TIFI SME Lending Toolkit Learning Brief

Introduction

Small and medium enterprises (SMEs) represent approximately 90% of businesses and more than half of jobs across the globe. They contribute up to 40% of GDP in developing countries. However, access to finance is a key constraint to SME growth, with an estimated financing gap of $5.2 trillion annually for 65 million SMEs[1]. SMEs tend to fall into the “missing middle,” often too large for microfinance but too small or informal for commercial bank lending. While some FinTech solutions show promise in bridging this gap, many SMEs perform better when they have an ongoing relationship with their lender and access to affordable services tailored to their needs.

Credit unions show potential to help fill the SME financing gap. They typically are viewed as long-standing trusted partners in their communities. Indeed, international credit union operating principles include a commitment to “support the growth of a broader just, healthy and prosperous community within which the credit union and its members reside.”[2] Their ability to leverage local deposits to finance growth positions them to become sustainable, client-centered financial partners with deep knowledge of local markets and a broad member base.

USAID has recognized the potential of credit unions to contribute to social and economic development. Since 2001, the USAID Cooperative Development Program (CDP) has strengthened more than 10,000 cooperatives and credit unions in more than 35 countries[3]. The USAID CDP Technology and Innovation for Financial Inclusion (TIFI) Project (2018–2024) leveraged the World Council of Credit Unions (WOCCU)’s long-standing relationship with credit unions in Burkina Faso, Guatemala, Kenya, and Senegal to support SME loan portfolio establishment and/or growth, thereby helping to bridge the financing gap.

KEY TAKEAWAYS

1. **Credit unions can introduce and scale SME lending. Their long-standing presence in the market and large member base gives them an edge in identifying and serving SMEs in need of finance.**
2. **Many credit unions need a change of mindset to make the necessary adjustments to offer market-responsive SME products while managing risk. Comprehensive capacity building can enable the board of directors (BOD) and senior management to lead this change.**
3. **Digitalization and innovation are essential to meeting the financial needs of SMEs.**
4. **Sustainable SME finance includes environmental and social considerations.**

1 World Bank SME Finance
2 WOCCU International Operating Principles
3 USAID Cooperative Development Program

The SME Lending Toolkit

Through TIFI, WOCCU collaborated with credit unions to develop an *SME Lending Toolkit,* a set of tested tools and templates designed to prepare credit unions to sustainably serve SMEs. Several credit unions had previously experimented with SME finance, but high portfolio risk drove them to reduce or stop lending. The SME Lending Toolkit helps credit unions evaluate their readiness to design and expand lending to SMEs. It takes a holistic approach, recognizing that financing SMEs can require credit unions to significantly adjust their lending strategy. In turn, this affects not only a credit union's products but also its policies and procedures, staffing, risk management, compliance, and importantly, governance, business strategy and leadership.

The SME Lending Toolkit increases credit union capacity to:

- Introduce lending to target the SME market segment,
- Increase the volume and quality of existing SME services among credit unions already serving the market,
- Develop staff structure and capacity to serve the SME segment at scale,
- Streamline and simplify the SME lending process to optimize costs,
- Reduce risk in lending to SMEs with less formal credit histories, financial management, or collateral.

TIFI partnered with the national credit union associations in each target country.

TIFI Partner Credit Union Networks:

- **National Association of Credit Unions in Burkina Faso (FCPB)**
- **Confederation of Financial Institutions of West Africa (CIF) in Burkina Faso**
- **National Federation of Savings and Credit unions (FENACOAC) in Guatemala**
- **Kenyan Union of Savings and Credit unions (KUSCCO)**
- **Union of Partner Mutual Societies for the Mobilization of Saving and Credit in Senegal (UM-PAMECAS)**

The Toolkit starts with building the Board of Directors (BOD) and credit union management's support for SME lending by deepening their SME understanding, building buy-in and improving decision-making. This is followed by market research and an institutional diagnostic to inform capacity development and staffing growth. The content has been tailored to each country, taking into consideration credit union maturity, SME experience, and local market conditions.

The SME Lending Toolkit

PURPOSE | **TOOLS**

Governance and Leadership

Inform strategic decision-making and segment targeting by reinforcing best practices in credit union governance and SME lending. Enhance BOD and management knowledge of SME:

- market landscape
- lending best practice
- risk management principles
- regulatory frameworks
- staffing needs and organizational structure
- product development and assessment methods
- reporting standards
- implications for business strategies

Governance workshop guide:

- SME definition
- SME legal types
- Market potential by sector
- Risk management and compliance
- Human resources
- Product development and pilot testing
- Portfolio management
- Credit policy, reporting and oversight
- Decisions and approvals
- Project planning

Institutional Diagnostic

Assess credit union readiness and capacity development needs to introduce or expand SME lending.
Establish a baseline against which progress can be assessed.

- Interview guide
- Documentation required for diagnostic
- Points of analysis and benchmarks
- Diagnostic report template
- Workshop guide for SWOT analysis

Market Research and Product Development

Determine market opportunities, consider sectors, types of business, and competition. Assess market demand volumes by geography and sub-segment, and gather information to inform loan terms, conditions, positioning, and marketing strategy. Test product uptake through pilots.

- Market study questionnaire
- Market analysis map
- SME definition
- Loan product fact sheet template
- Pilot test process and evaluation
- Internal communication plan template
- Promotion & advertising strategy template

Digital Readiness Guide

Provide digital transformation framework focused on efficiency and security in offering digital services to SMEs.

- Digitalization methodology
- Matrix of digital requirements
- Segmentation and roadmap
- TOR template for developers

Financial Feasibility

Determine institutional and financial requirements for SME loan products, including volumes, revenues, staffing and other costs to determine break-even point.

- Product financial projection tool:
  - Financial viability sheet
  - Scenario analysis
- Results monitoring template

Loan Underwriting

Introduce risk assessment, risk mitigation, and appropriate risk pricing for SME lending by using risk scoring methodology that incorporates thorough understanding of economic sectors and sub-sectors in which SMEs operate to analyze loan applications.

- Rapid assessment tool
- Loan underwriting tool
- Risk scoring template
- Technical guides:
  - Financial analysis
  - Cashflow management
  - SME loan appraisal

Policies and Procedures

To understand the internal and external factors impacting SMEs, including sector-specific and subsector risks, credit unions need to establish robust policies for sustainable growth, implement streamlined processes, adopt a risk management framework with diligent monitoring, and enforce stringent measures to address non-performing loans.

- SME loan policy template:
  - Loan description
  - Collateral policy
  - Approval procedures
  - Risk management policy
  - Monitoring and evaluation
- SME loan officer profile and job description template

Training and Capacity Building

Define work-flow structure and human capacity development to effectively serve targeted SME market. This includes training materials that aim to enhance accounting and finance skills of credit staff.

- Loan officer training program
- SME cashflow analysis training
- Loan underwriting training
- SME loan management training
- Monitoring results training

Business Development Services (BDS)

Support linkages to non-financial service providers who strengthen SME capacity to use financial services and manage growth.

- Template for mapping BDS providers
- Training on how to register an SME: options, requirements, and processes

Results

Through TIFI, WOCCU worked with five credit union association partners to offer technical support to 23 credit unions and one service company[4] to pilot the SME Lending Toolkit. This included joint market research and institutional diagnostics followed by SME lending tools and training design. Workshops, coaching, support in partnership development and on-going monitoring enabled these credit unions to understand their market, map their existing SME client base, design services, and implement best-practice SME lending. The SME Lending Toolkit implementation has had a positive impact on supported credit unions, increasing loan volumes, reducing portfolio risk, and improving confidence in their ability to lend to SMEs.

Highlights Across TIFI Partners

23
Credit Unions Adopted SME Toolkit

1,767
SME Loans

$41M
Total SME Loan Volume

35%
Women-led SME Borrowers

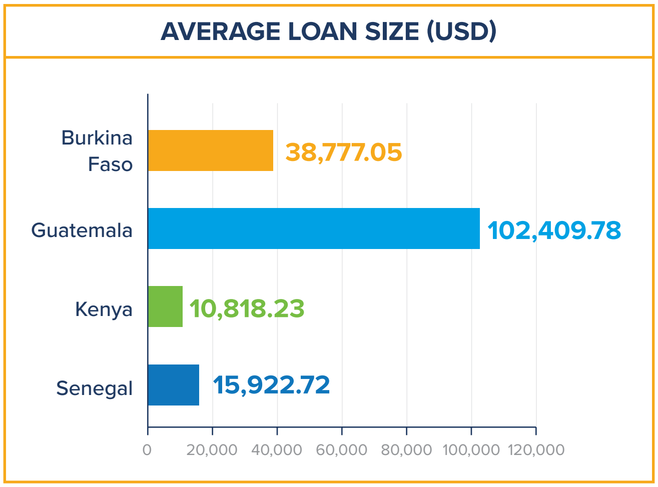
1.53%
Portfolio at Risk

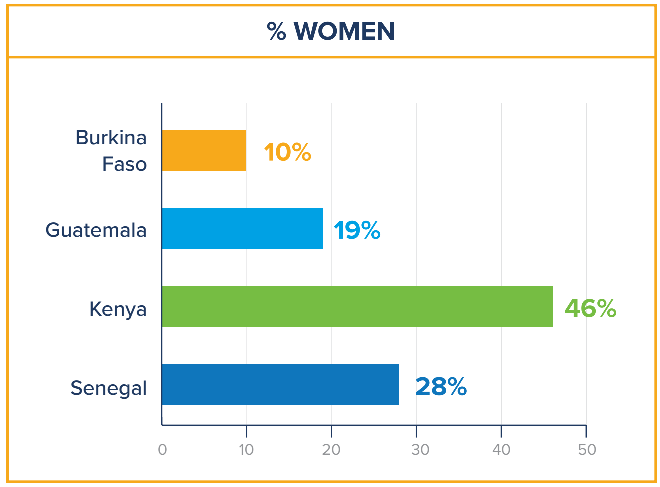
70,113
SME Members Mapped in Growth Plan

The size, sector and sub-segmentation of SMEs borrowing from participating credit unions using the TIFI developed SME lending methodology varied by country. As shown in the table below, average loan sizes ranged from USD 3,500 to USD 176,000. The gender breakdown reached as high as 46% women-owned SMEs in Kenya and as low as 10% in Burkina Faso.

4 CREDIPYME was established in Guatemala by FENECOAC member credit unions to offer SME loans.

TIFI SME Borrower Profiles





By the end of the project, participating credit unions demonstrated the necessary skills and policies to identify market segments, offer SME loans and manage associated risk. The table below summarizes the participating credit union changes in SME lending approach and the corresponding results.

Capacity Development Journey

BEFORE THE SME LENDING TOOLKIT	AFTER IMPLEMENTATION
Credit unions offered products that were misaligned with demand, often servicing SMEs with traditional social collateral-based lending	• Using demand driven financial products. • Mitigating risk with policies adapted to SME lending.
Weak loan appraisal and approval skills among staff responsible for SME applications, sometimes informed by personal biases rather than objective analysis	• Implement objective best practices in credit appraisal, in some cases enhanced with credit scoring. • Qualified personnel with SME lending skills.
Credit policy and organizational structures not adapted to SME lending best practices	• Revised credit policies • Standardized processes • Established dedicated SME departments • Reduced errors and loss of physical documents • Reduced cost of delivery and turnaround time • Built a SME skills development program
Managed and monitored portfolio without sufficient risk analysis **Held high concentration in high-risk sectors (such as agriculture)**	• Have a risk management system for SME lending with sector distribution limits • Have an SME control and monitoring system
High rate of non-performing loans, including frequent write offs in SME portfolios	• Major improvements in SME loan portfolio quality
Limited SME portfolio growth	• Increased risk appetite to lend to SMEs, with some credit unions targeting up to 50% of loan portfolio to SMEs
Inconsistent levels of digitalization	• Started to define digital transformation journey

Key Lessons

Each country had different experiences implementing the SME Lending Toolkit. However, TIFI identified some common lessons across the four countries.

1. Credit unions can introduce and scale SME lending. Their long-standing presence in the market and large member base gives them an edge in identifying and serving SMEs in need of finance.

- **SMEs prioritize convenience and time:** When selecting a lender, SMEs prioritize turnaround time, loan maturity, and affordability. They will forgo a loan if no lender meets their needs. The relative importance of these priorities varies by economic sector. Credit unions need to develop multiple loan products (short, medium, and long-term) with flexible terms, and improve processes to reduce turnaround time.

- **Successful marketing strategies leverage existing membership:** Credit unions adopted diverse marketing strategies, such as direct sales, workshops and networking events, direct marketing to existing members, and SME loan product informational marketing directed to walk-ins. They identify SME owners within their membership as an effective targeting approach contributing to further expand portfolios. Cross-selling to SME members can also be effective in establishing and growing SME portfolios.

- **SME informal operational structures impact product design:** Many SMEs are loosely structured and lack formal policies, procedures, and systems. Credit unions require loan products and appraisal processes that accommodate this, as well as partnerships with BDS providers to strengthen SMEs and prepare them for growth.

- **SMEs are affected by even small market shifts:** Effective risk management requires regular monitoring of the market and readiness/agility to act to mitigate market fluctuations.

- **Pilot tests need to assess institution-wide and client-level indicators:** Defining key performance indicators for product pilot tests is often challenging for Credit Unions. Successful pilots measure roll-out indicators (numbers, volumes, risk, profit), and SME product design assumptions (e.g., profitability, repayment capacity, cashflow, stock rotation, level of inventory, costs of goods sold.)

2. Many credit unions need a mindset change to make the necessary adjustments to offer market-responsive SME products while managing risk. A comprehensive capacity building approach can enable the BOD and senior management to lead this change.

- **Criteria for Success:** Credit unions with basic governance, organizational structures, and operating systems in place more effectively implement SME risk assessment and lending. Some management exposure to business loans and digital services are also helpful.

Criteria for Success – SME Lending Credit Union Profile

STRENGTHS

- **Formally regulated**
- **National branch network**
- **Diverse membership**
- **Experience with business loans such as working capital, equipment, and contract pre-financing.**
- **Supportive BOD**
- **Proven experience and high profile within national microfinance sectors**
- **Experienced senior management with exposure to SME finance**
- **Structured credit and collateral policies**
- **Operations in geographies with high potential for SME lending**
- **Some digital services**

CHALLENGES

- Insufficient liquidity positions
- Low share of business loans in loan portfolio
- High business loan NPLs
- Business loan portfolio dominated by trade, no value chain approach
- No clear SME definition, targets or segments
- Lack of market orientation in product design
- Lack of SME lending skills among credit officers and branch staff including business appraisal, callateral processing, loan monitoring procedures and computer skills
- Insufficiently trained credit committees
- Slow turnaround time due to cumbersome manual processes
- Limited use of technology resulting in limited monitoring and management reports, limited integration of credit process with core banking systems (CBS)
- Limited or poorly structured partnerships with BDS providers
- Lack of credit risk mapping
- Lack of procedures such as monitoring visits, loan archiving

- **Willingness to invest own resources:** Credit unions that demonstrate early buy-in and willingness to invest their own resources in capacity building experience higher growth.

- **Effective governance and board buy-in are preconditions for successful SME lending:** Introducing SME lending requires a shift in mindset to adopt a change-management approach. Using governance training modules to enable BODs to understand the SME market, approve product and policy revisions, identify needed operational changes, and upgrade skills. Credit unions with demonstrated capacity to roll out training within their institutions are better equipped to innovate and change.

- **Start with the market:** The BOD and management need to clearly understand the SME market opportunities, client needs, competition, and risk assessment prior to investing in the segment. Market research methodologies should include continuous feedback and design loops to ensure well-adapted products are versatile and respond to shifts in market realities. Market research tools need to include sample selection and location; data collection, supervision, testing and quality control all require planning and resources. Research requires training so that staff leading the research understand the objectives, are well versed in the instruments, understand how to monitor trends in economic sectors and subsectors and can identify competition.

- **Collaboration builds buy-in:** Diagnostic tools are more effective when implemented collaboratively with credit union leadership. It helps to establish a baseline for the change management process.

- **Innovation takes time:** The credit union member-driven governance structure can involve many people in decision-making and formal communication channels often translates into lengthy approval processes. As a result, credit unions struggle to modify loan assessment methodologies and procedures, requiring time and understanding across different departments, management, and the BOD.

- **Optimizing loan processing efficiency is key:** SMEs prioritize turnaround time; therefore, credit unions often need to make major changes to meet the demand for quick and effective processing. This includes developing and improving procedures, systems, automation, analytical skills, and reporting.

- **Risk management may undergo substantial changes:** Some credit unions have limited experience analyzing loan concentration, defining tolerable risk levels by sector and segment, and reflecting risk in pricing. Likewise, collateral processes often need to be optimized to reflect the local regulations and provide clarity on the use of legal and other service providers. Institution-wide adjustments to risk management processes are necessary for SME lending and can also benefit overall credit union health.

- **Human Resource processes contribute significantly to portfolio performance:** To ensure they have the appropriate skills, credit unions may consider introducing technical testing to inform recruitment and training of SME loan officers. Likewise, they can use SME loan portfolio monitoring data to ascertain ongoing training needs through results-based performance management linked to a training plan.

- **Internal communications are as important as external communications:** All staff need a general understanding of SME products, their benefits to SMEs, and to whom they should refer loan applicants.

3. Digitalization and innovation are essential to meeting the financial needs of SMEs.

- **Change is continual; digitalization is a necessity:** Given the quickly changing environments, credit unions need to develop skills to continuously review, update, and reinforce SME lending practices to remain responsive and competitive. Short turnaround times, secure transactions, and digital channels are increasingly demanded by SMEs, requiring digitization on both the loan process front and back ends. Automated workflows reduce the potential for error, tighten controls, and speed transaction processing, while user friendly digital channels make credit unions more attractive lenders to SMEs. Digitalization also facilitates collection and use of data to tailor products to different sub-segments of the SME market.

- **Digital readiness assessment is the starting point of the journey:** TIFI categorized credit unions in terms of digital readiness (see table below). Credit unions that designated digital focal points more easily identified options, defined agendas, vetted and executed solutions, and monitored rollout and performance.

Level and Use of Credit Union Digitalization

CATEGORY	PROFILE
INCIDENTAL	• Most processes are manual • Resource constraints for investment • Limited use of data throughout the institution • Basic CBS and Enterprise Resource Planning (ERP) with limited integration capacity • No experience with systems audit • Technology not prioritized by leadership
INTENTIONAL	• Mix of manual and automated processes • Solid governance and regular use of management data • Regular budget for digitalization • Essential technologies for operations • Systems audits as needed • Lack over digital framework across all departments, operations, and services
OPTIMIZED	• Clear digital framework or active progress in a digital journey • Technology integrated into daily operations across departments • Strong governance with data-driven decision-making • Annual budgets include digitization • Regular and frequent systems audits • Innovation encouraged and incorporated into processes • Clarity on staff roles and responsibilities • Regular updates of policies, which reflect use of technology

- **The core banking system (CBS) must be able to integrate digital services:** Credit unions seeking to automate their processes and offer digital services need CBS with capacity to handle different reporting formats by branch, officer, product as well as the capacity to link to digital solutions. If the CBS is not able to connect to FinTech Application Programming Interfaces (APIs) directly, credit unions can make use of middleware or integration platforms to connect to FinTech services. To be competitive, credit unions need to move to robust, cyber ready, and agile cloud-based IT platforms, whether it is CBS or other integration platforms and can benefit from partnerships with FinTechs.

4. Sustainable SME finance includes environmental and social considerations.

- **BDS provider partnerships create additionality:** Credit unions often target SME segments that are large enough to need solid business operating systems and financial management but may not have them in place. Mapping SME BDS providers helps to strengthen relationships with credit unions and build BDS provider pipelines thus improving SME access to business operating skills development support.

- **Environmental, Social and Governance (ESG) and Gender strategies are essential for growth:** Gender disaggregated market research is necessary for gender-informed product design and marketing strategies. Merely assigning gender targets is insufficient and will not ensure that products respond to the specific needs of SMEs led by women and men. An ESG policy with full buy-in from leadership is critical to mitigating credit union risk as they move into the higher risk SME segment.

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