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How Information Sharing Can Improve Access to Finance for SMMEs: Some Lessons for APEC Economies

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How Information Sharing Can Improve Access to Finance for SMMEs:
Some Lessons for APEC Economies

Asia-Pacific Credit Coalition

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The Logic of Information Sharing

Solidly established that full-file, comprehensive reporting:

- reduces "asymmetric information" problems, that is, lender can better assess the likelihood of repayments
- limits "moral hazard", by creating an additional incentive to pay on-time
- Replaces collateral in the form of assets with "reputational collateral"
- Solution to the problem faced may many SMMEs, which have insufficient fixed assets for collateral

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Variations in the Structure of Reporting

- Full-file reporting: The reporting of both positive payment information and negative information such as delinquencies, collection, bankruptcies, and liens. Late *and* on time payments are reported.

VS.

- Negative-only reporting: The reporting of only negative information, such as delinquencies, defaults, collection, bankruptcies, and liens.

- Segmented reporting: A system of reporting information, whether full-file or negative-only, in which only data from one sector, e.g., retail or banking, are contained in reports.

VS.

- Comprehensive reporting: A system of in which payment and account information, whether full-file or negative-only, are not restricted by sector, that is, the system contains information from multiple sectors.

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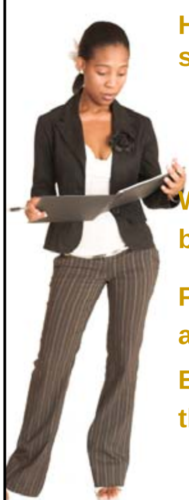
Why Full-File, Comprehensive Credit Information Sharing?



History of and experience with broader information sharing shows:

- **increased lending to the consumers and SMMEs especially among lower social segments and informal businesses; and,**
- **better loan performance, i.e. more stable lending.**

When lenders can use behavior to assess risk, lending is broader and safer

Private sector services previously excluded social segments as borrower history is used to assess risk

Especially true when privately owned credit bureaus are in the market

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Overlaps of Consumer and Commercial Credit Reporting

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Shared logic:

- Similar in that solution to “asymmetric information” and “moral hazard” problems
- For many economies with large informal sector, much commercial lending in the small and even medium space is lending to consumer
- Research indicates that propiertor’s credit report often better predictor of risk than business plan

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Measured Changes in Access is Significant

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Table 1:
Percentage Point Change in the Acceptance Rate by Shift in Reporting Regime
(percentage change shown in parentheses)

	Negative-only to Full-file					Segmented (Bank-only) to Comprehensive Reporting	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Default Rate	Barron and Staten, U.S. files	Turner et al., U.S. files	Turner and Varghese, Colombia	Majnoni et al., Argentine ...	Majnoni et al., Brazilian ...	Barron and Staten, U.S. files	Turner, Canadian files
0.5%							16.5 (52.7%)
1%							8.2 (13.1%)
2%		13.4 (47.0%)			15.9 (32.3%)		7 (8.8%)
3%	35 (87.9%)	9.2 (23.0%)	7.4 (290.6%)	10.7 (21.7%)	26.4 (47.3%)	8.0 (10.6%)	9.1 (10.9%)
4%	9.5 (12.9%)	8.4 (17.8%)			6.7 (7.9%)	10.0 (12.4%)	
5%	4.3 (5.1%)	4.9 (8.8%)	36.2 (702.9%)	0.6 (0.1%)	1.9 (2.0%)	2.2 (2.3%)	
6%	2.3 (2.5%)	3.3 (5.5%)					
7%	0.5 (0.5%)	2.3 (3.6%)	45.2 (332.5%)	1.76 (2.1%)			

Greater access: widened credit access follows with full-file, comprehensive data--by ~7% of market in many studies

Evidence from

- US
- Canada
- Brazil
- Colombia
- Argentina
- Others

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Measured Changes in Performance is Significant

Table 6: Percentage Point Change in the Default Rate in Reporting Regime Switch (percentage change shown in parentheses)									
	Full-file to Negative Only					Comprehensive to Segmented Reporting		Removal of Utility Data	Removal of Telecom. Data
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Acceptance Rate									
20%			4.94 (140%)						
30%		0.8 (62%)	4.94 (120%)					0.2 (22%)	0.2 (18%)
40%	1.84 (170%)	0.6 (33%)	8.96 (183%)	0.92 (60%)	1.48 (114%)	0.57 (108%)	0.18 (43%)	0.3 (25%)	0.5 (29%)
50%		0.3 (10%)	8.54 (146%)				0.19 (36%)	0.5 (28%)	1.3 (39%)
60%	1.45 (76%)	0.4 (8%)	8.1 (113%)	0.83 (28%)	1.53 (83%)	0.72 (61%)	0.24 (35%)	1.2 (40%)	2.7 (36%)
70%		0 (0%)					0.26 (27%)	2.7 (50%)	3.8 (31%)
75%	1.03 (34%)					0.84 (39%)			
80%				0.96 (19%)	0.86 (30%)		0.68 (47%)	4.3 (45%)	5.0 (31%)
90%							2.83 (114%)	3.9 (28%)	3.4 (19%)

Better performance: portfolios perform better for same market size, i.e., lower overindebtedness--by ~1% of portfolio in many studies

Evidence from
- US
- Canada
- Brazil
- Colombia
- Argentina
- Others

Private Full-File Coverage and Private Sector Borrowing

VARIABLE	Models Tested: I	Models Tested: II
Constant	-142.40*** (35.31)	-130.80*** (32.20)
Log of GDP per capita (adjusted for PPP)	**20.31*** (4.65)**	**16.85*** (3.87)**
Avg. Change in GDP (1995-2004)	-1.20* (0.70)	
Legal Rights of Creditors (from 0 to 10)	**4.55** (2.07)**	**4.80** (1.97)**
Credit Information (from 0 to 6)	-3.87 (2.88)	
PRIVATE FULL-FILE COVERAGE (0 TO 100, AS % OF ADULTS)	***0.72*** (0.20)***	***0.67*** (0.16)***
Private Negative-only Coverage (0 to 100, as % of adults)	-0.02 (0.86)	
Public Full-file Coverage (0 to 100, as % of adults)	-0.11 (0.41)	
Public Negative-only Coverage (0 to 100, as % of adults)	0.16 (0.46)	
R squared	0.7075	0.6883
F-stat (p value)	16.93 (1.88e-012)	44.9 (1.887e-015)
Residual Standard Error	29.45	29.12
N	65	65

***p < 0.1, ** p < 0.05, ***p < 0.01. Private full-file bureau captures effects of credit information (strongly correlated). 65 countries were examined. 2 outliers, which were removed, had recently experienced financial crises. As mention removing the US and the UK as outliers, does not alter results significantly.**

High coverage by a private full-file bureau dramatically expands private sector lending.

For an economy, going from no adults to having all (100% of) adults with positives and negatives in a private bureau increases private sector lending by more than 60% of GDP.

(Without the US and UK, which have high private sector lending, the estimated increase is still more than 45% of GDP.)

How Information Sharing Solves Challenges of SMME Financing

Traditionally, SMME financing reliant on:

- **Local lending, and**
- **Qualitative risk measures, e.g., knowledge of business by loan officer (relationship lending)**
- **Bank lending was limited, as consequence**

Credit reporting for SMMEs

- **Has reduced the importance of distance for lending**
  - Small businesses increasing not depending on local lending
  - Development of Small Business Credit Scoring and other analytic tools
- **Enabled also by inclusion of trade credit provides data to 'populate' credit records**
- **Has made relationship lending more efficient in some economies**

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Assisting Development of a Financial Information Sharing Infrastructure

Key aspects of a well-functioning reporting system

- **Allow positive and negative reporting**
- **Discourage fragmented reporting, encourage reporting of retail credit and non-financial obligations**
- **Private sector bureaus try to find solutions for risk assessment**
- **Understand the interface with consumer reporting; think of them both as important for SMME financing**
- **Give data subjects right to access, review, dispute and correct data--leads to improved data quality**

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For more information

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