From Laws to Loans: Opportunities and Challenges in Achieving the Promise of Secured Lending Reforms

A Summary

December 2018

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A SUMMARY

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INTRODUCTION

Between October 2017 and May 2018 USAID, Deloitte and Banyan Global collaborated on an extensive study of the lessons from investments to establish moveable property lending (MPL). We began with an extensive program of research and expert interviews to assess the progress of efforts to introduce MPL across more than 30 USAID presence countries, and complemented this with an in-depth assessment of the MPL market in Colombia, which recently enacted a world-class MPL legal and collateral registry framework. The detailed findings from this work can be found in two in-depth reports, and a comprehensive infographic. This brief report provides a summary of the study's key findings.

THE PROMISE OF MOVEABLE PROPERTY LENDING

Financial systems with institutional depth are core to inclusive economic development. Studies have shown that traditional measures of size of the financial sector and extent of financial intermediation are insufficient indicators of the financial sector's true contribution to economic strength. Rather, it is institutional depth that determines whether financial systems can reduce inequality and levels of poverty, and support broad-based economic growth and resilience.

Around the world, small and medium enterprises (SMEs) and women disproportionately struggle to access sufficient finance, and particularly credit. This places a significant constraint on economic and social development due to the outsized role of SMEs in employment and economic growth, and the pivotal role of women.

A large contributor to this imbalance is the distribution of assets required as collateral for loans. In developing countries, banks tend to rely on fixed assets (i.e. land and buildings) as collateral for lending. SMEs and women often do not own fixed assets sufficient to support their financing needs, as a result of historical factors and various socio-economic constructs respectively, thereby precluding them from accessing affordable credit products.

Over the last several decades many national governments, with support from the development community, have invested in the legal and institutional enablers of Movable Property Lending (MPL). By enabling borrowers to use a broader range of assets – notably movable assets – as loan collateral, MPL holds great promise to overcome these disparities and expand financial inclusion.

Our initial study sought to identify opportunities for program investments to support the implementation of MPL to advance women's access to finance, for which we conducted a global scan of over 30 countries in cooperation with development and secured transactions experts. What we learned from that study, however, was after several decades of investments to advance MPL across developing economies, the rate of take up and breadth of benefits has not kept pace with expectations, neither for women, nor men-owned SMEs at large. While many countries have succeeded in reforming their legal systems and implementing digital

What is movable property lending (MPL)?
Movable property lending (MPL) is the use of movable assets – such as equipment, inventory, receivables, motor vehicles, agricultural products, livestock, etc. – as collateral for loans. MPL offers the market opportunity to extend the borrower base beyond those able to provide real estate or immovable property (i.e. land and buildings) as collateral. Further, the availability of this collateral reduces the risk of default (compared to the alternative of unsecured lending) and thus is likely to have beneficial impacts on the availability and cost of credit.

registries – the main pillars of traditional MPL implementation approaches – too few have seen these translate into sustained, inclusive MPL markets on the ground.

Thus, we turned our sights to better understanding barriers to MPL market development and how these could be addressed through different implementation approaches. In doing so we focused our research on the supply side, looking at the business case for banks to invest in developing MPL products and services, one of the most common areas of underperformance across developing economies undergoing MPL reform. Through an in-depth study of the Colombian experience and related country experiences gathered through our global scan, we have been able to draw out lessons with applications for Colombia and at the global scale to advance MPL, in a manner that will support inclusion of women.

LESSONS FROM COLOMBIA'S EXPERIENCE WITH MPL

Colombia's experience in MPL implementation mirrors many other countries undertaking secured transactions reforms, in which reforms led to an early surge and then leveling of MPL activity. The country reformed its secured transactions laws to enable MPL in 2013 and introduced a web-based MPL collateral registry in 2014, making it one of most advanced MPL-enabling environments in Latin America. After introduction there was significant early uptake of MPL, yet activity has since plateaued. Current registry data shows a general lack of lending against asset categories other than vehicles (cars) that could signify increased lending to SMEs. Receivables lending was less than 3%, and business equipment just 2.6% of security interests registered in transactions with businesses by late 2017; as a share of total registered interests (including those with individuals) each represents only a fraction of a percent.

> *"Lending against cars [in Colombia] is not a new practice. As an economy, we are at an inflexion point where we should be thinking about sustainable mechanisms for financing such as lending against the movable assets that we know enterprises have." – Juliana Alvarez, Banca de las Oportunidades*

The MPL market for financing Micro, Small & Medium-sized Enterprises (MSMEs)

Who are MPL customers? MPL has applications for businesses of all sizes. However, its greatest potential to expand access to finance is among SMEs, particularly those in early growth stages, or those that may not own real estate or land.

Micro businesses and SMEs (together referred to as MSMEs) are a key segment of Colombia's economy, with an estimated 4m MSMEs (250,000 of which are formally registered), representing 80% of employment and 40% of GDP. Yet, less than 35%[1] of Colombian SMEs access formal credit, and 70% claim to be underserved by the finance industry. The total unmet demand for credit

[1] ANIF, "La Gran Encuesta PYME", 2017

among MSMEs (formal and informal), including all businesses with and without movable property that could qualify as collateral, is estimated over $35 billion[2][3].

Movable property lending represents an opportunity to tap a $6.2 billion credit market among formal SMEs alone. Including micro and informal enterprises, the market is estimated at nearly $23 billion

Based on an analysis of Colombia's MSME market, an estimated 85% of SMEs have assets categorically suitable for MPL, including accounts receivable, equipment or machinery, and inventory. Looking at total unmet demand for credit among formal SMEs in this category, MPL presents an opportunity to tap a credit market worth over $6.2 billion. This value is ultimately conservative, as it does not consider potential lending to large enterprises, or micro and informal businesses.

Barriers to introduction of MPL products

"The banking sector's delayed reaction may be perceived as disinterest in MPL products. Banks are interested, but also find it challenging to accept movable collateral due to additional considerations in valuation, seizure and resale."

– Ida Mestre, Asobancario

While a clear, lucrative market need exists, the traditional banking sector in Colombia has been slow to enter the market. Banks interviewed articulated a set of market constraints that, taken together, have prevented them from deciding to capitalize on the enabling MPL legislation and invest in creating the market. The foremost barrier to entry cited by banks is the weakness of related and supporting industries, particularly asset valuation, seizure, and liquidation. The relative underdevelopment of these enabling industries limits outsourcing opportunities for banks, requiring additional investment to build them in-house.

Beyond these constraints explicitly cited by banks, a range of other factors impact the scale of demand and the incentives for banks to enter the market for MPL:

- **Business formality:** high levels of informal, non-incorporated business activity limit the prevalence of certain collateral (e.g., invoices)
- **Alternative products:** some programs encourage unsecured lending and inefficient credit products crowd the market for MPL

[2] International Finance Corporation (IFC), "IFC Finance Enterprise Database", 2010, https://www.smefinanceforum.org/data-sites/msme-finance-gap

[3] $35 billion represents the total estimated credit market for MSMEs, including those businesses that would not qualify for movable property lending; $23 billion is the estimated credit market only for businesses with movable property that could potentially qualify as collateral.

- **Nature of competition within and among banks:** limited incentives for banks to aggressively capture additional market share limits the attractiveness of MPL
- **Data and product understanding:** banks' poor market and product understanding limits awareness of market potential and how it can be tapped
- **Relationship and reputational concerns:** mistrust between banks and borrowers rooted in recent historical context limit the perceived feasibility of MPL, particularly around seizure of assets
- **Risk assessment practices:** banks' generally limited understanding of how to assess the risk of growth-oriented SMEs precludes potential MPL customers from participation in the financial system

Specialization to overcome market constraints

Some of the market constraints listed above do represent limitations of the Colombia MPL market; while there are steps the Colombian government and other MPL reformers can take to ease them and help enable the market, lenders seeking to capture the market can do so through strategic specialization. Specialization is fundamental to MPL in developed financial systems, yet even more imperative in emerging systems where services that are commonly outsourced are weak or unavailable.

While our research focused on banks, the opportunity to capture the MPL market is not limited to traditional banks alone. A range of other financial institutions and lenders -- ranging from fintech and financing companies to equipment manufacturers and trusts -- are well positioned to break into the MPL market, and in some cases are already doing so.

Asset categories range in complexity in terms of maintenance, valuation, enforcement and liquidation, and may depend on different supporting legislation and industries. Based on the capabilities present in Colombia's financial system and the structure of the country's economy, three main opportunities emerge as the most beneficial entry points for both borrowers and lenders: accounts receivable, equipment financing and inventory-based financing

Accounts receivable financing:

Of all types of movable collateral, accounts receivable (often combined with inventory) are perhaps the most broadly applicable and easily accessible in the Colombian financial system today. More than 55% of SMEs across all sectors are believed to have accounts receivable among their assets

> *"Over 70% of our loan activities leverage **account receivables**. We coordinate with our client's client, utilizing their invoices to facilitate repayment." – José Ibarra, Aktiva*

Within accounts receivables financing, key opportunities exist in factoring and supply chain finance, particularly in food and retail value chains.

Equipment financing

Equipment-dependent business makes up a significant share of the Colombian economy. More than 45% of MSMEs in Colombia are estimated to use some form of machinery or equipment to operate their business, mostly in the industrial and technology sectors

Vehicle financing was among the first widespread uses of MPL in Colombia. Expanding this into other categories of equipment such as IT infrastructure lease-to-own; industrial, health and pharmaceutical equipment is promising. Partnerships with equipment manufacturers and vendors can further enable this.

*Partnering with a machinery distributor, we were able to lend - through our branch Financiamos su Maquina S.A.S. - **over US$1M in machinery to MSMEs** in the past couple of years…The ability to repossess the machinery and resell it through our machinery partner reduces our risk and opens up a new market" - Andres Zúñiga and Mauricio Buenaventura, Heritage Capital*

Inventory-based financing:

Inventory can account for a large share of an SME's assets depending on the business, making it one of the most important and potentially lucrative sources of collateral. Inventory represents around 13% of the total assets of SMEs in Colombia[4], which is almost equivalent to plant, property, and equipment[5] as a percentage of assets[6]. In Colombia, industries that depend heavily on inventory – including agriculture, manufacturing, and retail – account for 45% of SMEs by number[7].

*"In agriculture, the sectors that farm long-term crops may benefit from **inventory-backed financing**, given … proven market demand." – Rafael Mejia, Bolsa Mercantil*

The following chart presents an overview of sectors by attractiveness for MPL investment, based on size, growth, concentration of target SME customers and suitable collateral:

[4] Inventory includes the following asset sub-accounts: raw materials, unfinished products, ongoing movable construction projects, crops under growth, finished products, cattle, materials, replacements, and accessories, as well as inventory in transit

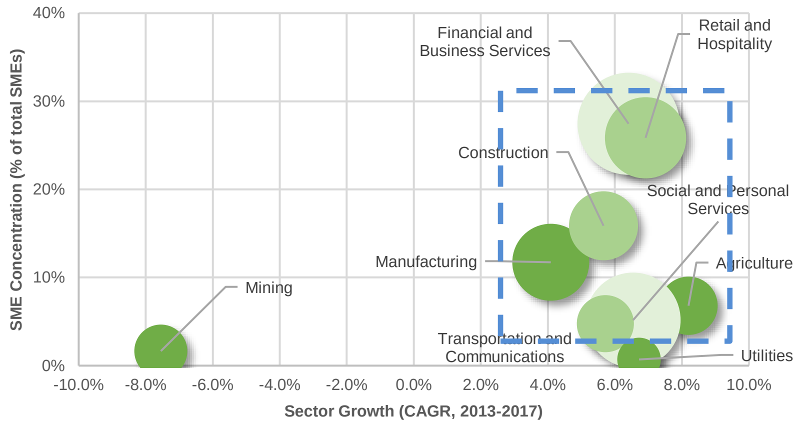
[5] Plant, property & equipment includes the following asset sub-accounts: land, petroleum project materials, ongoing construction projects, machinery and building equipment, construction and buildings, machinery and equipment, office equipment, computers and communication equipment, medical-scientific equipment, hotel and restaurant equipment, and ships and transportation equipment

[6] Superintendence of Societies and Deloitte Consulting, Percentage of assets calculated based on Deloitte Analysis on SIREM Income Statement Database, 2017, https://www.supersociedades.gov.co/Servicio_Ciudadano/tramitesyservicios/Paginas/SIREM.aspx

[7] Superintendence of Societies and Deloitte Consulting, Deloitte Analysis on SIREM Income Statement Database, 2017, https://www.supersociedades.gov.co/Servicio_Ciudadano/tramitesyservicios/Paginas/SIREM.aspx

Sector/Industry attractiveness

Sector Prioritization



LEGEND

Size = Contribution to total Colombia national GDP

= 10% total GDP

Color = collateral prevalence

Color	% SMEs with collateral
	Above 60%
	Between 30%-60%
	Below 30%

Sources: Banco de la Republica, Supersociedades, Deloitte Analysis

Next Steps for Colombia

The Colombian market is ripe for MPL today, and ongoing reforms stand to further enhance the market opportunity. For example, the introduction of the electronic invoice registry in 2019 is likely to dramatically widen the market for accounts receivable financing. Further down the line, increasingly uniform international legal standards may invite cross-border competition from foreign lending institutions.

Institutions looking to stimulate more rapid adoption of MPL in Colombia could consider the following enhancements to efforts already under way:

1. **Build awareness**: While a significant component of Colombia's approach to date, additional investment is needed to address gaps in understanding among banking executives and key regulators of the practical dimensions of MPL implementation who have been the traditional targets of training. In addition, reformers should work to extend training across staff levels within these institutions in order to reach customer-facing employees and their managers who are often best positioned to identify opportunities for MPL.

2. **Prove the market:** In particular, reformers and supporting investors should direct support beyond the traditional banking sector to other categories of lenders that exhibit promise as first movers (e.g., fintech, financing companies, etc.). These institutions – some of which are already incorporating MPL into their business models – can provide services

FinTechs often have the capabilities to be more nimble than banks and therefore evaluate risk differently. We saw a significant need for basic loans among SMEs to execute on short and mid-term plans. We have the capacity to keep it simple, and the agility to guarantee loans in a manner adequate to the SME's financing needs." – Esteban Velasco, Sempli and play a catalytic role in prove the potential of the MPL market. Investing in the development of comprehensive, reliable and authoritative data on SME credit, disaggregated by gender, would facilitate accurate assessments of the MPL market and targeted deployment of capital.

3. **Reduce barriers to entry:** MPL advocates should investigate the role that current guarantee programs are playing on banks' incentives to develop MPL offerings (e.g, Fondo National des Garantias - FNG), and consider ways in which guarantees could be structured in the future to promote uptake of new MPL opportunities. Encouraging specialization around select categories of MPL (e.g., retail inventory financing, supply chain invoice financing), not only at the business level but also at the economy level could also help jumpstart MPL in areas where there is most promise.

4. **Adapt regulation:** Legislators and regulators should consider adapting provisioning standards to reduce focus on valuation for highly rated credits, while keeping terms in line with international standards. Enhancing cross-government coordination on enabling business growth across various stages of development, particularly at transition hurdles, could also help reduce redundancies or competing programs that slow MPL uptake.

IS MPL A TOOL FOR WOMEN'S ACCESS TO FINANCE?

As described earlier in this report, MPL stands to enhance women's access to finance based on common gender disparities that preclude women from owning fixed assets. In particularly, there are four distinct mechanisms by which MPL could benefit women-owned businesses' and others broadly access to finance:

1. Enabling *women-owned SMEs who already desire additional financing to scale* by increasing their capacity to borrow;

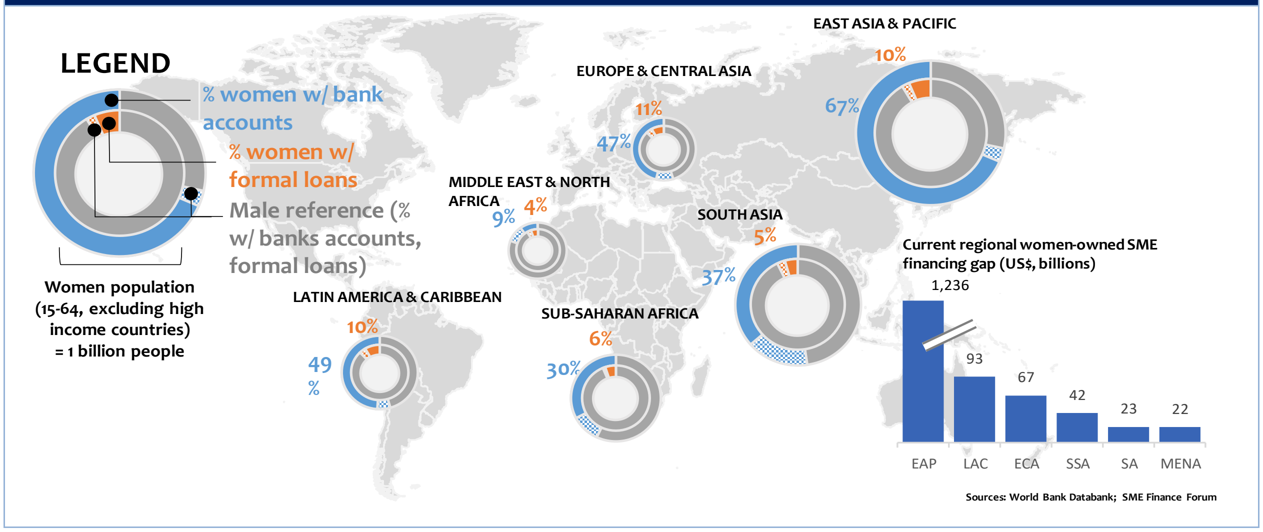
2. Activating *latent women-owned SME borrowers* not currently seeking finance but which would do so once a path to accessing is clear;

3. Due to the lower transaction and other costs of MPL compared to some other forms of borrowing (e.g. use of private credit cards to support a business), the lower costs of MPL should over time be able *to serve an expanded range of women borrowers*;

4. Indirectly *creating economic opportunities for women*, by funding the expansion of SMEs that are more likely to employ women.

The global gap in women's access to credit
While overall access to credit in mid and low income countries lags far behind OECD standards, women in emerging markets are disproportionally excluded from the financial system. The financing gap for women-owned SMEs exceeds $1.5 trillion.

The global gap in women's access to credit



Which of these channels is most important, the initial scale of impact and the timeframe over which effects materialize will vary based on a combination of factors affecting women's roles in the economy and society-at-large

Yet while the opportunity for women to benefit from MPL is clear and substantial, whether they are able to do so in the short term where reforms are underway or in place is more complex. Both our findings in Colombia and broadly from the global scan indicated that in some economies, near-term returns could be limited; ultimately a range of ecosystem factors must be addressed in order for women to capitalize on the benefits of legal reform.

Women are active participants in the Colombian economy, with specialist lending institutions such as Fundacion de la Mujer and Banco W having been present for some time. There is a lack of data on women's need for and access to finance to enable a comprehensive market assessment, but we identified two specific two barriers to achieving MPL's potential inclusive finance benefits:

- **A limited pipeline of growth-oriented female business owners:** The pipeline of growing, women-owned formal SME businesses which could represent an initial market for inclusive-finance oriented MPL products is limited by social norms that prevent women from aspiring to grow microenterprises to larger scales.
- **Support for alternative unsecured lending products:** Especially at the microenterprise level, unsecured microfinance and the use of personal lending products to support business activities creates disincentive from growing into MPL, or is used in place of MPL when MPL would be more suitable from a pure market perspective.

Overall, more research is needed to understand women's access to finance issues in general and the potential benefits of MPL specifically. A lack of data on the extent of latent women borrowers, the gender finance gap, etc. makes it hard to demonstrate untapped market size, or to countervail anecdotal belief among some banks and regulators that women already have equal access to finance. However, these findings do indicate that creating an MPL system that works for women relies on three main pillars:

- **Ecosystem approach:** Effectively reaching women with MPL requires understanding the full financial ecosystem that influences their demand for and ability to access credit, and the attractiveness of MPL products and services relative to alternatives.
- **Build a system that works for SMEs, keeping women in focus:** Particularly in cases where the immediate pipeline of women-owned SME demand for MPL may be limited, focusing on building an MPL system that works for all SMEs, including women, can provide an "on-ramp" for women to gain in the long run.
- **Understand women as customers:** whether women choose to access MPL will depend on the extent to which MPL products and services meet their needs, and are attractive relative to current product solutions, requiring a shift from thinking of women as beneficiaries, to viewing them as empowered customers.

IN CONCLUSION

MPL is an essential and beneficial element to deepening a country's financial sector, with consequent benefits for financial resilience, inclusion and economic growth. Around the globe, mature MPL systems help firms from SMEs to large multinationals access affordable credit suited to their business needs that enables them to grow and innovate, with far-reaching economic benefits. In Colombia, as in other countries, MPL represents both a lucrative business opportunity, and a chance to advance inclusive economies.

There are limits to MPL's applications: MPL is not an absolute substitute for unsecured or traditional fixed property lending. Regulators and financial services providers should view MPL as one of a series of tools that together can work to ensure that individuals and businesses are able to access affordable credit to meet their needs.

At the highest level, the findings from our research in Colombia and globally affirm a hypothesis that is increasingly gaining traction: that **movable property lending depends not purely on legal reform and a digital registry, but also on a complex "ecosystem" of factors** that together enable a market for MPL. Some of these factors can be developed and influenced, while others are fixed either for the medium-long term or indefinitely and must be adapted to. This has particular implications for countries currently facing challenges with MPL uptake among banks, as barriers may exist beyond traditional focus on capacity building and awareness.

In addition to adopting an ecosystem approach, the Colombia case points to five dimensions that can lead to improved outcomes for secured transactions reform with global applications:

- **Continuous education and training**: keeping up with natural employment cycles that may take place over the course of MPL implementation and reaching across staff levels, with an emphasis on practical implementation
- **Anticipate policy consequences and adapt:** crafting policies that both comply with international standards and reflect local contexts that may affect the behaviors that policies induce, together with putting monitoring and evaluation tools in place to indicate when policies may need to be adapted, particularly in early stages
- **Focus on strategic first movers:** looking beyond traditional banks to the priority first movers in the MPL market and directing supporting accordingly, while recognizing the important role for banks as part of the MPL system in the long term
- **Cultivate MPL as a product:** supporting lenders to develop not only a specific set of capabilities to conduct processes such as valuation and seizure, but also a tailored

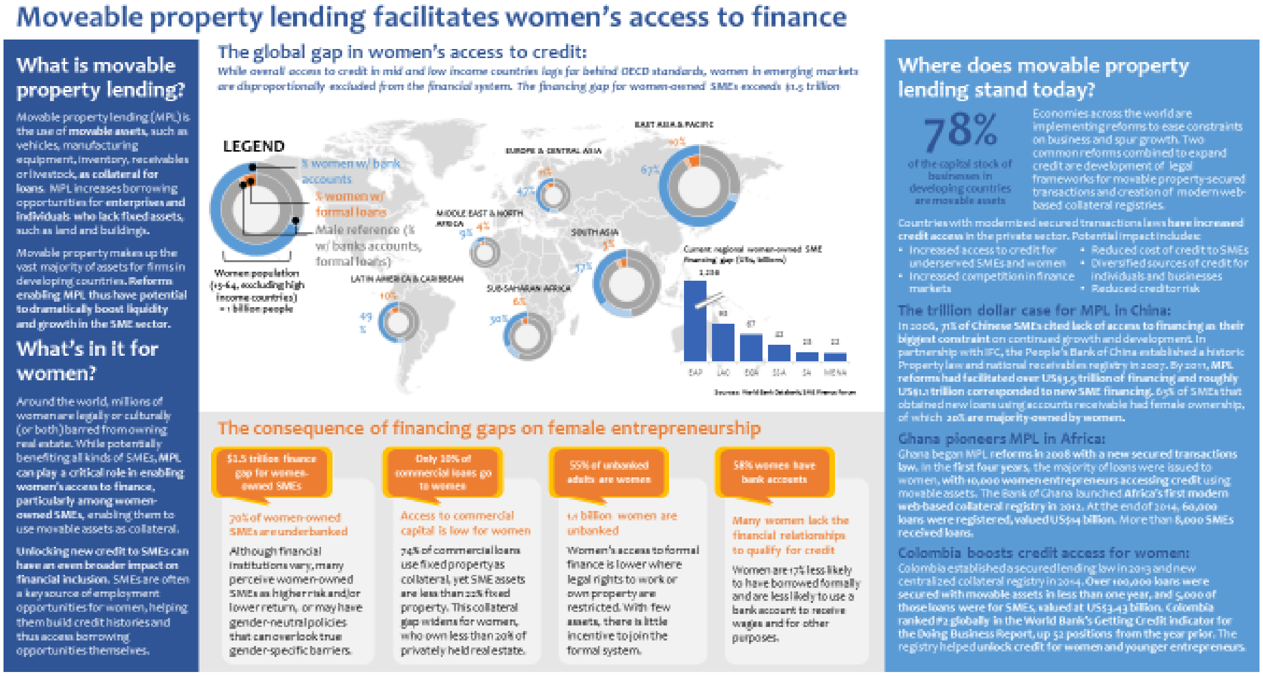
approach to risk assessment, pricing, customer selection, marketing, client management, and sales, among others

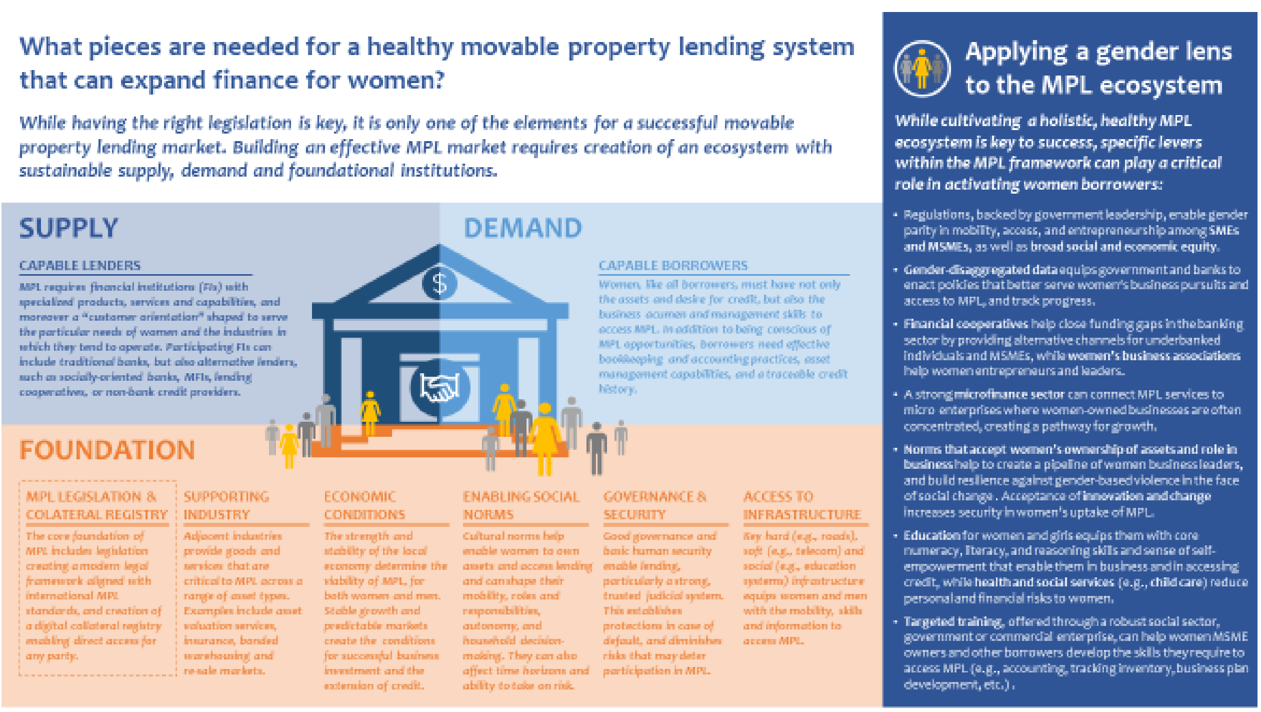
- **Careful use of incentive structures:** where required to stimulate the market, structuring incentives such as guarantees to stimulate market activities without encouraging long-term dependency

While the benefits of MPL are clear, the pace and extent with which those benefits can be realized depends on the complex interplay of many contextual dependencies, ranging from existing cultural norms related to lending, asset ownership and access to finance, to other aspects of banking regulation and financial industry structure. Even as law reforms take time to produce results and convert traditional ways of thinking, many of these variables are susceptible to tested development and regulatory interventions, presenting opportunities to both enable and accelerate implementation.

The secured transactions community today is at an inflection point. Moving towards an approach that intentionally takes into consideration the full ecosystem of factors that influence MPL is the first step towards better structured, better resourced and ultimately more successful implementation programs.

APPENDIX: MPL & WOMEN’S ACCESS TO FINANCE – INFOGRAPHIC





APPENDIX: INTERVIEWS & CONTRIBUTORS

This publication draws on interviews and other contributions from the following individuals and institutions in Colombia:

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Banco W
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Confecámaras
Diana Talero
Fondo Nacional de Garantias
iNNPULSA
Ministry of Commerce
National Registry of Valuation Experts (RNA)
PTP – Programa de Transformación Productiva
Superintendencia Financiera de Colombia
URF – Unidad de Regulación Financiera

Industry and Businesses
Alpina
Bolsa Mercantil de Colombia
Café de la Huerta – Guasca
Carmen Ceraje
Dosakin
Fede Cacao
La Migueria
Obleas Michelle
Pelanas
Termiexpress

Development Stakeholders
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