Naira billion, Nigeria

- **Deposit Money Banks (DMBs)**
- **Microfinance Banks (MFBs)**

![Bar Chart]

Only 5% of lending from DMBs reaches MSMEs

**DMB SME statistics**

- Average SME loan size: N6 million (USD40 thousand)
- Average interest rate charged for the lowest risk SME customers: 20%
- Average loan maturity for SME loans: 12 months
- Average non-performing loan (NPL) ratio for SME: 16% (with large variations across the industry)

Central Bank of Nigeria, 2011 speech by the governor, Banks in Nigeria and national economic development: a critical review
An effective intervention needs to understand the constraints of both banks and SMEs to bridge the gap*

Common reasons for banks’ rejecting SME loan applications

- Collateral or consigners unavailable: 42%
- Incompleteness of loan application: 13%
- Problems with credit history/report: 10%
- Insufficient profitability: 6%
- Other objections: 29%

SMEs most common reasons for not applying for loans**

- Interest rates not favourable: 28%
- Collateral requirements too high: 27%
- Application procedures for loan/lines too onerous: 25%
- Did not think it would be approved: 10%
- Size of loan and maturity not sufficient: 8%
- Other: 2%

* The World Bank survey refers to SMEs not MSMEs, Banks refer herein to DMBs
** Sample of 47 SMEs interviewed
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Creating a thriving environment for MSMEs requires sound policies on four levels:

1. Level 1: Prudent Macroeconomic Policies
2. Level 2: Enabling Regulatory Environment
3. Level 3: Institutional/Infrastructure Strengthening
4. Level 4: Public Sector Schemes

Source: Genesis Analytics Team Analysis 2012
Our focus is on interventions that address the supply side

What interventions can the Government design that successfully encourage banks to lend more to MSMEs?
The regulatory/policy environment defines the terrain for intervention

<table>
<thead>
<tr>
<th>Intervention</th>
<th>Key components</th>
<th>Recommendations/Implications</th>
</tr>
</thead>
</table>
| 1a Regulatory environment | **National Policy on MSMEs:**  
- Launched in 2007  
- Maps the MSME regulation landscape  
- Defines the MSME segments (due to be revised) | • Current proposed revisions to segment definitions (by SMEDAN) should be done with caution – to avoid adversely shifting the banks’ targets. |

| 1 | **Revised Microfinance Policy:**  
- Launched 2005, revised in 2011  
- Categorizes MFBs in Nigeria according to whether operating at a Unit, State of National level.  
- The CBN stipulates 80% of MFB lending portfolio must go to Micro | • Important given the structure of the market  
• Important for the policy to achieve the right trade off between focus and scale and risk |

| 2 | **SMEEIS:**  
- Launched in 2001, terminated in 2008  
- Mandated all bank set aside 10% after tax profit to invest as equity in SMEs (defined more broadly than the national definition above) | • SMEEIS failed to achieve its developmental aims as it did not match banks capabilities.  
• There is no indication SMEEIS will be reinstated. |

Source: Genesis Analytics Team Analysis 2012; Federal Republic of Nigeria and CBN brochures  
Definition: SMEEIS: Small and Medium Enterprises Equity Investment Scheme
## Some of the biggest constraints to MSME lending are environmental

### Intervention

<table>
<thead>
<tr>
<th>1b Enabling environment</th>
<th>Current Nigerian Initiatives</th>
<th>Recommendations/Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1 Credit bureaus:</strong></td>
<td>- There are currently 3 (Credit Reference Company, Credit Registry, XDS Credit Bureau)</td>
<td>- Credit bureaus will help to ease information uncertainty</td>
</tr>
<tr>
<td></td>
<td>- Current regulatory requirement is that institutions register with at least 2 credit bureaus</td>
<td>- Need to monitor effectiveness</td>
</tr>
<tr>
<td><strong>2 Collateral Registries:</strong></td>
<td>- Registration and realisation of collateral is a major challenge/obstacle for financial institutions</td>
<td>- Encouraging and regulating use of the bureaus will be important.</td>
</tr>
<tr>
<td><strong>3 Customer identification (ID):</strong></td>
<td>- The lack of an uniquely identifying national ID system in Nigeria has limited banks’ ability to know and identify their customers and extend credit</td>
<td>- This is an important area for reform and modernisation</td>
</tr>
<tr>
<td><strong>4 Taxation laws:</strong></td>
<td>- Nigeria’s complex State and Federal taxation laws can be a burden on MSMEs requiring time to understand and pay the various taxes; multiple taxation can occur.</td>
<td>- This is a significant national project that will bring enormous benefits to the financial sector</td>
</tr>
<tr>
<td></td>
<td>- Whilst simplifying tax laws is complex, it would be beneficial to partner with expert organisations to remove redundant processes, ensure unique taxpayer IDs.</td>
<td></td>
</tr>
</tbody>
</table>

Source: Genesis Analytics Team Analysis 2012; Federal Republic of Nigeria and CBN brochures
### Partial Credit Guarantee Schemes (PCGs)

#### SMEGS:
- Launched 2010, fund of N200bn, managed by CBN
- Eligible borrowers: SMEs (using national definition)
  - Max loan size: N100m, 7 year tenure, “adequate collateral” required
  - Lending rate for banks: prime
  - 80% guarantee

#### ACGSF:
- Launched 1977, fund of N3bn, managed by CBN, currently value N8.5bn
- Eligible borrowers: Agricultural industry
  - Max loan size: For cooperatives: N5m; For corporate: N10m; unspecified tenure
  - Variety of collateral options available, uncollateralised allowed for less N20 000 loans
  - Lending rate: not stipulated
  - 75% guarantee

#### NIRSAL:
- NIRSAL has not yet been officially made active, fund of N45bn, managed by CBN
- Eligible borrowers: Agricultural industry
- Modalities: Not yet specified

### Recommendations/Implications

- The eligibility criteria and modalities matter hugely to adoption
- Low level of confidence in the banking sector that they will be paid out by the CBN

- 3 banks (Union Bank, First Bank and Bank PHB) have taken up 96% of the scheme.
- Developing agricultural capabilities across more financial institutions may require adjusting the modalities

- Regular monitoring and evaluation will be important to assess outreach and success.
- Consolidating agricultural schemes ACGSF, innovation, technical assistance.

Source: Genesis Analytics Team Analysis 2012; CBN website, ACGSF Annual report, NIRSAL brochure; Definitions: SMEGS: Small and Medium Enterprise Credit Guarantee Scheme, ACGSF: Agricultural Credit Guarantee Scheme Fund; NIRSAL: Nigerian Incentive-Based Risk Sharing System for Agricultural Lending
## State owned institutions are complex to evaluate and manage

<table>
<thead>
<tr>
<th>Intervention</th>
<th>Current Nigerian Initiatives</th>
<th>Recommendations/Implications</th>
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</table>
| State banks and development finance institutions | **BOI:**  
- Goal: Supporting enterprise development with new focus on SME  
  - In 2010, 96% of retail values disbursed went to SME or large corporations with MSME links  
  - Network: 5 branches  
  - Total balance sheet: N191 bn  
  - 50% on deposits at commercial banks  
  - Balance sheet is one tenth of the size of largest Nigerian bank  
- Development fund administrator for a range of foundations and funds (eg Dangote)  |  
- State banks need wide scale infrastructural distribution if they are to lend directly  
- BOI principally providing refinancing and liquidity to financial institutions.  
- Refinancing activities do not expand access, but reduce and concentrate losses  |

| **NERFUND:**  
- Established in 1989  
- Received N200bn from the government in 2010  
- Goal: Provide loans to eligible SMEs  
- Network: Unknown, although applications for loans can be solicited directly with the NERFUND committee or through a number of development agencies  
- Total balance sheet unknown  
- No annual report available online. |  
- Given the significant funding NERFUND receives, transparency is vital and it would be beneficial if annual reports were made available online. |

Source: Genesis Analytics Team Analysis 2012; BOI Annual report 2009 and NERFUND website; Definitions: NERFUND: National Economic Reconstruction Fund
Wholesale funding schemes are needed when institutions struggle with liquidity

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<thead>
<tr>
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<th>Current Nigerian Initiatives</th>
<th>Recommendations/Implications</th>
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</table>
| Apexes and wholesale funding | **1 N200bn manufacturing refinancing facility:**  
  - Approved in 2010, fund of N200bn  
  - Issued by BOI (on behalf of CBN)  
  - Fund used for loans made to the manufacturing sector  
    - Max loan size: N1bn  
    - Max interest chargeable by bank: 7% (per annum)  
    - Interest charged by BOI: 1% (per annum)  
    - Maximum tenure: 15 years | • The fund has assisted banks refinance manufacturing loans – alleviating pressures on the short term.  
• This has also helped SMEs in the manufacturing sector who had existing loans, but has not extended additional loans. |
| | **2 NERFUND:**  
  - Approved in 1989, fund of N200bn  
  - Managed by the NERFUND committee  
  - Fund used for loans to SMEs wholly Nigerian owned, some local sourcing requirements  
    - Max loans size and tenor: not specified  
    - Max interest rate chargeable by banks: 2% above MPR (per annum) | • Whilst a full analysis was not possible without an annual report, to achieve maximum reach (to MSMEs instead of just SMEs) NERFUND may consider providing funding to MFBs specifically (rather than DMBs). |

**Microfinance fund**

Discussions on-going over a potential MFB fund, size and modalities currently unknown*

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* Information gathered through interviews with SMEDAN and CBN, January 2012
The size of the Nigerian population makes scalability vital in the capacity building initiatives

<table>
<thead>
<tr>
<th>Intervention</th>
<th>Current Nigerian Initiatives</th>
<th>Recommendations/Implications</th>
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</thead>
</table>
| 1f Supply side capacity building | **1 SMEDAN:**  
  - Operational since 2005, funded by the Federal Ministry of Trade and Industry, BOI and NERFUND  
  - Goal: facilitate growth and development of MSMEs  
  - Plays a role in policy formulation and data collection  
  - 15 Business Support Centres, 37 Business Info Centres; trained 9,000 MSMEs in 2011.  
  - Currently focuses more on demand side capacity building | • Outreach is currently very limited  
• Mainly a demand side intervention so outside of the core scope of the study. |
| | **2 RUFIN:**  
  - Operational since 2010, funded by IFAD and Federal Government of Nigeria  
  - Goal: Actualizing food security, employment and wealth creation in the rural areas  
  - Has helped bring together cooperatives for MSMEs and delivered MFB training to 33 MFBs – promoting information sharing via MixMarket and the benefits of an MFB ratings system | • Has been effective at formalising cooperative structures and promoting rating  
• Key challenge is to ensure the sustainability of such structures and that they receive appropriate funding |

Source: Genesis Analytics Team Analysis 2012; BOI Annual report 2009 and NERFUND website
Whilst NIRSAL has not yet been launched it has the capacity to boost innovation if well managed

**Intervention**

- Encouraging innovation

**Examples in Nigeria context**

1. **NIRSAL:**
   - Launch date undecided, facilitated and designed by CBN
   - NIRSAL incorporates two innovation schemes:
     1. Insurance facility N4.5bn
     2. Agricultural lending
       - Bank rating mechanism (rating effectiveness in developing long term agricultural lending): costing N1.5bn
       - Cash reward for banks that develop long term lending: N15bn

**Recommendations/Implications**

- Innovation funds have the **potential for far reaching impact** (given the necessary monitoring and assessment criteria).
- Innovation funds can serve as the springboard for new and innovative ways of lending in constrained for complacent markets.

Source: Genesis Analytics Team Analysis 2012; NIRSAL brochure
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Nigeria is making a very substantial commitment to promote MSME development

Comparison of total cost of interventions in Nigeria and South Africa

The total value for Nigeria was calculated by summating the cost of all the interventions analysed in the report.

Unfortunately given the range of interventions there is no standard comparative international measure of the level of Government support for MSME development

Source: Genesis Analytics Team Analysis 2012, World Bank 2010 figures
How appropriate these interventions are given local conditions will determine their effectiveness...

Types of Interventions Relevant to the Local Context

- **Strengthen basic legal and enabling environment**
  - Fragile
  - Implement specific public support initiatives* to support MSMEs
- **Design non-judicial resolution systems**
  - Civil Law
  - Strengthen courts and enforceability
- **Focus on less complex interventions. Seek donor support and expertise when implementing public initiatives**
  - Weak
  - Empower state organisations to design and manage the interventions
- **Promote innovation and use of unsecured lending, leasing options**
  - Low
  - Extend credit to funding constrained financial institutions and PCGs to support SMEs
- **Promote mobile platforms and use of cooperatives. Leverage existing financial infrastructure (providing credit to rural MFBs)**
  - Low
  - Promote partnerships with retailers and distributors

*Initiatives such as PCGs, directed wholesale funding, supply side capacity building and innovation funds*
... and reveal the types of interventions on which Government should focus

**Political conditions**: Considerable benefit will be achieved by improvements in the overall operating environment.

**Legal System**: For lending to small and medium sized businesses the functioning of the legal system and registry process is critical to the level of credit extension..

**Implementation Capacity**: When the state has a weak implementation capacity interventions should focus on those that leverage the private sector, are simple to design and execute and have a low monitoring requirement.

**Income level**: Nigeria needs to provide finance to the huge number of micro-enterprises, but it can also help institutions to overcome some of the constraints that arise from the environment through the provision of PCGs.

**Degree of formalisation**: Given the very low level of formalisation in many business segments, interventions should focus on the development of microfinance, cooperatives and mobile payment services.
An effective intervention should aim to positively influence a financial institution's decisioning process...

Expected revenue from the loan

Expected costs to provide the loan

Risks involved to provide the loan

<table>
<thead>
<tr>
<th>Intervention in Nigeria</th>
<th>Effect on credit decisioning</th>
<th>Revenue</th>
<th>Costs</th>
<th>Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enabling environment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• ID system</td>
<td></td>
<td>-</td>
<td>½</td>
<td>✓</td>
</tr>
<tr>
<td>• Credit bureaus &amp; registries</td>
<td></td>
<td>-</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Partial Credit Guarantees</td>
<td></td>
<td>-</td>
<td>½</td>
<td>✓</td>
</tr>
<tr>
<td>State banks</td>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Apex and wholesale funding</td>
<td></td>
<td>✗</td>
<td>✓</td>
<td>-</td>
</tr>
<tr>
<td>Supply side capacity building</td>
<td></td>
<td>-</td>
<td>½</td>
<td>✓</td>
</tr>
<tr>
<td>Encouraging innovation</td>
<td></td>
<td>-</td>
<td>½</td>
<td>✓</td>
</tr>
</tbody>
</table>

Scale:

Positive effect: ✓
Semi-positive effect: ½
No effect: -
Negative effect: ✗
... and represent an effective use of state resources

Source: Genesis Analytics Team Analysis 2012
The best interventions are simple, scaleable, sustainable and affordable

- Innovation fund
- Wholesale funding
- PCGs
- Supply side capacity building
- Maintaining credit bureaus & registries
- State owned banks
- Simplifying taxation laws
- National Policy on MSMEs
- Microfinance Policy
- ID system

Sustainability scale:
- Poor → good

Costing scale:
- Costly → Cheap
Different interventions are appropriate for different segments

<table>
<thead>
<tr>
<th>Intervention</th>
<th>Segment relevance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Micro</td>
</tr>
<tr>
<td><strong>General Regulatory Environment</strong></td>
<td></td>
</tr>
<tr>
<td>• National Policy on MSMEs</td>
<td>H</td>
</tr>
<tr>
<td>• Microfinance Policy</td>
<td>H</td>
</tr>
<tr>
<td>• Taxation laws</td>
<td>L</td>
</tr>
<tr>
<td><strong>Enabling environment</strong></td>
<td></td>
</tr>
<tr>
<td>• ID system</td>
<td>H</td>
</tr>
<tr>
<td>• Credit bureaus &amp; registries</td>
<td>L</td>
</tr>
<tr>
<td><strong>Partial Credit Guarantees</strong></td>
<td>M</td>
</tr>
<tr>
<td><strong>State banks</strong></td>
<td>L</td>
</tr>
<tr>
<td><strong>Apex and wholesale funding</strong></td>
<td>H</td>
</tr>
<tr>
<td><strong>Supply side capacity building</strong></td>
<td>M</td>
</tr>
<tr>
<td><strong>Encouraging innovation</strong></td>
<td>M</td>
</tr>
</tbody>
</table>

Scale:
- **Low**: L
- **Medium**: M
- **High**: H
The banks demonstrated limited awareness of the interventions except for the PCGs and wholesale funding

- **Partial Credit Guarantee Schemes**
  “Although we are informed about the PCGs, we don’t subscribe because the eligibility criteria are too stringent”
  “we don’t believe Government will payout, timeously”

- **State banks and other donor organisations**
  “The wholesale funding provided by the BOI has been a help in managing troubled deals”

- **Apexes and wholesale funding**
  “Although we subscribe to the wholesale funding options such as the manufacturing N200bn fund this hasn’t really incentivized us to extend additional loans to SMEs”

- **Supply Side Capacity Building**
  “We are not aware of the work of RUFIN or SMEDAN”

- **Encouraging Innovation**
  “Our bank would respond positively to greater funding available for innovation – it would help to focus innovation in key areas”
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**Progress is required on all four levels**

<table>
<thead>
<tr>
<th>Intervention</th>
<th>Recommended changes</th>
<th>Organisation</th>
<th>Likely impact</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Change</td>
<td>Detail</td>
<td>Organisation</td>
</tr>
<tr>
<td><strong>General Environment</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• National Policy on MSMEs</td>
<td>-</td>
<td>Revised definition?</td>
<td>Federal Government of Nigeria, SMEDAN</td>
</tr>
<tr>
<td>• Microfinance Policy</td>
<td>↑</td>
<td>Enforce</td>
<td>Federal Government of Nigeria, CBN</td>
</tr>
<tr>
<td>• Taxation laws</td>
<td>↑</td>
<td>Simplify</td>
<td>Federal Government of Nigeria, CBN</td>
</tr>
<tr>
<td><strong>Enabling environment</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• ID system</td>
<td>↑</td>
<td>Introduce</td>
<td>Federal Government of Nigeria</td>
</tr>
<tr>
<td>• Credit bureaus</td>
<td>-</td>
<td>Maintain</td>
<td>CBN</td>
</tr>
<tr>
<td>• Registries</td>
<td>↑</td>
<td>Introduce/reform</td>
<td>CBN</td>
</tr>
</tbody>
</table>

Source: Genesis Analytics Team Analysis 2012
Progress is required on all four levels (cont.)

<table>
<thead>
<tr>
<th>Intervention</th>
<th>Recommended changes</th>
<th>Organisation</th>
<th>Likely impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partial Credit Guarantees</td>
<td>↑ Review criteria</td>
<td>CBN</td>
<td>Improved utilisation</td>
</tr>
<tr>
<td></td>
<td>(see next slide)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>State banks and development finance institutions</td>
<td>Maintain role as liquidity provider if needed</td>
<td>CBN, BOI and NERFUND</td>
<td>Reduced refinancing to the DMB</td>
</tr>
<tr>
<td>Apex and wholesale funding</td>
<td>- Adjust to reach MFBs</td>
<td>CBN</td>
<td>Extend reach to the micro segment through the MFBs</td>
</tr>
<tr>
<td>Supply side capacity building</td>
<td>↑ Adjust to amplify scale</td>
<td>SMEDAN, RUFIN</td>
<td>Amplify impact</td>
</tr>
<tr>
<td>Encouraging innovation</td>
<td>↑ Monitor NIRSAL; Design MFB Development Fund</td>
<td>CBN/ Federal Government</td>
<td>Encourage new and innovative ways of lending to MSMEs</td>
</tr>
</tbody>
</table>

Scale: Increase funding/focus: ↑ Maintain funding/focus: - Decrease funding/focus: ↓

Source: Genesis Analytics Team Analysis 2012
Importantly, making some adjustments to Nigeria’s current PCGs could increase efficiency and amplify their impact in the market.

1. **Adjust the monitoring mechanism:**
   - Currently in the event of an NPL, both the bank and CBN conduct an evaluation process.
     - Time consuming and can create moral hazard
   - **Consider...**
     - The CBN conducts due diligence on the financial institution to identify eligible financial institutions who can access the PCG.
     - No need thereafter to conduct dual monitoring in the event of an NPL.

   **Implications:**
   - Shorten assessment times for CBN to cover the loan.
   - Lower moral hazard – encourage banks to take ownership of risk

2. **Extend PCGs to the small segment:**
   - Currently, by design, the PCGs target the SME sector excluding the micro segment
   - **Consider...**
     - Relaxing collateral requirements to enable access for smaller firms.
     - To compensate for the added risk:
       - Implement loan ceilings
       - Introduce a fee paid by banks to CBN

   **Implications:**
   - Increase the reach of the PCGs
Promoting credit extension for MSMEs therefore rests on developing strong foundations and promoting sustainability and scaleability

**Developing strong foundations**
- Strengthening the regulatory and enabling environment:
  - Simplifying tax laws
  - Implementing a national ID system
  - Collateral processes

**Promoting sustainability and scalability**
- Tailoring the design of PCGs to achieve optimal reach
- Providing wholesale funding to credit constrained MFBs not DMBs
- Strengthening MFB capacity building and promoting greater coordination across training organisations
- Improve monitoring and evaluation and disclosure on all schemes

**Fostering innovation**
- Utilising well-designed development funds to promote new innovations within the banking sector

Source: Genesis Analytics Team Analysis 2012