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Access to credit for micro, small and medium-sized enterprises (MSMEs)

Note by the Secretariat

Contents

Introduction

1. This document is an addendum to document A/CN.9/WG.I/WP.119 which discusses – in the form of an annotated list of contents – possible topics to be addressed in a future instrument (the "Future Instrument") on access to credit for MSMEs for consideration by the Working Group. By way of example, this document illustrates how topics in the chapters on "access to credit for MSMEs: sources and challenges" (see paras. 3 to 23, A/CN.9/WG.I/WP.119) and "improving access to credit for MSMEs" (up to subsection B.2 (a). "moveable assets as collateral", see paras. 24 to 34, A/CN.9/WG.I/WP.119) may be addressed in the Future Instrument. These sample chapters (reproduced as an annex to this Introduction) are preceded by some preliminary considerations regarding the scope, intended audience, structure and style of the Future Instrument. The Working Group may wish to discuss those preliminary considerations and whether the approach proposed by the Secretariat it is appropriate for the preparation of the Future Instrument.

2. The sample chapters on "access to credit for MSMEs: sources and challenges" and "improving access to credit for MSMEs" are reproduced as an annex to this introduction.

1. Scope

3. The aim of the Future Instrument will be to provide guidance on the establishment or adaptation of domestic legal frameworks to facilitate MSMEs' access to credit. While the Future Instrument's primary focus will be on improving those areas of the law that preclude or otherwise affect MSMEs' access to credit, the Future Instrument will not avoid discussion on relevant policy and operational measures if these measures are instrumental in reducing the legal constraints that make access credit difficult for MSMEs.

4. The Future Instrument will be drafted as a flexible tool, such as a legislative guide, so as to allow States to tailor its guidance to their domestic needs.

2. Intended audience

5. The Future Instrument will be addressed both to States that do not currently have an extensive legal framework that supports MSMEs access to credit and to States that wish to modernize their existing laws and harmonize them with the laws of other States. National legislators and policymakers from all geographic regions and legal traditions will be the principal target group. Other stakeholders in the State or international organizations that are interested or actively involved in improving the legal framework of access to credit for MSMEs may also benefit from the text as well as those that may be affected by legal reforms based on the Future Instrument.

6. The Commission agreed that the materials prepared by the Secretariat should draw as appropriate on the UNCITRAL Model Law on Secured Transactions (the "Model Law") (see document A/74/17, para. 192(a)), however, users of the Future Instrument should not be required to have a particular knowledge of the Model Law and even those who are unfamiliar with the regime contemplated in that legislative text should be able to use the Future Instrument.

3. Structure

7. The Future Instrument will be drafted mainly as a self-contained text, that may incorporate materials from relevant UNCITRAL texts if that is useful to clarify the topics discussed. Those users who are not familiar with the referenced UNCITRAL texts should particularly benefit from this approach. Similarly, the Future Instrument will make reference to relevant texts of other organisations and may incorporate them to the extent this improves the quality of the discussion.

8. Following the approach taken by Working Group V with regard to insolvency of micro and small businesses, the discussion on the topic concerning secured lending

using movable assets as collateral (see paras. 72 to 95) will build upon the existing UNCITRAL framework that is the Model Law, the UNCITRAL Legislative Guide on Secured Transactions (2007) as well as the UNCITRAL Legislative Guide on Secured Transactions: Supplement on Security Rights in Intellectual Property (2010) and the UNCITRAL Guide on the Implementation of a Security Rights Registry (2013). The Future Instrument will include the most relevant tools to facilitate MSME access to credit provided in those texts.

4. Style

9. The Future Instrument will use neutral legal terminology so as to be easily adaptable to the diverse legal traditions and States' legal drafting techniques. In order to enhance its readability and usefulness, the Future Instrument will also make a balanced use of legal terminology and plain language so as to be easily readable by non-experts while avoiding the risk of oversimplification.

Annex

I. Access to credit for MSMEs: sources and challenges

[*This chapter explains the features of MSMEs and why access to credit is key for them. It then discusses different sources of financing for MSMEs and related challenges*].

A. MSMEs and the importance of access to credit

1. MSMEs constitute the vast majority of business types in all States. They account for around 55 per cent of GDP in developed economies and 35 per cent in developing economies.[1] Worldwide, they represent more than 90 per cent of businesses and 50 per cent of employment.[2] While MSMEs account for around two-thirds of total employment in both developing and developed countries, the figure becomes starker in terms of job creation in developing economies, as much as 95 per cent.[3] In particular, micro-enterprises tend to be started and run by the young, women, and the laid-off and otherwise marginalized. As the World Bank forecasts that around 600 million jobs will be needed to absorb the youth entering the labour market over the next 15 years, a number of governments in this regard have prioritized MSMEs' roles in job creation.

2. There does not exist an internationally standardized definition of MSME. It thus may refer to all non-large businesses at large. While the number of employees, turnover, and assets are the more commonly used criterion, other variables, such as loan size, formality, years of experience, can also be found.[4] As it is for each economy to define its own parameters, MSMEs vary incredibly depending on the specific context, whether economic or otherwise.

MSME characteristics

3. Although it is in the interests of States and MSMEs that businesses operate in the formal economy,[5] many in reality still do not and those that do, run in multifarious sectors, take various legal forms, and have different human resources structure and management.[6] Due to their disparate nature and practices, providing a general description of or identifying common denominators in MSME characteristics, may not be so straightforward.

4. Still, certain possible characteristics of MSMEs may be shared. They include some or all of the following:[7] (a) small size; (b) disproportionate impact of burdensome regulatory hurdles; (c) reliance on family and friends for loans or risk-sharing; (d) limited access to capital or to banking services; (e) limited source of employees; (f) limited markets; (g) vulnerability to arbitrary and corrupt behaviour; (h) limited access to dispute settlement mechanisms, which puts them at a disadvantage in disputes with the State or with larger businesses; (i) lack of ability to partition assets, so business failure often means that personal assets are also lost; (j) vulnerability to financial distress; and (k) difficulty in transferring or selling a business and in profiting from both tangible and intangible assets.

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[1] WTO, World Trade Report 2016, (2016), p. 18.

[2] A/CN.9/991, para. 7.

[3] ITC, SME Competitiveness Outlook 2015: Connect, Compete and Change for Inclusive Growth, (2015), p. 13.

[4] IFC, MSME Country Indicators 2014: Towards a Better Understanding of Micro, Small, and Medium Enterprises, (2014), p. 5 et seq.

[5] UNCITRAL Legislative Guide on Key Principles of a Business Registry, paras. 1–4; A/CN.9/941, paras. 28–31.

[6] In this regard, UNCITRAL has been considering a simplified business entity suited to the needs of MSMEs (see e.g., document A/CN.9/WG.I/WP.118).

[7] A/CN.9/941, para. 12.

5. While most of the characteristics are derived from or in relation to the size of MSMEs, two characteristics may be particularly relevant for MSMEs' access to credit, namely (a) that there is no or little distinction between the business and the individual running it and (b) that the amount of loans involved is generally small, leading to reliance on family and friends or requiring the transaction costs to be minimal. From the creditors' point of view, limited access to information on MSMEs or information asymmetry is one of the most significant problems that frustrates external financing, since it is often too costly to collect the information themselves in order to assess MSMEs' creditworthiness.[8]

MSME credit gaps

6. Studies indicate that there is a considerable mismatch between the need for MSME finance and the actual funding, that is, the finance gap. Such discrepancies are felt throughout the world and may pose more constraints to women than to men due to cultural, economic and legal constraints. For instance, women are said to have less access to credit since they have less physical and reputational collateral, particularly as their microfinance repayment rates are often not captured by credit bureaus.[9]

7. A recent working paper by the International Finance Corporation (IFC) estimates the unmet demand for financing from formal MSMEs in developing countries and reveals a gap of USD 5.2 trillion, the potential demand of USD 8.9 trillion less the credit supply of USD 3.7 trillion.[10] According to the study, there are 65 million credit-constrained formal MSMEs, representing 40 per cent of all enterprises in the 128 reviewed countries, and the potential demand for finance from informal enterprises in developing countries is valued at another USD 2.9 trillion. While East Asia and the Pacific accounts for the largest share of the total gap, Organisation for Economic Co-operation and Development (OECD) countries are not entirely free from such gap as a sizeable share of MSMEs finds it more difficult to access credit from banks, capital markets or other suppliers of finance.[11]

8. In developing economies, it was estimated that about 1.7 billion adults who may be already or potentially running MSMEs globally were excluded from the formal financial system without an account at a financial institution or through a mobile money provider, and women were overrepresented among these unbanked.[12] These excluded adults, amounting to 30 per cent worldwide, also need to seize economic opportunities.

9. While the reduction, or ideally closure, of the MSME finance gap matters, a balance needs to be sought as there may exist a tension between the measures aimed at improving access to credit and those designed to protect MSMEs. As noted above in paragraph 1, MSMEs may play a significant role in job creation and overall economic development. Although enterprises of all size create jobs, since most start out small, new MSMEs in particular, create new jobs and bring indirect effects such as improving the overall competitiveness and innovative capacity of the industry.[13] The access to credit for MSMEs, presumably the number one challenge to their growth and health, needs to be unlocked so that MSME growth may further extend and spill over into economic growth as a whole and thus poverty reduction. On the other hand, the gap may mean a new market segment which banks and other financial

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[8] World Bank, International committee on credit reporting: facilitating SME financing through improved credit reporting, (2014), p. 1.

[9] ITC, Unlocking Markets for Women to Trade, (2015), pp. 23 and 25.

[10] IFC, MSME Finance Gap : Assessment of the Shortfalls and Opportunities in Financing Micro, Small, and Medium Enterprises in Emerging Markets, (2017), p. 27 et seq.

[11] OECD, Financing SMEs and Entrepreneurs 2020: An OECD Scoreboard, (2020), pp. 26–27; OECD, The SME Financing Gap (Vol. I): Theory and Evidence, (2006), p. 15 et seq.

[12] World Bank, The Global Findex Database 2017, (2018), pp. 35–36.

[13] Deutsche Gesellschaft für Internationale Zusammenarbeit, Is Small Still Beautiful? Literature Review of Recent Empirical Evidence on the Contribution of SMEs to Employment Creation, (2013), p. 15.

institutions would be interested to fill in. It is for the government to take actions addressing MSME financing constraints and economic conditions in general so that credit remains at affordable rates without giving up any necessary protection or jeopardizing sound banking operations.

10. Improving financing for MSMEs would support the sustainable development goals (SDGs).[14] MSMEs may make a huge impact on the SDGs through job creation in particular, but also otherwise. The International Trade Centre (ITC), for instance, suggests that MSMEs contribute in particular to achieving SDG 8 (Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all) and SDG 9 (Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation) through the business practices they choose to adopt, the sectors in which they operate and the impact they have on the broader economy, and have positive impact on 60 per cent of the individual SDG targets, with sufficient funding in place.[15] Improved access to credit for MSMEs would allow the great potentialities to grow and scale, leading to advancement of women's economic empowerment and contributing to alleviating poverty.

B. Sources of financing and related challenges

11. While MSMEs may be varied in nature and scope, the importance of financing for MSMEs in the appropriate forms and at all stages of their business life cycle is common to all MSMEs. MSMEs usually need different sources of financing since they have limited access to capital or to banking services. Banks, still the main source of external finance for MSMEs, are often reluctant to extend credit because of the high costs of gathering adequate information to assess the creditworthiness of typical MSME borrowers or to grant them unsecured credit even at high interest rates.[16]

12. MSMEs consequently seek funding elsewhere during their different stages of development. In the initial stages, when MSMEs generate little revenue and lack a reliable credit record, access to formal credit is often limited and MSME entrepreneurs often rely on their own savings or support from family and friends. Start-up MSMEs with growth potential but high risks may attract venture capital and other specialized private equity funds. As MSMEs grow and build a reliable credit record, other sources of financing such as bank loans and asset-based finance may become increasingly available. Finally, developed MSMEs may issue debt and equity through stock exchange markets or private placements.[17]

13. It should be noted that the availability of different sources of financing for MSMEs largely depend on the development of relevant financial markets. While traditional lending, public equity, corporate bonds, microfinance credit and family/friends support are generally available in all countries, other types of financing (e.g., private equity, crowdfunding, asset-based finance, securitized debt, covered bonds, hybrid financing instruments and supply chain financing) may differ significantly from one region to another or also within the same region. Moreover, MSMEs' access to certain types of financing may also be further limited due to the lack of supportive legal and policy frameworks.

[14] Inter-agency Task Force on Financing for Development, Financing for Sustainable Development Report 2020, (2020), p. 8, box I.2.

[15] ITC, SME Competitiveness Outlook 2019: Big Money for Small Business – Financing the Sustainable Development Goals, (2019), pp. xiv–xv.

[16] A/CN.9/991, para. 8(c); IFC, MSME Finance Gap (see footnote 10), p. 44 (noting that nearly 79 per cent of loans or lines of credit surveyed required collateral and this figure was similarly high in most regions of the world).

[17] IMF, Financial Inclusion of Small and Medium-Sized Enterprises in the Middle East and Central Asia, (2019), p. 21.

1. Equity finance

14. Equity finance refers to financing provided to MSMEs in return for an ownership interest. Capital markets are a key source of equity finance but remain underdeveloped in many countries and mostly inaccessible to smaller MSMEs.[18] Public equity and private equity are the main categories of equity finance, which are discussed in detail below.

Public equity

15. Public equity financing refers to listings on stock exchange markets and could play a significant role in countries that have developed specialized stock markets for MSMEs.[19] As part of the listing process, enterprises are usually required to disclose basic information about their activities and financial situation through a prospectus. Once listed, they are requested to provide regular disclosure and trading takes place under rules and procedures set out by the respective stock exchanges.[20]

16. Public listing is especially relevant for larger MSMEs to attract external financing.[21] It could also potentially improve creditworthiness of MSMEs, open up other sources of finance, as well as offer brand recognition and more visibility.[22] Specialized stock markets are important for the development of public equity market for MSMEs.[23] Compared to the main stock exchanges, specialized platforms for MSMEs could offer reduced listing fees and discounts on annual fees, relaxed entry requirements, business development assistance, and/or less frequent reporting requirements.[24]

17. Due to the fixed costs of due diligence and listing, the process of public listing at main stock exchanges is typically more demanding for MSMEs than for large firms. Other than costs, the disclosure and reporting requirements set out by these main stock exchanges also present challenges for many MSMEs. Despite the remarkable growth in specialized platforms for small and medium-sized enterprises (SMEs) worldwide, low-income countries have significantly fewer SME platforms than high-income countries.[25] Furthermore, cultural factors and management practices (e.g., lack of education and confidence about the listing process, fear of being exposed to stock price volatility, aversion to sharing sensitive information, and concerns for the loss of control implied by the wider equity ownership) constitute important reasons for some MSMEs' reluctance to approach public equity markets.[26] Last but not least, in some jurisdictions the different tax treatment between equity and debt financing is also relevant for the limited development of public equity market for MSMEs.[27]

Private equity

18. Private equity includes a broad range of external financing instruments, whereby enterprises obtain funds from private sources in exchange for an ownership interest.[28]

[18] Inter-agency Task Force, Financing for Sustainable Development (see footnote 14), p. 67.
[19] ITC, SME Competitiveness Outlook 2019 (see footnote 15), p. 13, box 3.
[20] OECD, New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments, (2015), para. 413.
[21] Large MSMEs usually have highly structured governance and management systems with extensive disclosure, making them intelligible to market intermediaries, credit analysts and investors.
[22] OECD, Financing SMEs (see footnote 11), p. 44.
[23] Several jurisdictions have laid down special regulatory frameworks for SME stock exchanges with relaxed conditions for public listing, including the United Kingdom of Great Britain and Northern Ireland (AIM), Canada (TSXV), Hong Kong, China (GEM), Japan (Mothers), the Republic of Korea (KOSDAQ) and the United States of America (NASDAQ).
[24] UNCTAD and World Federation of Exchanges, The Role of Stock Exchanges in Fostering Economic Growth and Sustainable Development, (2017), p. 12.
[25] Ibid., p. 13.
[26] OECD, New Approaches(see footnote 20), para. 426.
[27] Ibid., para. 429.
[28] Ibid., para. 332.

Globally, private equity funds hold about $2 trillion in cash.[29] Venture capital (VC) and business angel investment (see para. 20 below) represent the main categories of formal sources of private equity, which are discussed in detail below.

19. VC is an important source of funds for MSMEs.[12] VC fund managers make direct investment in unlisted MSMEs, with the aim of bringing capital, technical and managerial expertise to raise the enterprise's value and make a profit at the exit (e.g., by selling the enterprise after some years).[30] VC investments are divided into three groups depending on different investment stages: (i) seed (e.g., funding to develop product or service), (ii) start-up (e.g., funding to start mass production and initial marketing) and (iii) later-stage (e.g., funding provided to an operating enterprise).[31]

20. Business angel investment is another form of private equity and a valuable source of funds for MSMEs, especially those that are not yet ripe for VC funding. Business angel investors[32] are usually actively involved in business management, and can offer business expertise, access to a network and other non-financial benefits to enterprises they invest in (including MSMEs), which enable them to scale up to a stage where VC fund managers may step in.[33] There are difficulties in measuring the size of business angel investments because such investors often stay anonymous and rarely disclose the details of their investments.[34]

21. The underdevelopment of private equity markets constitutes the main challenge for MSMEs to access credit in many countries. For instance, in Africa, about half of respondents to an industry survey cited the limited number of established private equity fund managers as a deterrent to investment.[35] Secondly, while private equity could potentially narrow the financing gap for MSMEs, it is not suitable for all. VC fund managers are often interested only in a small group of MSMEs with (at least) a rapidly scalable business model.[36] Business angel investors typically invest in early-stage, innovative MSMEs.[37] Thirdly, European fund managers identified the exit environment, fundraising, high investee company valuations and the number of high quality entrepreneurs to be the biggest challenges in the VC business.[38] Fourthly, the lack of an enabling regulatory framework, training and industry data also discourages VC investments (possibly also business angel investments) in developing countries.[39]

22. It is worth mentioning that there also exist informal sources of equity financing from family and friends, who often invest in start-up MSMEs because they are part of the entrepreneur's close social network. They do not have the same approach as professional investors in terms of risk assessment.[40] For start-up MSMEs in the United States of America, for example, the amount of funds raised through informal sources generally exceeded other private equity sources (e.g., VC and business angel

[29] While the amount invested in emerging markets almost doubled between 2015 and 2018 to reach $70 billion, it still represents only a fifth of investment made in the United States alone (i.e., $375 billion), and is mainly directed to a few large economies, such as Brazil, China, India and South Africa. The amount of private equity investments in portfolio companies based in Europe was €80.6 billion in 2018. See Inter-agency Task Force, Financing for Sustainable Development (see footnote 14), p. 67; European Investment Fund, European Small Business Finance Outlook, (2019), p. iv.

[30] Inter-agency Task Force, Financing for Sustainable Development(see footnote 14), p. 67.

[31] EIF, European Small Business (see footnote 29), p. 25.

[32] Business angel investors tend to be wealthy individuals, or groups of them, who provide financing, typically their own funds, in exchange for ownership equity (sometimes also convertible debt). Generally, the term "investors" refers to persons or entities who commit capital with the expectation of receiving financial returns.

[33] OECD, Financing SMEs (see footnote 11), p. 43.

[34] EIF, European Small Business (see footnote 29), p. 32.

[35] Inter-agency Task Force, Financing for Sustainable Development (see footnote 14), p. 67.

[36] ITC, SME Competitiveness Outlook 2019 (see footnote 15), p. 25.

[37] OECD, Financing SMEs (see footnote 11), p. 43.

[38] EIF, EIF VC Survey 2019 – Fund managers' market sentiment and policy recommendations, (2019), p. iv.

[39] ITC, SME Competitiveness Outlook 2019 (see footnote 15), p. 27.

[40] Ibid., p. 24.

investments).[41] According to a survey of the European Central Bank (ECB), 18 per cent of European SMEs surveyed between April and September 2019 identified funds from family, friends or related companies as relevant sources of financing for them.[42] As VC and business angel networks in developing countries are less developed, it is likely that MSMEs in those countries rely more on family and friends.[43] However, such informal sources are rarely a guaranteed source for all types of businesses and MSMEs do not seem to face any particular challenge different from large firms.

2. Traditional lending

23. Traditional lending refers to the extension of credit primarily based on the overall creditworthiness of enterprises, and financers usually consider their expected future cash flow as the main source of repayment.[44] According to OECD, the demand from SMEs for bank credit in the form of traditional lending varied significantly from country to country in 2018, even in the same geographical region.[45] The share of outstanding SME loans to total business loans also varied materially across countries.[46]

24. Specific challenges that limit traditional lending to MSMEs in some countries largely relate to the difficulties that financers encounter in assessing and monitoring MSMEs relative to large enterprises. Firstly, information asymmetry due to the lack of supporting financial information infrastructure limits financers' ability to lend.[47] MSMEs often lack the expertise and skills needed to produce adequate financial statements. As a result, financers only have access to limited documentation on activities and financial status of MSMEs, and are likely to incur high due diligence costs relative to the size of the loan.[48]

25. Secondly, in order to mitigate credit risk, financers often impose strict collateral and guarantee requirements on MSMEs. As cited by one IFC report, data from the World Bank Enterprise Surveys showed that nearly 79 per cent of loans or lines of credit required collateral and this figure was similarly high in most regions of the world.[49] Whereas movable assets (e.g., machinery, equipment or receivables) may account for most of MSMEs' capital stock, financers are often reluctant to accept them as collateral due to non-existent or outdated secured transactions laws and collateral registries.[50] For MSMEs, credit guarantees may be difficult to obtain in countries where a network of local or sectoral guarantee institutions for MSMEs is not well established.[51]

26. Last but not least, a lack of competition among financers reduces access to credit for MSMEs.[52] In many developing countries with less competitive banking sectors, banks are more likely to charge higher service fees and have fewer incentives to service MSMEs.[53] Notably, the establishment of digital challenger banks in several

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[41] Ibid., p. 21.

[42] European Central Bank, Survey on the Access to Finance of Enterprises in the euro area: April to September 2019, (2019), p. 18.

[43] ITC, SME Competitiveness Outlook 2019 (see footnote 15), p. 21.

[44] OECD, New Approaches (see footnote 20), para. 51.

[45] In 2018, for example, Chinese SMEs were far more likely to apply for credit (58.36 per cent) than SMEs in Indonesia (3.35 per cent). See OECD, Financing SMEs (see footnote 11), p. 33.

[46] In 2018, the share of outstanding SME loans to total business loans varied significantly across countries, which ranged from around 20 per cent or less in Canada, Chile, France, Indonesia, Peru, the Russian Federation and the United States, to levels of more than 70 per cent in the Republic of Korea, Latvia, Portugal and Switzerland. See OECD, Financing SMEs (see footnote 11), p. 26.

[47] World Economic Forum, The Future of FinTech: A Paradigm Shift in Small Business Finance, (2015), p. 9.

[48] Inter-agency Task Force, Financing for Sustainable Development (see footnote 14), p. 64.

[49] IFC, MSME Finance Gap (supra note 10), p. 44.

[50] Ibid.

[51] EIF, European Small Business (see footnote 29), p. 62.

[52] IMF, Financial Inclusion (see footnote 17), p. 13.

[53] Inter-agency Task Force, Financing for Sustainable Development (see footnote 14), p. 64.

countries (e.g., the United Kingdom of Great Britain and Northern Ireland, Germany, China and Brazil) attracts more MSMEs by charging transparent and low fees, providing faster services, and enhancing user experience through their digital interfaces.[54] Nevertheless, interest rates still remain high for MSMEs compared with larger enterprises.[55]

27. Women entrepreneurs may face more difficulties in accessing credit in the form of traditional lending due to legal, institutional and socio-cultural factors. Internationally collected data revealed that women were less likely than men to have formal bank accounts. Restrictions on opening or using a bank account, for example the requirement for a male family member's permission or authorization, limit women's access to bank accounts. Moreover, partly due to lack of financial education, women often lack access to other financial services, such as savings, digital payment methods, and insurance.[56] Because of such constraints, the finance gap for women entrepreneurs in emerging markets was estimated to be $1.5 trillion.[57]

3. Microfinance credit and family/friend support for micro-businesses

28. Micro-businesses often rely on microfinance credit and/or family and friends support for starting or expanding their business,[58] which are discussed in detail below.

Microfinance credit

29. Compared to banks, microfinance institutions (MFIs) do not always charge lower interest rates, but they are less demanding in terms of collateral and guarantee requirements and offer more personal, tailor-made and simple financial products.[59] Microenterprise loans are often the first product that MFIs offer to clients.[60] Microfinance has made a major contribution to improve micro-businesses' access to credit particularly for businesses run by women, as it was estimated that 8 out of every 10 microfinance clients are women entrepreneurs.[61]

30. According to the Microfinance Information Exchange (MIX), the gross loan portfolio for micro-businesses in 2017 (i.e., 762 financial service providers operating in the microfinance sector of 103 developing markets) was around $34 billion.[62] Importantly, the MIX data differentiated the financial needs of micro-businesses and personal needs of owners of such businesses. The gross loan portfolio for household financing[63] constituted a separate category, amounting to roughly $29 billion.[64] In

[54] OECD, Financing SMEs (see footnote 11), p. 50, box 1.2.

[55] In 2018, for instance, SME interest rates in a number of middle-income countries (e.g., Peru, Brazil, Colombia, Mexico and Ukraine) were near 17 per cent, and even in high-income countries (e.g., Chile and New Zealand) the SME interest rates were close to 10 per cent. See OECD, Financing SMEs (see footnote 11), pp. 28–29.

[56] See World Bank, "Expanding Women's Access to Financial Services", website, available at https://www.worldbank.org/en/results/2013/04/01/banking-on-women-extending-womens-access-to-financial-services.

[57] IFC and Goldman Sachs, IFC & Goldman Sachs 10,000 Women: Investing in Women's Business Growth, (2019), p. 4.

[58] International Labour Office, Making Microfinance Work: Managing Product Diversification, (2011), p. 112.

[59] EIF, European Small Business (see footnote 29), p. vi.

[60] Other products MFIs may offer to micro-businesses include savings, micropensions, microinsurance, emergency loans, leasing and grants. See ILO, Making Microfinance Work (see footnote 58), p. 112.

[61] WBG, Secured Transactions, Collateral Registries and Movable Asset-Based Financing, (2019), p. 23.

[62] Microfinance Information Exchange, Global Outreach & Financial Performance Benchmark Report – 2017–2018, (2019), p. 36.

[63] Household financing is defined as loans that finance household purchases not related to an individual's or household's business.

[64] MIX, Global Outreach (see footnote 62), pp. 36 and 38.

Europe, the latest market survey data showed that total microenterprise loan portfolio outstanding in 2017 reached €3.1 billion reported from 136 MFIs.[65]

31. Several challenges faced by micro-businesses seeking affordable financing have previously been identified when exploring legal and regulatory issues surrounding microfinance, which included: (i) the non-transparent manner in which most microfinance products are priced; (ii) the extent and impact of government intervention, in particular in setting limits on the interest rate chargeable on microfinance loans; (iii) the increased use of collateral, resulting in abusive collection practices by some MFIs; (iv) the need for measures to ensure client protection, including the prevention of unscrupulous practices and the building of financial literacy in the community generally; and (v) lack of regulation on the wide range of institutions that provide microfinance services.[66]

32. In addition, the strict payment structures of some microenterprise loans may also prevent micro-businesses from using them for the higher-risk and longer-term investments that are essential for growth. Furthermore, while digitalization of microfinance operations proves to be efficient, MFIs are only partially digitalized and poor micro-businesses often have no access to digital payments.[67] For instance, the *Consultative Group to Assist the Poor (CGAP) National Surveys of Smallholder Households (2018)* revealed that mobile money was the most important formal financial tool but few smallholder households owned smart phones.[68]

Family and friends support

33. Other than microfinance credit, micro-businesses often rely on family and friends for initial capital, especially when access to capital market is not an option.[69] Based on the CGAP survey cited above, it is common for smallholder households to lend money to and borrow money from family and friends.[70] According to the World Bank, in a survey of women businesses in the Middle East and North Africa, most women entrepreneurs did not have access to formal credit and financed their business mainly through loans from family and friends as well as own savings.[71]

34. As discussed in paragraph 22 above, family and friends support also constitutes an informal source of equity financing for MSMEs (in particular micro-businesses during their early stage of development). There is in fact very little difference between such support in the form of debt and that in the form of equity. For debt, quite often the terms of the loan are verbalized and not written down, which makes borrowing a delicate situation for micro-businesses. Oral agreements often lack clarity on the terms and conditions of the loan, repayment schedules and remedies for defaults. Also, borrowing from family and friends is rarely a guaranteed source of financing for all types of businesses and MSMEs do not seem to face any particular challenge different from large firms.

4. Crowdfunding

35. Crowdfunding (i.e., a technique to raise external finance from a large audience, rat than a small group of specialized investors, where each individual provides a small amount of the funding requested) has gained popularity among enterprises (including MSMEs) in many countries. It comprises different kinds of activities, broadly organized in three categories (debt-based, equity-based and non-investment).[72] Over

[65] EIF, European Small Business (see footnote 29), p. 98.
[66] A/CN.9/727, paras. 29–52; A/CN.9/780, para. 37.
[67] EIF, European Small Business (see footnote 29), p. vi.
[68] This survey studied the financial lives of smallholder households throughout Mozambique, Uganda, Tanzania, Côte d'Ivoire, Nigeria, and Bangladesh. See Consultative Group to Assist the Poor, Executive Summary – CGAP National Surveys of Smallholder Households, (2018).
[69] Inter-agency Task Force, Financing for Sustainable Development (see footnote 14), p. 67; UNESCAP, Small and Medium Enterprises Financing, (2017), p. 3.
[70] CGAP, CGAP National Surveys (see footnote 68), p. 15.
[71] WBG, Secured Transactions (see footnote 61), p. 23.
[72] Non-investment category includes reward-based crowdfunding, whereby backers provide funding

time, crowdfunding is increasingly managed by online platforms, which typically allow applications to be completed within a few hours and do not involve any visit to physical bank branches.[73] Debt-based activities in 2018 accounted for a very significant portion (96.4 per cent) of online crowdfunding volumes globally.[74]

36. ITC statistics suggested that crowdfunding has grown rapidly (from $1 billion in 2011 to $34 billion in 2015), notably in Asia and Africa.[75] Although the crowdfunding market in the developing countries was estimated to total $96 billion a year by 2025,[76] online debt-based crowdfunding activities continued to be strongly concentrated in a few countries. Despite a sharp decline in 2018, China still has the largest market by far, representing 62.5 per cent of global volumes, followed by the United States (20.5 per cent) and the United Kingdom (7.5 per cent).[77]

37. By design and due to regulatory limitations, crowdfunding is suitable for start-ups that require relatively small amounts of funding. It may be less suitable for MSMEs that are based on complex innovations in very high-tech and cutting-edge areas, which require specific knowledge on the side of investors. Secondly, it can be very costly to convince people to participate in crowdfunding, especially through cutting-edge communications and outreach involving pitches and social media.[78] Indeed, according to ITC, roughly two out of three crowdfunding campaigns failed to raise the target investment.[79] Thirdly, institutional investors are unlikely to use online platforms and may still prefer in-person meetings for the extensive information exchange necessary for them to feel comfortable providing large amounts of credit.[80]

38. In many developing countries, MSMEs face more obstacles in raising funds through crowdfunding due to interrupted access to electricity and the Internet. The need to make online payments presents another challenge in countries with underdeveloped formal financial sectors. In Africa and the Caribbean, for example, a significant part of the population does not have a credit card, bank account or access to electronic transfers, making participation in online platforms impossible.[81] Moreover, concerns about protecting contributors from fraud and lack of a specific legal and regulatory framework for crowdfunding do not help improve the business environment for crowdfunding.[82] Enabling legislation which protects contributors and facilitates crowdfunding is crucial for MSMEs to attract funds through crowdfunding. Notably, several domestic markets (e.g., China and the Republic of Korea) shrank significantly due to concerns about dubious or outright fraudulent behaviour and insufficient guarantees in terms of capital requirements and loss provisions for investors.[83]

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to individuals, projects or companies in exchange for non-monetary rewards or products, and donation-based crowdfunding, whereby donors provide funding to individuals, projects or companies based on philanthropic or civic motivations with no expectation of monetary or material return. See ITC, SME Competitiveness Outlook 2019 (see note 15), p. 72.

[73] WEF, The Future of FinTech (see footnote 47), p. 13.

[74] OECD, Financing SMEs (see footnote 11), p. 45.

[75] ITC, SME Competitiveness Outlook 2019 (see footnote 15), pp. 72–73.

[76] See Information for Development Program and World Bank, Crowdfunding's Potential for the Developing World, (2013).

[77] Notably, the share of volumes in continental Europe remained relatively modest, with France the most active market (with a global share of 0.6 per cent), followed by Italy (0.6 per cent) and the Netherlands (0.5 per cent). Latin America accounted for a small share of global online alternative finance volumes: Peru (0.4 per cent) and Chile (0.2 per cent). See OECD, Financing SMEs (see footnote 11), p. 47.

[78] WBG, Crowdfunding in Emerging Markets: Lessons from East African Startups, (2015), p. 3.

[79] ITC, SME Competitiveness Outlook 2019 (see footnote 15), p. 78.

[80] Ibid.

[81] WBG, Crowdfunding in Emerging Markets (see footnote 78), p. 8.

[82] Information for Development Program and World Bank, Crowdfunding's Potential (see footnote 76); UNDP, "Crowdfunding.", website, available at https://www.sdfinance.undp.org/content/sdfinance/en/home/solutions/template-fiche12.html#mst-4.

[83] In 2016, the Chinese Banking Regulatory Commission found that about 40 per cent of existing online platforms were fraudulent, and authorities began to tighten regulations. Only 427 P2P platforms were still operating as of October 2019, against 6000 in 2015. The market in the

5. Asset-based finance, alternative debt and hybrid instruments

39. In recent years, an increasing range of financing options (asset-based finance, alternative debt and hybrid instruments) has become available to MSMEs, although some of these are still at an early stage of development or, in their current form, only accessible to a small portion of MSMEs.[84] Their limited use is due to a combination of demand-side and supply-side barriers, which are elaborated below.

Asset-based finance

40. Asset-based finance comprises all forms of finance that are based on the value of specific assets, rather than the creditworthiness or debt capacity of enterprises, including leasing, factoring and warehouse receipts.[85] The key advantage of asset-based finance is that MSMEs can access cash faster and under more flexible terms than they could have obtained from traditional lending, regardless of their balance sheet position and future cash flow prospects.[86]

41. Leasing is a common mechanism to finance use and purchase of equipment, motor vehicles and real estate in many countries. It allows the owner of an asset (lessor) to provide a customer (lessee) with the right to use the asset for a specified period of time, in exchange for a series of payments.[87] The lessor evaluates on the value of an underlying asset and on the ability of the lessee to generate sufficient cash flow from business operations to meet regular payments, rather than its overall creditworthiness.[88] Hire purchase is a special form of leasing with a well-defined purchase option for the lessee.

42. Factoring, as explained in the *UNCITRAL Legislative Guide on Secured Transactions*, is a form of receivables financing which involves the outright sale or assignment of receivables by the grantor as seller (commonly called the assignor) to the factor (commonly called the assignee).[89] The factor does not evaluate the financial statements, fixed collateralizable assets or credit history of the grantor, but primarily focuses on the creditworthiness of the grantor's customers and the validity of invoices.[90] The practice is commonly known as "reverse factoring" when the factor purchases accounts receivables only from selected customers of the grantor.[91] Given that MSME grantors may have more creditworthy enterprises as customers (who are liable for the invoices), the factor can issue credit at better terms than it would grant if the riskier MSMEs were the direct borrower.[92] In recent years, fintech companies engaging in activities that use technologies to support financial transactions have developed accounting software for factoring, which allow applications to be processed online automatically and payment be made instantly.[93]

Republic of Korea, another relatively developed market, also plummeted by 77 per cent in 2018. See OECD, Financing SMEs (see footnote 11), pp. 46–47.

[84] OECD, Enhancing SME access to diversified financing instruments, (2018), pp. 10–11.

[85] Warehouse receipt financing is less widely used compared with leasing and factoring. It allows producers (exporters) and global traders (importers) of agricultural commodities or other assets to access loans using warehouse receipts issued against assets deposited in warehouses as collateral. See A/CN.9/1014 for more details on UNCITRAL's work on this topic.

[86] OECD, New Approaches (see footnote 20), para. 69.

[87] International Financial Reporting Standards (IFRS) for Leasing (IAS 17).

[88] OECD, New Approaches (see footnote 20), para. 126.

[89] UNCITRAL Legislative Guide on Secured Transactions, para. 31.

[90] There are a number of different types of factoring arrangement. The factor (assignee) may pay a portion of the purchase price for the receivables at the time of the purchase (discount factoring), it may pay only when the receivables are collected (collection factoring), or it may pay on the average maturity date of all of the receivables (maturity factoring). UNCITRAL Legislative Guide on Secured Transactions, para. 32; See also OECD, New Approaches (see footnote 20), para. 97.

[91] Ibid., para. 91.

[92] IFC, MSME Finance Gap (see footnote 10), p. 45.

[93] WEF, The Future of FinTech (see footnote 47), p. 20. For a definition of "Fintech" see A/CN.9/WG.I/WP.119, para. 55.

43. Based on ECB's survey, 45 per cent of European SMEs surveyed between April and September 2019 indicated that leasing was a relevant source of financing, and only 9 per cent of those SMEs used factoring.[94] In other regions, based on available data, SMEs' leasing activities increased considerably in Colombia, Kazakhstan and the Russian Federation.[95] While factoring volumes showed a strong decline in Canada and Turkey, the figures nearly doubled in the Republic of Korea.[96]

44. One challenge faced by MSMEs when accessing asset-based finance relates to the costs incurred and the complexity of procedures (e.g., asset appraisal, auditing, monitoring and up-front legal costs), which may be substantially higher that those associated with traditional lending, thereby reducing MSMEs' levels of profits.[97] In addition, funding limits for asset-based finance are often lower than traditional lending.[98] More specifically, leasing companies are typically non-deposit taking institutions for which the cost of raising funds may be higher, as they need to source funding from more volatile and expensive markets.[99] A weak information infrastructure also discourages the use of factoring as it imposes excessive burdens on factors to collect information and conduct credit risk assessment.[100] In some jurisdictions, tax reasons further constrain the development of factoring.[101]

Alternative debt

45. Alternative debt differs from traditional lending in terms of financer profile. Alternative debt includes "direct" tools for raising funds from investors in the capital market, such as corporate bonds (including private placement), and "indirect" tools, such as securitized debt and covered bonds.[102]

46. Corporate bonds are debt obligations issued by private and public enterprises, including MSMEs. By issuing corporate bonds, the enterprise makes a legal commitment to pay interest on the principal, independent of their performance, and to repay the principal when the bond matures. The issuer may have the option to buy back the bond before the maturity date.[103] Corporate bonds can be either secured over specific assets or unsecured, and the credit quality of such bonds is often determined by credit rating agencies.[104] In most jurisdictions, enterprises (including MSMEs) that intend to issue corporate bonds must file a prospectus with the relevant authority (describing the financial conditions of the enterprise, the terms of the bond, the risks of investing, and how the enterprise plans to use the bond sale proceeds).

47. In some countries, the regulatory frameworks also allow private placements of corporate bonds, i.e. the offer of bonds to only a few selected investors by unlisted enterprises (including MSMEs). Private placements are subject to less stringent reporting requirements and do not need a formal credit rating. It is particularly relevant for larger and more mature SMEs facing a major transition, such as a change in ownership, expansion into new markets and activities, or acquisitions.[105] Although the private placement market is well developed in the United States and Europe, it remains relatively underdeveloped in other regions of the world.[106]

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[94] ECB, Survey on the Access to Finance (see footnote 42), p. 18.
[95] OECD, Financing SMEs (see footnote 11), p. 38.
[96] Ibid., p. 39.
[97] OECD, New Approaches (see note 20), para. 70.
[98] Ibid.
[99] Ibid., para. 140.
[100] Ibid., para. 105.
[101] Factoring can be at disadvantage with respect to traditional lending if interest on factoring is not deductible in the same way as interest payments to banks. VAT taxes may be applied on the entire transaction, rather than on service fees only, and stamp taxes may be imposed on factored invoices. See ibid., para. 104.
[102] Ibid., para. 175.
[103] Ibid., para. 177.
[104] Ibid., paras. 181–182.
[105] OECD, Financing SMEs (see footnote 11), pp. 42–43.
[106] Ibid.

48. Similar to those challenges faced by MSMEs in accessing public equity finance (discussed in paragraph 17 above), the process of corporate bond issuance may be more burdensome for MSMEs than for large firms due to the fixed costs of due diligence, and the issuance costs may be as high as 10 per cent of the issued amount.[107] Other than costs, the disclosure and reporting requirements set out by relevant authorities also present challenges for many MSMEs that lack the expertise and experience in drafting prospectuses. In addition, the rigidity implied by the fixed schedule of interest and principal repayments may discourage some MSMEs from issuing corporate bonds as such repayment schedule requires a relatively stable cash flow pattern.[108]

49. Securitized debt refers to debt obligations in the context of loan securitization, under which a bank extends loans to its customers (including MSMEs), bundles them in a pool of portfolio, and sells the portfolio to capital market investors through the issuance of notes, by a special purpose vehicle (SPV) backed by the loan portfolio.[109] As explained in the *UNCITRAL Legislative Guide on Secured Transactions*, securitization is intended to lower the cost of financing because the SPV is structured in such a way as to make the risk of its insolvency remote (theoretically not possible) by restricting the amount of debt that the SPV can incur and the activities in which it can engage.[110] This structure may significantly reduce the risk that banks generally take into account when deciding what interest rate to charge for the loan.[111] Securitization also allows the issuing banks to free up space on its balance sheet, increasing their lending capacity.[112]

50. Covered bonds are bonds backed by the cash flows from mortgages or loans (e.g., bank loans to MSMEs), and work similarly to securitized debt except that there is no transfer of the assets pool to a SPV. When covered bonds are secured by the issuing bank's assets (e.g., MSME loans), they are considered to be less risky than unsecured bonds, which implies low-cost funding for the issuing bank and ultimately lower interest rate for MSME loans. In case of default, investors have a double recourse to the issuing bank and the cover pool of assets. For this reason, covered bonds benefit from a more favourable regulatory treatment than securitized debt, and greater liquidity in the market.[113]

51. While securitization can be a cost-effective form of financing when transactions are sufficiently large, carefully structured and properly monitored, it is a complex market that requires significant resources from the investors' side.[114] Long-term institutional investors have the scale and resources available to invest in securitized debt but are faced with regulatory and information availability challenges. For securitization of many small MSME loans to be successful, there should be ample diversification.[115] It should be noted that the current market for SME covered bonds is relatively new and the use of SME loans as an asset class in covered bonds is still not permitted in many countries with an active covered bond market.[116] The United States is the largest securitization market, which reached about $1 trillion in 2019, including SME loans.[117] In Europe, the overall issued SME securitized debt in 2018 was roughly €29.5 billion.[118]

52. Hybrid financing instruments lie in the middle of the investors' risk spectrum, combining features of both debt and equity into a single financing vehicle. Some of

[107] OECD, New Approaches (see footnote 20), para. 191.
[108] Ibid.
[109] Ibid., para. 215.
[110] UNCITRAL Legislative Guide on Secured Transactions, para. 36.
[111] Ibid.
[112] Inter-agency Task Force, Financing for Sustainable Development (see footnote 14), p. 69.
[113] OECD, New Approaches (see footnote 20), para. 222.
[114] UNCITRAL Legislative Guide on Secured Transactions, para. 35.
[115] Inter-agency Task Force, Financing for Sustainable Development (see footnote 14), p. 70.
[116] OECD, New Approaches (see footnote 20), paras. 222 and 230.
[117] Inter-agency Task Force, Financing for Sustainable Development (see footnote 14), p. 70.
[118] EIF, European Small Business (see footnote 29), pp. 72–73.

the most commonly used hybrid instruments include: subordinated debt and convertible debt.[119] Subordinated debt refers to loans or bonds in which the financer agrees that senior or secured creditors will be fully paid before any interest or principal is paid to the financer.[120] Convertible debt is a debt instrument with a maturity date and stated repayment terms, which includes an option to convert the debt into another financial instrument, such as other forms of debt, derivatives or stocks.[121]

53. Hybrid instruments are an appealing form of finance for enterprises (including MSMEs) that are in need of capital. However, the use of hybrid instruments is typically in private markets that are often restricted to professional, institutional or sophisticated investors.[122] Moreover, the use of hybrid instruments also requires a certain level of financial skills on the side of MSME entrepreneurs, who often lack awareness and capabilities to understand and access a wider range of financial options other than traditional lending.[123] The traditional market for hybrid instruments has been larger SMEs with high credit ratings.

6. Supply chain financing

54. As a form of trade finance, supply chain finance refers to the techniques and practices used by banks and other financial institutions to manage the capital invested into the supply chain and reduce risk for the parties involved. Based on a World Trade Organization (WTO) report (2016), it was estimated that half of SMEs' trade finance requests globally were rejected, compared to only 7 per cent for multinational companies.[124] According to International Chamber of Commerce (ICC) (2018), although SMEs accounted for more than 80 per cent of businesses in Africa, on average they represented only 28 per cent of the trade finance portfolios of banks.[125] More recently, one Asian Development Bank (ADB) survey (2019) indicated that SMEs accounted for 37 per cent of trade finance demand based on the proposals received by banks surveyed worldwide (51 per cent for banks in Asia and the Pacific), and the rejection rate of SME proposals was much higher than multinational enterprises.[126]

55. Different from traditional trade finance products (e.g., letters of credit and bank guarantees), supply chain finance is more likely to be used in relation to "open account" trade where the buyer and seller have existing business relationship.[127] In practice, MSMEs are often exporters based in a developing country, supplying to a large buyer. Supply chain finance provides MSME suppliers with a range of options for accessing affordable financing (such as receivables discounting, forfaiting, distributor finance and pre-shipment finance),[128] thereby reducing the time taken to collect payment and thus significantly improving MSME suppliers' cashflow. Notably, reverse factoring (as discussed in paragraph 42 above) is also a key component in supply chain finance as a means for creditworthy buyers to facilitate

[119] OECD, New Approaches (see footnote 20), paras. 285 and 286.
[120] Ibid., para. 287.
[121] Ibid., para. 294.
[122] Ibid., para. 308.
[123] Ibid., para. 310.
[124] WTO, Trade finance and SMEs: Bridging the gaps in provision, (2016), p. 23.
[125] ICC, 2018 Global Trade – Securing Future Growth, (2018), p. 98.
[126] ADB, ADB Briefs No. 113, 2019 Trade Finance Gaps, Growth, and Jobs Survey, (2019), p. 4.
[127] ICC Academy, "Supply Chain Finance: An Introductory Guide", website, available at https://icc.academy/supply-chain-finance-an-introductory-guide.
[128] Receivables discounting refers to the financing technique under which companies discount all or part of their receivables (represented by outstanding invoices) to a financer to provide a one-off cash injection for a particular purpose; Forfaiting refers to the purchase of a future payment obligation without recourse; Distributor finance is generally made available to distributor of a large manufacturer to cover the holding of goods for re-sale and to bridge the liquidity gap until they receive funds following the sale of goods; and pre-shipment finance, also known as purchase order finance, is commonly provided against purchase orders on a transactional basis but can also be made against demand forecasts or underlying commercial contracts.

favourable financing options for their MSME suppliers, by explicitly confirming deliveries and resulting payment obligations to a factor.[129]

56. Although supply chain finance can, in principle, facilitate access to credit for both MSME suppliers and MSME distributors that purchase goods,[130] the share of MSME trade finance remains relatively low worldwide. According to ADB (2019), challenges for SMEs to access trade finance mainly related to (i) lack of additional collateral, (ii) the SME's unsuitability for support, (iii) serious know-your-client concerns, (iv) poorly presented requests for credit with insufficient information, (v) requests were not profitable enough to process, and (vi) requests were not profitable to process due to regulatory capital constraints.[131] In Africa, the low share of SME trade finance was explained partly by the higher risk perception and cost of doing business associated with SME financing.[132]

57. In the agriculture industry, contract farming is a mechanism that coordinates agricultural production and trade and also functions as a credit vehicle as it promotes supply chain financing by facilitating the provision of credit to producers and to contractors, with derived benefits for all participants (including MSMEs) in the chain.[133] A typical feature of contract farming is the provision of working capital by the contractor on advance terms over future delivery, which allows the producer to begin production without facing upfront payments that it otherwise cannot afford.[134] Occasionally, the contractor also uses the agricultural production contract to obtain credit from a bank through, for example, offering the future receivables under the contract as collateral.[135]

58. While contract farming offers a number of advantages for MSMEs' access to credit, it also brings risks for producers and contractors. Following a poor seasonal production and unexpectedly low prices on the market, producers may not be able to repay advances provided by contractors. Such problems may also arise from unfavourable contract clauses drafted by the more powerful party (i.e., contractors), highlighting the possible issues stemming from market fluctuations and power imbalance.[136] Inevitably, producers' inability to repay large advances may also be financially burdensome on contractors.[137] In this context, the *UNIDROIT/FAO/IFAD Legal Guide on Contract Farming* is a good tool for producers and contractors as it provides advice and guidance on the entire relationship, from negotiation to conclusion, including performance and possible breach or termination of the contract.[138] At present, such contract farming financing mechanism does not apply to all industries.

II. Improving access to credit for MSMEs

[*This chapter presents, by way of background, a summary of policy initiatives at global, regional and national levels for improving access to credit for MSMEs. It then approaches the issue of improving access to credit for MSMEs from the perspective of secured lending using movable assets as collateral. While acknowledging the importance of regulatory, institutional and practical measures, this chapter focuses*

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[129] OECD, New Approaches (see footnote 20), para. 92.
[130] IFC, MSME Finance Gap (see footnote 10), p. 48.
[131] ADB, ADB Briefs No. 113 (see footnote 126), p. 5, figure 5.
[132] ICC, 2018 Global Trade (see footnote 125), p. 98.
[133] UNIDROIT, FAO and IFAD, UNIDROIT/FAO/IFAD Legal Guide on Contract Farming, (2015), para. 26.
[134] Working capital can be in the form of inputs (such as seeds and seedlings, fertilizers and other chemicals, and animals and veterinary products) and services (such as land preparation, planting, harvesting or produce transportation). Ibid.
[135] Ibid., para. 27.
[136] Ibid., para. 28.
[137] Ibid.
[138] Ibid., pp. xv–xvii.

on legal measures in the context of secured lending using movable assets as collateral].

A. Policy initiatives for improving access to credit for MSMEs

59. At various levels, from global down to national, and for some time, studies have been conducted and efforts have been made to enhance access to credit for MSMEs. As much of MSME lending principally revolves around banks, credit reporting systems and digitization using fintech appear to be relevant and spreading. Various guarantee schemes, in relation to bank loans and beyond, are also being placed throughout the world. Some governments have sought to enable rapid and easy access to new funding and setting up further financial support, from loan guarantees to direct loans and grants. Many are being encouraged to transition into paperless trading without delay, by removing legal obstacles to the use of electronic documents, including by adopting the *UNCITRAL Model Law on Electronic Transferable Records* (2017).

60. Since access to credit depends on a number of factors, a holistic approach should be considered, with legal reform being only one aspect of promoting access to credit for MSMEs. A summary of some policy initiatives and measures at different levels is provided below to background and, while it is in no way exhaustive, show to a certain extent that those initiatives and measures are widespread. It also shows a degree of commonalities in the approaches that regardless of the variety of challenges and circumstances, permits to identify several best practices.

1. Global level

61. The latest report of the United Nations Secretary-General's Special Advocate for Inclusive Finance for Development (UNSGSA) promotes the use of good regulatory practices for fintech services (defined as technology-enabled innovation in financial services) so that they are inclusive, safe and responsible.[139] In particular, the UNSGSA identifies as worth of consideration: (i) innovation offices that engage with and provide regulatory clarification to financial services providers seeking to offer innovative products and services; (ii) regulatory sandboxes which are formal regulatory programs that allow market participants to test new financial services or business models with live customers and (iii) regulatory technology that assists in better regulating and supervising a rapidly digitizing financial marketplace.[140] These practices can help fintech services to extend the benefits of financial inclusion to a great many.

62. Similarly, the Group of Twenty (G20)[141] advocates that digitization offers an unprecedented opportunity to address eligibility and affordability barriers to formal financial inclusion, in particular by improving identity verification, digital payments and the information environment.[142] To financially include individuals and MSMEs operating in the informal economy into the formal economy, the G20 set out four non-binding policies which include: digital identity on-boarding;[143] digital

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[139] UNSGSA FinTech Working Group and Cambridge Centre for Alternative Finance, Early Lessons on Regulatory Innovations to Enable Inclusive FinTech: Innovation Offices, Regulatory Sandboxes, and RegTech, (2019), p. 9. Since 2009, the UNSGSA has engaged in inclusive finance for development at both global and country levels with the aim to advance universal access to and responsible usage of affordable, effective and safe financial services.

[140] Ibid., pp. 19, 26 and 33.

[141] The G20 has a Subgroup on SME Finance that focuses on improving SME access to finance in the poorest countries, improving access to finance for agricultural SMEs, and promoting access to finance for women entrepreneurs.

[142] Global Partnership for Financial Inclusion, G20 Policy Guide: Digitisation and informality – Harnessing digital financial inclusion for individuals and MSMEs in the informal economy, (2018), p. 9.

[143] Digital identity onboarding refers to the introduction of legal, digital identification systems. Such systems have the potential to broaden access to financial services by increasing the ease with

payment infrastructure; use of alternative data for credit reporting and financial consumer protection;[144] financial literacy and data protection. These policies support the implementation of the G20 High Level Principles for Financial Inclusion which provide the basis for country action plans to leverage digital technologies to achieve financial inclusion.

63. In a 2017 report,[145] the IFC recognized the key role of the public sector in reforming the institutional environment around MSMEs' access to credit and highlighted key market-enabling policies that governments might pursue to close the MSME finance gap. Those policies include: improving competition within the financial system and allowing a variety of financial institutions to operate; establishing directed lending programs and risk-sharing arrangements; and developing solid credit information systems, movable collateral frameworks and registries, and efficient insolvency regimes. The IFC and its sister organization the World Bank (both part of the World Bank Group (WBG))[146] have in place several programs to support States in need of assistance to implement those policies and introduce innovations in MSME finance. The WBG aims to achieve Universal Financial Access by 2020 so that one billion accountholders may use financial services to start and expand their businesses.[147]

2. Regional level

64. Credit bureaus, collateral registries, and credit guarantees for bank loans to SME finance are also the focus of the recommendations of the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) to assist governments in improving the environment for MSMEs' access to credit. UNESCAP also supports the diversification of financing modalities beyond conventional bank lending as an alternative to expand MSMEs' financial access.[148] In this respect, UNESCAP encourages developing holistic policy and regulatory frameworks for non-banking financial institutions that many countries in the region lack. Such introduction would form the basis of a sound competitive environment between banks and non-banking financial institutions, and the resulting financially diverse markets would improve MSMEs' financial access.

65. In the context of a research on financial inclusion of small and medium-sized enterprises in the Middle East and Central Asia, the International Monetary Fund (IMF) encourages development of specific policy and regulatory frameworks for SME financing through greater reliance on capital markets and new technologies. Among others it recommends providing adequate incentives for MSME financing; the availability of credit information and strong legal frameworks (for example, for property rights, contract enforcement, collateralization, and insolvency).[149] In the Middle East and North Africa (MENA), where a demand for Islamic products exists, IFC has proposed a framework for a dedicated Islamic SME banking strategy in order to tailor Islamic banking products to the needs of small businesses. Among others, the framework recommends the use of mobile banking to reduce costs and banking correspondents to ensure last-mile connectivity of banking services. It also suggests

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which individuals can obtain ID, and by streamlining the work of the financial sector in particular in developing countries.

[144] There is no single definition of "alternative data". However, most definitions highlight that these data are "alternative" to conventional methods (e.g. documented credit history) and can be generated by the increasing use of digital tools.

[145] IFC, MSME Finance Gap (see footnote 10).

[146] The World Bank Group provides support for SME finance such as, implementation support of development of credit guarantee schemes, improving credit infrastructure (credit reporting systems, secured transactions and collateral registries, and insolvency regimes), and introducing innovation in SME finance.

[147] World Bank, "UFA2020 Overview: Universal Financial Access by 2020", website, available at https://www.worldbank.org/en/topic/financialinclusion/brief/achieving-universal-financial-access-by-2020.

[148] UNESCAP, Small and Medium Enterprises Financing (see footnote 69), pp. 8–9 and 16.

[149] IMF, Financial Inclusion (see footnote 17), p. vi.

that Islamic banks should streamline their transaction execution processes to make the execution of transactions easier for SMEs.[150] In addition, governments and regulatory authorities need to incentivize lending and other banking services to the SME sector as well as to strengthen the legal environment in order to safeguard the SME assets of the Islamic banks.

66. In the Latin America and Caribbean (LAC) region, the United Nations Economic Commission for Latin America and the Caribbean (UNECLAC) in recent years carried out a project to identify and promote the development of a wide set of financial instruments that enabled development banks to foster financial inclusion of SMEs.[151] In UNECLAC's view, development banks have a role to play in promoting innovation in financial processes as they can better evaluate SMEs' payment capacity, help reduce information asymmetries and facilitate monitoring.[152] In addition, there is an institutional dimension that must be considered since development banks in the LAC region have different models and can be the object of coordination at a national level and of complementarity with private banks, all of this in the context of regulatory frameworks that favour innovation. More recently, a study published under the aegis of UNECLAC has recommended to address reform of the collateral lending system and properly institute guarantee schemes in the Caribbean subregion.[153]

3. National level

67. In recent years, several countries have developed legal and regulatory strategies to promote access to credit for MSMEs. They involve various levels of actions and types of initiatives aimed both at lowering the cost of credit but also at otherwise facilitating access. The following paragraphs provide a few examples.

68. Bangladesh launched its first comprehensive SME policy in 2019 through concerted efforts in high-level upstream work, enhancement of the regulator's capacity, and formulation of key recommendations with a sharper gender lens. The policy requires three factors for SME development, namely, supportive policies and conducive environment, sustainable and effective institutions, and access to financial and business related services of destitute and underprivileged.[154] Strategic tools to be used will include: increasing the amount of credit flow to the SME sector; introducing an "SME Bank" in the country; strengthening the existing refinancing scheme to provide SME loan at a reduced interest rate to SMEs; ensuring easy access to credit and lowing the interest rate for SMEs by strengthening the Credit Wholesaling program and launching the SME Credit Guarantee Fund.

69. China, since its law on promotion of SMEs came into force in 2003, has developed funds to support SMEs. In addition to the Special Funds for SME Development that support financing guarantees, National Financing Guarantee Fund with a registered capital of around $9 billion was established in 2018 to support national financing guarantee system, an essential part for facilitating SME financing.[155] As the Chinese government encourages financial institutions to expand SME credit and use new technologies to innovate SME financial service, SME loans in total is estimated to exceed $4.3 billion and the application of fintech is also expanding.[156]

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[150] IFC, Islamic Banking Opportunities Across Small and Medium Enterprises in MENA, (2017), pp. 7, 46 and 51.

151 The UNECLAC Project for promoting financial inclusion of SMEs focused on the experience of Argentina, Brazil, Colombia, Costa Rica, Ecuador, Mexico and Peru, with the goal to identify best practices that allowed the formulation of policy recommendations for strengthening the role of development banks.

[152] UNECLAC, "Background", website, available at https://www.cepal.org/en/inclusion-financiera-pymes/background.

[153] UNECLAC, A preliminary review of policy responses to enhance SME access to trade financing in the Caribbean, (2020), p. 35.

[154] Ministry of Industries of the People's Republic of Bangladesh, SME Policy 2019, p. 5.

[155] OECD, Financing SMEs (see footnote 11), p. 168.

[156] Mintai Institute of Finance and Banking, China MSME Finance Report 2018 (Compact Edition),

70. India in 2005 initiated the creation of the SME Rating Agency of India (SMERA), the first of its kind in the world, to provide comprehensive ratings for the use of financial institutions in the assessment of credit,[157] and it has completed more than 50,000 ratings of SMEs since.[158] SMERA recently launched a fintech platform that facilitates credit flow to MSMEs by providing enterprise level information. Small Industries Development Bank of India (SIDBI), a financial institution for developing and financing MSMEs, in 2017 launched a digital MSME lending aggregator and matchmaking platform, and in 2018 a contactless lending platform built on the learning from it. The contactless lending platform has sanctioned about 130,000 loans, worth $2 billion, and reduced turnaround time and credit cost, leveraging fintech solutions and data analytics tools.[159]

71. In 2016, the Kingdom of Saudi Arabia (KSA) presented its vision for 2030. To increase SME contribution to GDP to 35 per cent, the KSA seeks to provide business-friendly regulations and easier access to funding, and aims to see its financial institutions allocate up to 20 per cent of overall funding to SMEs by 2030. Specifically, one programme is committed to increasing by 2020 the share of SME financing at banks to 5 per cent and that of non-cash transactions to 28 per cent. The SME Authority has been established to review laws and regulations and facilitate access to funding.

B. Improving access to credit through secured lending

[This section discusses secured transactions using movable assets as collateral, and how they could improve access to credit for MSMEs. It elaborates on (i) the types of movable assets that can be used as collateral, (ii) the features of a security rights registry that facilitate transactions using movable assets as collateral, and (iii) issues specific to micro-businesses, drawing, as appropriate, on relevant provisions of the UNCITRAL Model Law on Secured Transactions[160] *and guidance provided in the accompanying texts.].*

1. Moveable assets as collateral

(a) Types of assets

72. Many MSMEs rarely own any land or other types of real estate property. This means that movable assets are the main types of asset that they can offer as collateral. Some legal systems allow businesses to grant a security right in movable assets only to a limited extent or only in a very restrictive way. Even where a legal system allows movable assets to be used as collateral, the rules are often complex or unclear.

73. Therefore, it would greatly assist MSMEs if there exists a legal framework that makes it possible and easy to use movable assets as collateral. This would likely reduce the cost of credit and make it possible for MSMEs to obtain credit for longer periods. Readily available credit at a reasonable cost helps MSMEs grow and prosper. In that sense, the Model Law provides a sound basis for reforms to provide a legal framework for secured transactions involving all types of movable assets.

74. As noted, it should be simple for MSMEs to grant a security right in their movable assets. Under the Model Law, it is easy to grant a security right; the parties only need to enter into a security agreement that satisfies certain limited requirements. More importantly, the Model Law also allows a person to grant a security right in an asset without having to give possession of the asset to the secured creditor.

(2018), p. 9.

[157] IFC, SME Finance Policy Guide, (2011), p. 35.

[158] Acuité Ratings & Research, "WHO WE ARE", website, available at https://www.acuite.in/who-we-are.htm.

[159] World Bank, Implementation Completion and Results Report No ICR00004943, (2019), pp. 17–18.

[160] A/RES/71/136.

75. The legal framework governing secured transactions should also be comprehensive. It should be possible for an MSME (acting as "grantor") to grant a security right in almost any type of movable asset, including inventory, equipment, receivables, bank accounts and intellectual property; an asset that it may acquire in the future; and all of its movable assets, both present and future. In order to simplify the creation of a security right in all assets of an MSME, where the financer is financing the on-going operation of the MSME, single-document and all-asset security agreements should be permitted.[161]

76. MSMEs might not have "current" assets and may need to rely on assets that they will acquire at a later stage (e.g., future receivables) or will acquire using the financing provided. Therefore, provisions in the Model Law concerning future assets (i.e., assets with respect to which the grantor expects to acquire rights or the power to encumber in the future) are particularly relevant for MSMEs. Notably, for future assets, the security right is created if and when the grantor acquires such rights or power to encumber.[162] The creation of a security right over future moveable assets, however, should not override statutory limitations on the creation or enforcement of a security right in specific types of movable asset (e.g., employment benefits in general or up to a specific amount), which should be described in the law in a clear and specific way.[163]

77. In practice, MSMEs may agree with financers that the asset will be only partially encumbered (e.g., only to the extent of an undivided 50 per cent interest) or that the asset will be encumbered only for a limited amount (e.g., only to the value it had at the time the security right was granted).[164] In the absence of such agreement, however, the security right should encumber the entirety of the asset, the entirety of the MSME's rights as grantor in the asset and the entirety of the value of the asset at the time that it becomes necessary to enforce the security right.[165]

(b) Security rights registries

78. Under the Model Law, there is no need for the secured creditor to possess the assets in order to obtain a security right. Instead, it can simply register a notice in the registry to make its security right effective against third parties and the existence of a registry system facilitates such non-possessory transactions. In many jurisdictions, this is done through establishing a general security rights registry. The registration process, which is usually conducted by the secured creditor, should be cheap as any related costs could have a negative impact on the cost of financing.

79. Under article 18 of the Model Law, a security right in an encumbered asset can be made effective against third parties by registering a notice with respect to the security right in the security rights registry.[166] Based on article 29 of the Model Law, the time of registration, as a general rule, constitutes the basis for determining the order of priority between a security right and the right of a competing claimant.[167] This mechanism provides financers with certainty about their rights in secured transactions, which allows them to be more willing to lend to MSMEs.

80. As regards the features of a security rights registry, it is worth mentioning a number of features that would facilitate secured transactions and makes it easier for MSMEs to gain access to credit. Firstly, the legal and operational guidelines governing registry services, including registration and searching, should be simple, clear and certain from the perspective of all potential users.[168] Secondly, registry services, including registration and searching, should be designed to be as fast and

[161] UNCITRAL Legislative Guide on Secured Transactions, p. 81.
[162] Ibid., p. 79.
[163] UNCITRAL Model Law on Secured Transactions: Guide to Enactment, para. 93.
[164] UNCITRAL Legislative Guide on Secured Transactions, p. 77.
[165] Ibid.
[166] UNCITRAL Model Law on Secured Transactions: Guide to Enactment, para. 143.
[167] Ibid.
[168] UNCITRAL Guide on the Implementation of a Security Rights Registry, para. 10.

inexpensive as possible, while also ensuring the security and searchability of the information in the registry record.[169] Thirdly, a notice registration system (rather than a document registration system) should be adopted which does not require the underlying documentation to be registered or even tendered for scrutiny by registry staff,[170] thereby reducing transaction costs for registrants as they do not need to submit evidence of their off-record security agreement in order to register.[171]

81. More specifically, a security rights registry should be electronic permitting information in registered notices to be stored in electronic form in a single database, so as to ensure that the registry record is centralized and consolidated.[172] Furthermore, access to registry services should also be electronic permitting users to submit notices and search requests directly over the Internet or via networking systems.[173] Importantly, electronic access to registry services helps to eliminate the risk of registry staff error in entering the information into the registry record, facilitates speedier and more efficient access to registry services by users, and greatly reduces the operational costs of the registry which leads to lower fees for registry users.[174]

(c) Issues specific to micro-businesses

82. Despite the obvious advantages that MSMEs may benefit from the existence of a legal framework based on the Model Law, this by itself may not remove all the obstacles MSMEs may face in obtaining access to credit, in particular those faced by micro-businesses as listed below.

Lack of collateral

83. Micro-businesses face financing constraints as banks and other financial institutions are usually reluctant to extend uncollateralized credit to them, even at high interest rates, in part because of the high costs of obtaining and assessing adequate information on the true credit quality of micro-businesses. Many of them do not have the necessary amount and type of assets that could serve as collateral. Consumer goods are often not accepted as effective collateral given that they generally have low value and depreciate too quickly.

84. Unlike banks and other financial institutions, individual microlenders sometimes may accept jewellery, productive assets from the business, and even household furniture and appliances as collateral.[175] From the perspective of microlenders, these forms of non-traditional collateral serve primarily to demonstrate the micro-business's commitment, rather than a secondary repayment source.[176]

85. Collateral requirements are quite high worldwide for borrowers (including micro-businesses). In Asia and the Pacific, financial regulations in many developing countries require collateral to be at least 125 per cent of loan value.[177] In other countries, collateral requirements are even higher and can be as high as 250 per cent of loan value.[178] According to one ADB survey (2019), lack of collateral was cited as the top challenge for SMEs to access trade finance.[179] Compared with SMEs, micro-businesses are likely to have even less assets that could serve as collateral.

86. While high collateral requirements and collateral shortage constrain micro-businesses in accessing to credit, in certain jurisdictions this is an issue particularly for women entrepreneurs as any asset/property is often owned or

[169] Ibid.
[170] Ibid., para. 57.
[171] Ibid., para. 59.
[172] UNCITRAL Model Law on Secured Transactions: Guide to Enactment, para. 145.
[173] Ibid., para. 146.
[174] Ibid.
[175] ILO, Making Microfinance Work (see footnote 58), p. 120.
[176] Ibid.
[177] ADB, Thematic Evaluation: ADB Support for SMEs, (2017), p. 3, footnote 12.
[178] IMF, Financial Inclusion (see footnote 17), p. 16.
[179] ADB, ADB Briefs No. 113 (see footnote 126), p. 5, figure 5.

registered in the spouse's name. In certain States, for example, unequal inheritance rights and work restrictions limit women's access to collateral.[180] In the Middle East and North Africa region, female entrepreneurship rates are the lowest worldwide, partly due to women's limited rights to family capital for collateral and the associated difficulties in accessing credit.[181] In some States of that region , women do not have the right to administer marital property, including property that they brought into the marriage and property acquired during the marriage.[182]

Asset valuation

87. Lending based on movable assets require their valuation, and valuation rules are generally quite complex. In practice, there are many ways to determine the value of the assets to be encumbered and the chosen method often differs depending on the specific type of asset. For instance, if the assets are receivables, their value will usually be based on the amount that the financer would expect to collect from the debtors of the receivables.[183] If the asset is inventory that is likely to be disposed of, its value will normally be calculated based on prices in the relevant secondary market.[184] The financer, however, may not be able to recover the current market value as the realizable value may be affected by deteriorating market conditions, and, in case of urgent sales, buyers often expect to acquire the asset at a substantially lower price.[185]

88. Furthermore, specific expertise is often required for financers to perform reliable valuations of the assets to be encumbered. The value of certain assets – such as manufacturing and industrial equipment, crops, and agricultural products – can be affected not only by their condition but also by market conditions and trends.[186] For example, equipment in good working condition may have little resale value if a more efficient model is available or market trends favour a newer design.[187] Other external factors (e.g., weather conditions and natural disasters) may also present risks for crops and agricultural products.[188]

89. For financers lending to micro-businesses, asset valuation presents more challenges because certain valuation methods may be too costly relative to the value of the asset. Often leaving valuation of the encumbered assets to financers (rather than independent appraisers) seems to be a more efficient and less costly mechanism.[189] As noted in the *UNCITRAL Practice Guide to the Model Law on Secured Transactions*, it may also be particularly difficult to determine the value of the asset if it is a type that is not regularly traded in the given market.[190]

Over-collateralization

90. Financers may not be equipped with inexpensive and effective tools for risk assessment, and micro-businesses often lack credit history and transaction records. This may lead financers to require collateral, the value of which significantly exceeds the amount of the loan (often referred to as "over-collateralization"). In some instances, due to the costs and difficulties involved in asset valuation, financers simply require micro-businesses to grant a security right over all its assets. While financers cannot claim more than the loan amount plus interest and expenses (and perhaps damages upon default), over-collateralization may create problems for micro-businesses. For instance, over-collateralization makes it difficult or even

[180] ITC, Unlocking Markets for Women to Trade, (2015), p. 22.
[181] Ibid.
[182] WBG, Secured Transactions (see footnote 61), p. 22.
[183] UNCITRAL Practice Guide to the Model Law on Secured Transactions, para. 121.
[184] Ibid.
[185] Ibid., para. 122.
[186] WBG, Secured Transactions (see footnote 61), p. 104.
[187] Ibid.
[188] Ibid.
[189] UNCITRAL Legislative Guide on Secured Transactions, p. 70.
[190] UNCITRAL Practice Guide to the Model Law on Secured Transactions, para. 123.

impossible for micro-businesses to obtain secured credit from another financer granting a second-ranking security right in the same encumbered assets.[191] In addition, because all the assets of a micro-business are encumbered, enforcement by its unsecured creditors may be made more difficult or even.[192]

91. To address over-collateralization, courts in different jurisdictions have developed various solutions summarized as follows: (i) declaring void any security right that encumbers the value of an asset to an extent that is grossly in excess of the secured obligation plus interest, expenses and damages; (ii) giving the grantor a claim for release of such excess security; and (iii) upon the grantor's request, requiring the secured creditor to negotiate in good faith with the grantor [193] It is worth noting that the *UNCITRAL Legislative Guide on Secured Transactions* does not recommend that courts be given the authority to declare a security right void or to reduce the scope of a security right by means of a judicial declaration of over-collateralization.[194]

92. The appropriate response to over-collateralization is likely to vary from State to State and may sometimes be addressed in other areas of law. For example, the law of some States may also provide for the reduction of the scope of assets that can be encumbered if their value substantially exceeds the amount of the secured obligation.[195]

Enforcement

93. In the event of default, a security right makes it possible for a financer to recover what it is owed from the value of the encumbered asset. There are a number of ways to do so: (i) selling the encumbered assets and recovering what it is owed from the sale proceeds, (ii) leasing or licensing the encumbered assets and recovering what it is owed from the rent or royalty payments, and (iii) acquiring the encumbered assets in total or partial satisfaction of the amount due.[196]

94. The choice of how to enforce a security right largely depends on the type of asset and commercial circumstances.[197] For tangible assets of micro-businesses (e.g., equipment and inventory), the most common choice of how to enforce is for the financer to take possession and then dispose of the encumbered asset, typically by sale.[198] For intangible assets of micro-businesses (e.g., a receivable), the financer can collect payment of the receivable directly from the debtor of the receivable, which may realize more value than selling the receivable.[199]

95. Traditionally, financers were required to apply to a court or other authority for enforcing their security rights, and could only seize and sell encumbered assets under a judicial process.[200] Out-of-court enforcement was allowed only in certain cases and under very restrictive conditions.[201] Besides costly and time-consuming, judicial processes may lead to uncertain outcomes and destroy the relationship between micro-businesses and financers. In recent years, out-of-court enforcement has increasingly become available in many jurisdictions. Secured creditors are typically required to send a notice of default or notice of intended disposition, act in good faith and in a commercially reasonable manner and account to the grantor for the proceeds of disposition.[202]

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[191] UNCITRAL Legislative Guide on Secured Transactions, p. 82.
[192] Ibid.
[193] Ibid.
[194] Ibid., p. 83.
[195] UNCITRAL Practice Guide to the Model Law on Secured Transactions, para. 25.
[196] Ibid., para. 305.
[197] Ibid., para. 306.
[198] Ibid.
[199] Ibid.
[200] UNCITRAL Legislative Guide on Secured Transactions, p. 71.
[201] Ibid.
[202] Ibid., p. 283.

96. For micro-businesses, relevant legislation in some jurisdictions does not impose any limit on what can be seized by the secured creditor for enforcement. Importantly, essential personal assets would need to be protected and excluded from the scope of enforcement by relevant legislation, particularly in the context of a sole entrepreneur. The laws of some States may restrict the creation of security rights in household goods or the seizure of personal assets, or may limit the amount for which a security right in those assets can be enforced. In the context of judicial enforcement processes, courts may have the power to impose certain protection on essential personal assets of micro-businesses under relevant national laws.

2. Immovable assets as collateral

[For a short description, see paras. 35 to 40 of A/CN.9/WG.I/WP.119. This section will be expanded, as appropriate, in the next iteration of this document.]

C. Improving access to credit through issuance of guarantees

1. Credit guarantee schemes

[For a short description, see paras. 42 to 44 of A/CN.9/WG.I/WP.119. This section will be expanded, as appropriate, in the next iteration of this document.]

2. Personal guarantees

[For a short description, see paras. 45 to 47 of A/CN.9/WG.I/WP.119. This section will be expanded, as appropriate, in the next iteration of this document.]

D. Improving access to credit through enhanced infrastructure

1. Credit reporting

[For a short description, see paras. 49 to 51 of A/CN.9/WG.I/WP.119. This section will be expanded, as appropriate, in the next iteration of this document.]

2. Financial ombudsman

[For a short description, see paras. 52 to 53 of A/CN.9/WG.I/WP.119. This section will be expanded, as appropriate, in the next iteration of this document.]

3. Digital financial services

[For a short description, see paras. 54 to 56 of A/CN.9/WG.I/WP.119. This section will be expanded, as appropriate, in the next iteration of this document.]

4. Restructuring support

[For a short description, see paras. 57 to 59 of A/CN.9/WG.I/WP.119. This section will be expanded, as appropriate, in the next iteration of this document.]

5. Safeguards for MSMEs

[For a short description, see paras. 60 to 63 of A/CN.9/WG.I/WP.119. This section will be expanded, as appropriate, in the next iteration of this document.]

E. Improving access to credit through capacity-building

1. Capacity-building for MSMEs

[For a short description, see paras. 65 to 66 of A/CN.9/WG.I/WP.119. This section will be expanded, as appropriate, in the next iteration of this document.]

2. Capacity-building for financers

[For a short description, see paras. 67 to 68 of A/CN.9/WG.I/WP.119. This section will be expanded, as appropriate, in the next iteration of this document.]