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Access to Finance for Youth SMEs in Rwanda: A Look at Youth SME Financing Impediments from a Policy Perspective

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A B S T R A C T

In many developing countries and developed countries alike, small and medium enterprises (SMEs) are the lead drivers of job creation and economic development. This review paper explores access to finance for youth-led Small and Medium Enterprises (SMEs), analyses youth SME financing impediments from a policy perspective and concludes with a consolidated view and relevant recommendations to enable youth in developing countries like Rwanda to build thriving businesses.

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1. Introduction

Small and Medium Enterprises (SMEs) are regarded as the backbone of every country's economy. Research has confirmed that small business is the engine of economic growth in developed and developing economies (Losccoco, 1993). In Rwanda, the statistics are on par. According to the Rwandan Ministry of Trade and Industry, 98% of businesses are considered SMEs, contributing 41% of all private-sector jobs in the nation. Rwanda's government has created a supportive environment for these SMEs to thrive. In Rwanda, over one-third of the population is between the ages of 16 and 35, constituting 62 percent of adults (MINECOFIN, 2013). However, there is a problem of rising unemployment levels among youth (LFS, 2017). However, national policies and programs encourage youth to embrace self-employment through innovation, entrepreneurship and business development; and the majority of the businesses they create fall under the classification of "small and medium enterprises". According to Caliendo & Schmidl (2015), access to finance is vital for any business development; and this is because investment and innovation are impossible without adequate financing. Youth are strategically important from the standpoint of national policy and financial sector

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development. Financially capable youth can positively impact the economy through increased savings and investments (MINECOFIN, 2013). However, challenges of acquiring adequate finance is named among the main barrier to the growth of many small and medium-sized enterprises (SMEs). Access to finance is still a major problem for several SMEs and a comparison of the different enterprises has revealed so despite many youths venturing into self-employment (Caliendo & Schmidl, 2015). A growing number of financial responsibilities for young people, such as starting one's own business, paying taxes, or starting a family, provide important opportunities or teachable moments for financial education and planning for the future (MINECOFIN, 2013).

2. Access to Finance for SMEs in Developing Countries and General Policy Perspectives

Access to finance is the ability of individuals or enterprises to obtain financial services, including credit, deposit, payment, insurance, and other risk management services. Those who involuntarily have no or only limited access to financial services are referred to as the unbanked or under banked, respectively (Demirgüç-Kunt, et. Al, 2008; Richardson, B. 2008). In developing countries, SMEs typically suffer from limited access to long-term and affordable finance, insufficient institutions for developing a skilled class of entrepreneurs and workers, a low income, and poor policies to support economic and social upgrading of SMEs (Hansjörg and Zeynep, 2017). A study done by Newcastle Business School (2012) revealed that the main characteristics that are considered to be most important for the assessment of creditworthiness are: project viability; business acumen; sources of repayment; applicants' financial strengths and weaknesses and; ability to repay. The two most frequent reasons for proposals being rejected were identified as a lack of quality and/or sufficiency of collateral as well as the lack of a prior track record of the firm/owner.

Table: Impediments for youth access to financing

Policy Areas	Impediments for young Entrepreneurs	Main Recommended Actions for Policymakers
Improving access to finance for youth.	Inappropriate and/or lack of youth-friendly financial products. Excessive restrictions (age required to open a bank account) Low financial literacy levels High credit and collateral requirements	➢ Facilitate the development of youth-friendly financial products, including mobile banking technologies ➢ Inform young people of youth-oriented financial services, including informal lending and other viable financing options ➢ Undertake financial sector reforms aimed at increasing financial inclusion. ➢ Promote youth-oriented financial literacy training. ➢ Support public-private partnerships aimed at building the financial sector's capacity to serve start-ups. ➢ Recognize business development support and mentoring in lieu of traditional collateral. ➢ Implement policies that promote access to finance for youth

Adapted from UNCTAD, 2015

Table: Improving access to finance

Policy Objectives	Policy Options	Youth-Specific Measures
Improving access to relevant financial services on appropriate terms	➢ Develop public credit guarantee schemes ➢ Stimulate the creation of private mutual guarantees ➢ Promote FDI in financial services, supply chain finance ('factoring') and leasing ➢ Facilitate collateral-free loan-screening mechanisms ➢ Encourage equity and 'risk capital' financing modalities	➢ Inform young people of youth-oriented financial services, including informal lending and other viable financing options. ➢ Shift lenders' perception of collateral to include ideas, business support, mentoring, psychometric tests etc.
Promoting funding for innovation.	➢ Provide incentives to attract venture capital investors and business angels ➢ Provide performance-based loans and incentives for innovation and green growth ➢ Facilitate the use of intellectual property as collateral.	➢ Facilitate linkages between youth-led start-ups and growth-oriented entrepreneurs and investors
Building the capacity of the financial sector to serve start-ups.	➢ Establish a national financial charter ➢ Promote public-private grants and technical assistance to expand lending activities (e.g. financial service provision through post offices and other 'proximity lenders'; use of new banking technologies to reach rural areas)	➢ Facilitate the development of youth-friendly financial products ➢ Support the development of youth-friendly mobile banking technologies
Providing financial literacy to entrepreneurs and encourage responsible borrowing and lending.	➢ Set up financial and accounting literacy ➢ Expand private credit bureau and public registry coverage ➢ Undertake appropriate supervision of financial products offered to social ➢ and micro-entrepreneurs	➢ Promote youth-oriented financial literacy training

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3. SMEs Financing Landscape in Rwanda and Related Policy Perspective

3.1. Defining SMEs in the Rwandan Context

According to Rwanda's SME Development Policy 2010, SMEs have to fulfill two of three indicators- net capital investments, annual turnover, and the number of employees.

- A **Micro Enterprise** is therefore defined as an enterprise employing maximum 3 people; annual sales/revenue turnover of maximum 0.3million and net capital investment of maximum 0.5 million.
- A **Small Enterprise** is defined as an enterprise employing 4 to 30 people; annual sales/revenue turnover of between 0.3 to 12million and net capital investment of between 0.5 to 15million.
- A **Medium Enterprise** is defined as an enterprise employing 31 to 100 people; annual sales/revenue turnover of 12 to 50 million and net capital investment of 15 to 75million.

Table: Defining SMEs in Rwanda

Size of Enterprise	Net Capital Investment (in Million RWF)	Annual Turnover (in Million RWF)	Number of Employees
Micro Enterprises	Less than 0.5	Less than 0.3	1 to 3
Small Enterprises	0.5 to 15	0.3 to 12	4 to 30
Medium Enterprises	15 to 75	12 to 50	31 to 100
Large Enterprises	More than 75	More than 50	More than 100

Source: Rwanda SME Development Policy 2010

3.2. The Role of SMEs in Rwanda

Across the globe, small and medium enterprises (SMEs) are the lead drivers of job creation and economic development. In Rwanda, the statistics are on par. According to the Rwandan Ministry of Trade and Industry, 98% of businesses are considered SMEs, contributing 41% of all private sector jobs in the nation. Rwanda's government has created a supportive environment for these SMEs to thrive. Often cited are Rwanda's policies which speed entrepreneurs through an online formal business registration at a record four hours. Protections for investors, practically non-existent corruption, and infrastructure for online payments, access to energy, and an increasingly educated workforce are all hallmarks of a nation that is both smart and serious about economic development (Leedom, S. 2016). Rwandan small and micro businesses comprise 97.8% of the private sector and account for 36% of private sector employment. There are over 72,000 MSMEs operating in Rwanda. Rwandan medium-sized enterprises are well-established businesses that are individually or jointly owned. They have set administrative processes, qualified personnel and trained staff, employ between 50-100 people and account for 0.22% of businesses in Rwanda contributing 5% of total private sector employment. MSMEs comprise approximately 98% of the total businesses in Rwanda and account for 41% of all private sector employment. The vast majority of MSMEs (93.07%) work in commerce and services. This is followed by 1.86% in professional services, 1.66% in Arts & Crafts, 1.33% in industry, 0.94% in financial services, 0.7% in tourism and 0.45% in agriculture and livestock.

3.3. MSME's Policy Objectives

- Promote a culture of entrepreneurship among Rwandans

- Facilitate SME access to development services including business development services, access to local, regional and international markets and market information, promote innovation and technological capacity of SMEs for competitiveness
- Put in place mechanisms for SMEs to access appropriate business financing
- Simplify the fiscal and regulatory framework for SME growth
- Develop an appropriate institutional framework for SME development

3.4. Challenges facing micro small and medium enterprises in Rwanda

- Lack of entrepreneurial culture in terms of building human capacity and supporting potential growth
- The unstructured environment in which SMEs operate and their inability to be open to new or innovative ideas presents a major challenge to the development of the SME sector
- Limited innovation and competitiveness in the SME sector caused by a lack of technical and managerial skill.
- Lack of good quality business development services tailored to their needs.
- High cost of doing business is cited by MSME owners in terms of high energy and transport costs.
- MSMEs in Rwanda face significant compliance burdens dealing with existing regulation. The current tax regime is both costly and difficult to comprehend
- SMEs face difficulties accessing and utilizing information regarding local, regional and international pricing, a major constraint to business planning as well as about the regulatory environment in Rwanda and regionally.
- Poor participation in the policymaking process, meaning they have little knowledge of interventions designed to assist them.
- SMEs have inadequate access to market information that could benefit their businesses as well as inadequate knowledge about marketing their products both nationally and internationally.
- SMEs often have limited abilities to develop the skills of their staff or to take advantage of local economies of scale in terms of energy, transport or raw materials.

Youth generally use financial services in the same way as middle-aged adults, but the data also show that teenage youth are less likely to use a bank, savings group, or Umurenge SACCO, suggesting that teens could benefit from learning more about financial services available

3.5. Analysis of Rwanda's SME Development Policy

The Government of Rwanda (GoR) has a vision to become a middle-income country. In order to achieve this goal the medium term Economic Development and Poverty Reduction Strategy (EDPRS) states that it must achieve an annual GDP growth rate of 8.1% and increase off-farm employment to 30% by 2012. The SME sector, including formal and informal businesses, comprises 98% of the businesses and 41% of all private sector employment in Rwanda. Most micro and small enterprises employ up to four people, showing that growth in the sector would create significant private sector non-agricultural employment opportunities. Currently, over 80% of the population is engaged in agricultural production. (Source: SME Development Policy 2010).

The SME sector also has the potential to lower Rwanda's trade imbalance and it is the GoR's vision to

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increase the role of value-added exports to increase export revenue and reduce the import-export gap. The GoR also seeks to reduce its dependency on foreign aid and debt by increasing internal tax revenue. Since 2009, tax revenues have increased largely from the collection of Value Added Tax (VAT), and the role of SMEs in this cannot be undermined. Despite the above, there had not been a coordinated policy to address the SME landscape and unlock the underlying potential of SMEs in national development prior to 2010. In order to contribute to achieving increased off-farm employment and tax revenue, the GoR developed and is currently implementing a coherent and well-coordinated SME Development Policy. The major aim of the policy is to create an enabling environment for the growth and development of the SME sector in Rwanda (Fortunes of Africa, 2019.)

4. Conclusion

Small and medium enterprises (SMEs) contribute to the business growth and economic development of countries; however, the funding of SMEs is fundamental to this growth and development (Al-Hyari, 2013; Lewandowska, Mateusz, Stopa, & Humenny, 2015; Neagu, 2016). Youth-led Small and medium-sized enterprises (SMEs) play an important role for development. include start-ups that trigger innovation, boost productivity, and bring about structural change. Youth are strategically important from the standpoint of national policy and financial sector development. Over one third of the population is between the ages of 16 and 35, constituting 62 percent of adults. Financially capable youth can positively impact the economy through increased savings and investments. A growing number of financial responsibilities for young people, such as starting one's own business, paying taxes, or starting a family, provide important opportunities or teachable moments for financial education and planning for the future. The Government of Rwanda is committed to addressing the problem of lack of access to finance which has been frequently cited as one of the biggest challenges for SMEs, and this is reflected in various policies. In Rwanda, there are funds available for SMEs to assist in lending to youth SMEs, including credit lines and guarantee funds created by the government of Rwanda for which youth-led SMEs are eligible. These include funds for export promotion, agricultural development and SME development. There are also other initiatives to increase youth access to finance for women and youth. However, youth-led SMEs still face challenges due to the nature of their SME governance, the lack of capacity for SME owners to manage their own businesses efficiently, and collateral requirements that still marginalizes the realities of youth-led SMEs, contributing to stagnation for youth-led SME finance. More policy considerations should be promoted to support youth-led SMEs to build successful businesses through financial business formalization, business management and financial literacy, as well as easing access to finance for youth-led SMEs.

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