Outcome Document
UfM Conference on MSME finance during and after COVID-19,
"Resilience and Innovation in the wake of COVID-19"
Online - Wednesday, 23 June 2021

I. Context

Acting upon the Work Programme of the Economic Development and Employment Division (EDE) for the year 2021, the Conference was held to showcase pathways for supporting MSMEs in navigating the current pandemic and in entering a sustainable economic recovery phase, a transition towards a greener and digital economy in the Mediterranean region.

The Conference also responds to the UfM Co-Presidency Statement of November 2020 emanating from the Fifth Regional Forum of the Union for the Mediterranean, where the UfM Ministers of Foreign Affairs stressed on the need *"to show solidarity and mobilize resources and capacities towards a sustainable post-pandemic recovery paving the way for the creation of more resilient societies and economies in the region."* It also responds to the New Agenda for the Mediterranean of the European Commission which has called upon the support of private sector and namely SMEs, in addition to boosting innovative digital transformation in the Mediterranean region.

The main purpose of the Conference is to encourage countries to develop a more conducive environment to broaden the range of available options and actors to better support the needs of MSMEs and, ultimately, of the countries themselves.

The Conference brought together policy-makers (from ministries, central banks, regulators, the European Commission), as well as academics working on this subject, MSME finance advocates, and diverse market participants covering the whole eco-system (banks, microfinance institutions, investment funds, incubators, accelerators, fin-techs, leasing companies, credit guarantee companies, business angels, crowdfunding platforms, development cooperation frameworks) and international financial institutions active in the region. We have also made sure to incorporate pertinent best practices into the Conference from other regions, by inviting speakers and panelists representing institutions covering regions beyond the UfM and MENA.

II. Key takeaways/insights from the Conference include the following points:

- **Timing matters!** It is a common understanding that MSMEs are the backbone of any economic development and job creation. However, the current crisis has shown that many countries and institutions were not prepared to provide the necessary support to small businesses in a timely manner. Much too late for many SMEs.

  In this context, learning from experience may mean for governments to pre-emptively create a recipe book for financial incentives and support products for SMEs that can be applied immediately in the event of another crisis.

- **Financial infrastructure matters!** First and foremost, this means that digitalisation should be used to drastically speed up lending decisions and thus enable quick access to finance. The goal must be that banks do not have to shut down their (digital) systems in the future in order to cope with a sudden flood of loan requests piece by piece. However, this requires progress not only in areas such as cloud banking, e-KYC, automated credit approval processes, but also the utilisation of electronic signatures and digitised documents in lending processes to make them as efficient as possible.

  In this context, access to data will be crucial, and the performance of data depends on how much information can be processed. Establishing a data ecosystem at regional or at least national level is therefore a key element for the digital transformation in the Mediterranean countries. Combined with Artificial Intelligence (AI), Big Data enables financial service providers such as banks or fintech entrepreneurs to develop innovative solutions of various kinds and serve their customers more efficiently.

  For example, the combined use of different data sources (e.g. open banking, accounting, invoicing and transaction data) can provide end-users and SMEs not only with innovative financial management tools, but also with intuitively easy-to-understand ones that thus also promote financial education. Similarly, enhanced data use can provide insights into, for example, individual spending patterns, so that personalised financial products can be developed, or more appropriate ones offered.

  In this respect, open information remains the key to freedom!

  However, it is also important to consider possible unintended developments that may accompany the use of AI, e.g. for credit approval decisions. Many studies reveal that AI repeats past patterns. Accordingly, it is important to work on ensuring that credit approval decisions by means of algorithms do not, for example, perpetuate the fact that women have less access to finance.

- **Regulation matters!** On the one hand, regulation is indispensable, for example, to ensure customer protection and the protection of personal data in the digital world. On the other hand, inadequate regulations, e.g. on the protection of personal data, can prevent technology delivery through the cloud, the implementation of open banking opportunities, credit automation and even e-payments.

Therefore, it is important to consider essential areas of protection as well as to keep pace with technological developments in order to respond to the needs of SMEs. In this respect, trial-and-error policy-making methods, such as regulatory sandboxes, can be helpful in developing balanced and flexible regulations through inclusive dialogue.

Moreover, regional integration can be crucial for driving technological development in the Mediterranean. Regionally harmonised frameworks can, for example, facilitate access to other markets for fintech entrepreneurs, increasing both competition and the potential to attract a critical mass of customers for their financial services. Accordingly, positive effects on access to finance for MSMEs can be assumed.

- Sustainable Finance and Inclusive Green Finance matters! Like the effects of the SARS-CoV-2 pandemic, those of climate change and environmental degradation will hit the most vulnerable in our societies hardest, deepening poverty and existing vulnerabilities. To increase individual as well as societal resilience and achieve the SDGs, both sustainable and long-term socio-economic recovery is needed.

  The global green financing gap is estimated at between US$2.5 trillion and US$4.8 trillion. Accordingly, significant shifts in public and private investments are needed to be able to bring about the transition to carbon-neutral and resource-efficient economies. Green investments that promote innovative green technologies and business models must be drastically increased. In order to achieve inclusive socio-economic growth at the same time, the current focus of sustainable financing on capital markets and large-scale project financing must be expanded to include SME financing.

  Just as important as mobilising new sustainable/green investments is dealing with the volatility of capital flows. In this regard, an appropriate regulatory framework is needed to make private investments sustainable in the long term on the one hand and conducive to the real economy on the other. This is where sustainable financing for SMEs must work.

  However, this also means working on the business environment and the investment climate. An adequate market infrastructure as well as mature financial and capital markets are a basic prerequisite for this. The greening of the financial market needs to be worked out in a very strategic approach at national, regional and global levels in a coordinated manner.

  The current lack of bankable options for green finance also requires the creation of the necessary investment pipelines and the development of products such as green bonds, green credit products, equity funds, and perhaps even venture loans. This includes setting up rigorous systems to track investments and assess their sustainability. The latter is what the EU taxonomy is all about, avoiding greenwashing.

To bring SME financing and sustainability together, the recipe is basically: long-term financing at attractive interest rates, credit risk guarantees and technical assistance.

However, green lending to SMEs is an immense challenge, e.g. on the part of the EIB, as EIB loans already come with many conditions, such as project eligibility or application of EU standards regarding environmental and social standards, compliance and procurement. Accordingly, there has been little interest from Mediterranean partner banks in credit lines, which in turn come with additional climate change and environmental sustainability conditionalities, as it is already difficult for them to provide SMEs with access to finance.

Thus, it will require significant technical assistance, appropriate incentive and guarantee schemes and complementary public sector interventions to create awareness and stimulate market demand.

According to AFI, a policy interface approach between financial inclusion and green finance, which the network calls "inclusive green finance", will be essential for the necessary strategic intervention on green SME finance in developing countries and emerging economies.

This first requires a change in mindset to match the commitment to urgency. Furthermore, it is necessary to define what "green finance" means in a national or regional context and to develop taxonomies. Once the definitions are in place, it is important to build capacity on the part of financial regulators, central banks, banks and non-bank financial institutions, but also on the demand side (e.g. SMEs and individuals). In the following, it will be crucial to establish appropriate coordination mechanisms to develop guidelines and a strategic approach for inclusive green finance. This is also where, for example, the question of how fintech can be best used for inclusive green finance comes in.

It will be important that financial regulators as well as central banks are involved in ongoing national, regional or global policy processes on climate strategies and adaptation plans, as climate and environmental protection cannot be effectively addressed from different angles. Similarly, the successful implementation of European green strategies will not be achieved without the willingness of the EU's Mediterranean neighbours (e.g. governments, regulators, financial intermediaries, local business associations, etc.) to cooperate in this regard.

- **Renewal matters!** Call it more generally "build back better" or more thematically "green recovery", renewal has many facets. But an essential guiding principle for future policy action will certainly have to be improving access to finance for entrepreneurs. Particularly if the impact of the SARS-CoV-2 pandemic dragged businesses into insolvency, because the entrepreneurial power of the entrepreneur behind the failed business and his or her will to quickly generate new income opportunities will most likely be very much alive.

In this regard, however, the challenges that need to be addressed are not only in areas of financial system development or the promotion of alternative sources of finance. For example, SME exclusion from the formal economy is a structural problem in several Mediterranean countries, for which practical solutions need to be found through a clear vision and an adequate snapshot of the state of the respective economy.

Practical solutions can range from legalising property, legalising informal SMEs without tracing taxes and liabilities, tax incentives for formalisation, cutting red tape for licensing and permits, digitising bureaucratic processes, to reforms of bankruptcy and insolvency laws, depending on the context. The latter, for example, in a supportive sense for young entrepreneurs to improve a credit rating shattered by the crisis, so that access to certain start-up capital instruments remains within the realm of possibility.

However, it is also important to note here that there is a significant difference between SME and start-up investments. For innovative start-ups, the financing focus is mainly on equity, as most start-ups do not usually generate revenues in the seed phase of business development. Innovative entrepreneurship, therefore, and due to the inevitable lack of credit histories to obtain bank loans, mostly relies on alternative sources of financing such as business angel investments to acquire the necessary equity for product and business development.

But the impact of the SARS-CoV-2 pandemic has led to private investors becoming more cautious about investing in new start-ups and the number of deals has declined. Except for specific sectors such as fintech, healthtech, e-commerce and shopping, there was a decline in start-up investment with the onset of the pandemic.

To encourage more investors to put private capital into seed-stage start-ups and thus close this financing gap of conventional banking, tax incentives for angel investments, for example, could be a solution. Similarly, investment guarantees from credit guarantee institutions could be a way to fuel start-up investments in the Mediterranean region.

Credit guarantees have already proven their worth during the SARS-CoV-2 pandemic as a channel for government intervention in the credit sector, using guarantees to incentivise banks to continue lending to MSMEs. What was clearly noted within the UfM conference, however, is that reality is now slowly setting in and credit guarantee institutions (CGIs) are facing huge challenges and will inevitably have to break new ground.

On the one hand, there is the urgent question of how CGIs in the Southern Mediterranean can manage the huge portfolio growth resulting from government intervention when government support ends and the expected high SME loan default rates emerge in the near future, resulting in high guarantee payments. On the other hand, CGIs need to adapt their business models to new realities such as the digitalisation of the financial sector, financial technology innovations and the recovery and promotional urgency of the MSME sector as a job creator in the Mediterranean.

This requires out-of-the-box thinking, which must result in completely new guarantee products and models. The range of possibilities here extends from start-up equity products, bond securitisations, to guarantee products for certain SME segments or even entire value chains.

And here, too, the credo must be to make digitisation conducive. Firstly, digitalisation must lead to faster guarantee and thus lending decisions, so that MSMEs ultimately have faster access to financing.

Secondly, a digital infrastructure must be created. This can mean setting up a digital platform where information on MSMEs is collected and can be accessed by different financial actors. This information could enable financial actors to develop realistic models to address the real needs of MSMEs. It is also conceivable that such a digital platform could already list guarantee-worthy MSMEs and thus create a direct investment incentive for banks and investors and possibly also generate conducive competition with regard to financing costs.

- Under the heading "Resilience and Innovation in the wake of COVID-19", the UfM conference on "MSME Financing during and after COVID-19" obviously offered insightful contributions from and lively discussions between various experts. And one thing certainly remains to be said: **Cooperation matters!**