

# DEFINING MICRO, SMALL AND MEDIUM ENTERPRISES (MSMEs) IN THE AFI NETWORK

Survey Report  
March 2017



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## BACKGROUND

In 2014, at its very first set of meetings, AFI's SME Finance Working Group (SMEF WG) decided to publish a guideline note of basic terminology that would help to create a clear and common understanding of SME financing tools. When the final product was presented two years later, it became clear to the sub-group in charge that the proposed terminology included terms already defined by international organizations, and national differences in the AFI network would make it difficult to settle on universal definitions if the most important term was not defined: micro, small and medium enterprises (MSMEs).

Is it possible to create a standardized universal definition for MSMEs? At the 6th Working Group Meeting in Mongolia, the SMEF WG decided to first agree on the best way to respond to this question. A group breakout discussion shed light on the difficulties of reaching consensus on one definition, and the group realized it would be easier to define MSMEs by defining the criteria that defines MSMEs.

The Reserve Bank of India, Bangladesh Bank, Bangko Sentral ng Pilipinas and the Central Bank of Seychelles proposed exploring how these criteria were commonly understood. An on-the-spot survey defined the criteria as number of employees, assets, sales revenue and turnover, and existence of a legal definition. Twenty-one countries provided responses and it was clear that most SMEF WG countries define MSMEs based on number of employees, assets and turnover. The Working Group agreed to supplement these initial findings with additional surveys and prepare a report. The survey results were presented at the 7th SMEF WG meeting in Fiji and, with the support of AFI, the group decided to report on its findings and pose further research questions to the group.

## INTRODUCTION

Micro, small and medium enterprises (MSMEs) make a vital contribution to economic growth and development. They represent a seedbed of entrepreneurial skills and innovation, contribute to job creation, and are considered the backbone of the global economy. The World Bank has reported that formal MSMEs contribute up to 45% of total employment and up to 33% of national income (GDP) in emerging economies.<sup>1</sup> These numbers would be significantly higher if MSMEs in the informal sector were also included.

Despite the important role of this sector in achieving more inclusive economic growth, access to finance for MSMEs remains a challenge. MSMEs typically do not have collateral to back their loans, lack credit history and, because most MSMEs have a low equity ratio, they are more vulnerable to external influences (e.g. price risks, interest rate risk) than large enterprises.

Government regulators and policymakers have introduced a variety of measures to support the MSME sector, ranging from legislation to supportive regulations, infrastructure, and capacity building and education, among others. A detailed report of these initiatives can be found in the AFI SME Finance Working Group Guideline Note No. 23, “The Role of Financial Regulators in Promoting Access to Financing for MSMEs: Lessons from the AFI Network”, in which 25 member institutions describe policies implemented in their countries to harness access to financing for MSMEs.

To cater to the financial needs of the MSME sector, financial policymakers and regulators need to understand them better. One way to do this is to look at how MSMEs are defined – what constitutes an MSME and how should they be categorized? Defining MSMEs is important and useful for policymakers and other stakeholders working to develop and strengthen this sector. Having a definition that is universally used and recognized would also be helpful for generating statistics and monitoring the health of the sector over time. It would enable policymakers to identify and focus on special interventions, such as credit lines, loan guarantees, business development services, eligibility for technical assistance from international and local donor agencies, or other fiscal incentives like tax holidays. Finally, defining MSMEs would help with benchmarking against other economies and between regions, preventing arbitrary thresholds for tax or other regulations and determining eligibility for public support.<sup>2</sup>

Globally, MSMEs are defined differently by international institutions, national law and industry. Indeed, one of the main challenges of analyzing SME data across countries has been the lack of consensus on what constitutes an SME.<sup>3</sup>

## OBJECTIVE OF THIS SURVEY REPORT

The objective of the SMEF WG survey was to take stock of MSME definitions across AFI’s global network, identify what criteria was being used to define MSMEs and whether a specific policy informs these classifications.

The survey has two phases. First, the survey was completed by individuals from AFI member institutions, who answered questions about how MSMEs are defined in their countries and whether the definition is official (i.e. defined by law or in a government policy). The second part of the study will take a closer look at country experiences to understand how comprehensive MSME definitions are and how they have been implemented. This will reveal the advantages and challenges of current definitions, how well they reflect the state of MSMEs in AFI member countries and whether the definitions need to be refined.

## SCOPE OF THE SURVEY

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1 <http://www.worldbank.org/en/topic/financialsector/brief/smes-finance>

2 OECD-UNIDO, 2004, “Effective policies for small business”

3 The World Bank, 2011, “Small and Medium Enterprises: A Cross-Country Analysis with a New Data Set”

## THE SURVEY – FIRST PHASE

### A. DESIGN

The survey was conducted within the AFI network among member countries of the SMEF WG. Data was collected using a structured questionnaire distributed to members of the SMEF WG through email.

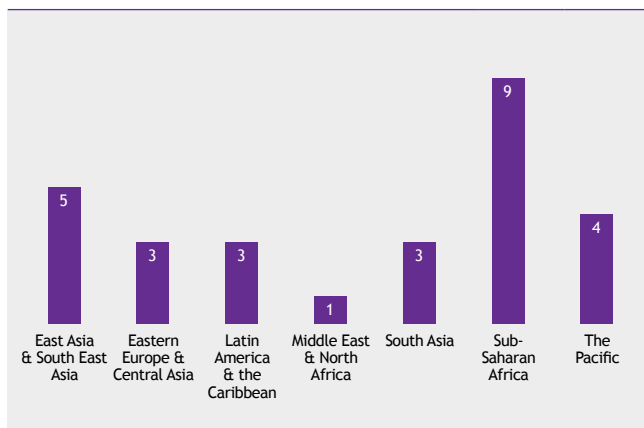
The survey questions were as follows:

- i Name of country
- ii Region to which the country belongs
- iii Criteria used to define MSMEs in their country
  - > Assets
  - > Number of employees
  - > Sales turnover
  - > Sector
  - > Others
- iv Whether the definition is official (legally defined)

### IMPLEMENTATION

The questionnaires were submitted to 40 member countries of the SMEF WG. Only 28 member countries successfully completed the questionnaire – a 70% response rate. These countries represent seven regions of the AFI network.

FIGURE 1: TOTAL RESPONSES BY REGION

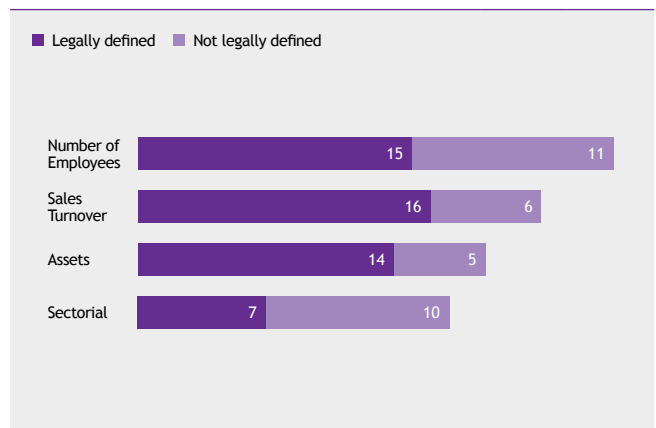


Source: AFI

### FINDINGS

- 1 The top criteria used to define MSMEs in AFI member countries were
  - (1) number of employees,
  - (2) sales turnover and
  - (3) asset size.
 There were no distinct regional patterns in criteria use.
- 2 Survey responses were analyzed using income data (GDP per capita) and population. There does not appear to be a strong relationship between income level and the number of definitions a country has. The same was observed when trying to identify patterns between population and number of definitions.
- 3 Definitions varied by region. This is expected and understandable due to country-specific issues and regional considerations. However, we should be mindful of drawing conclusions based on limited data.
- 4 Latin America seems to have the most diverse definitions, with assets and employee numbers being the most common criteria. The SMEF WG will need to conduct further research to determine whether this is unique to this region.
- 5 Having a definition backed by policy or law is seen to strengthen the legal and contractual status of MSMEs. Sixty percent of the countries surveyed have legally defined their MSMEs. Latin America has a relatively larger share of countries that have legally defined their MSMEs. (There was only one respondent for Middle East and North America, however.)

FIGURE 2: TOP CRITERIA USED TO DEFINE MSMEs BY REGION



Source: AFI

## THE DEEP DIVE: FOCUSING ON COUNTRY EXPERIENCES

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At the 2016 Global Policy Forum in Fiji, the SMEF WG met to discuss how to move forward with the second phase of the study: a deep dive into country experiences. The idea is to present actual cases of what has worked, is still working and definitions that need to be refined. This will be particularly helpful for countries that have not yet officially defined their MSMEs and those that need to revisit their definitions.

Phase two will highlight both the challenges and advantages of having official definitions. Aside from identifying the criteria being used to define MSMEs in the AFI network, the second phase seeks to answer the following questions:

- > What is/are the rationale for defining MSMEs in these ways?
- > Which agency(ies) developed the definitions of MSMEs?
- > Is there a law/act backing up the definition of MSMEs?
- > Who championed/lobbied for the passing of the act/law on the MSME definition?
- > Which definition do financial regulators subscribe to?
- > If more than one agency in your country has defined MSMEs, do you have challenges harmonizing the definitions?
- > If your country has an official definition of MSMEs, was there a significant observed change in terms of access to finance?

During the meeting, the following countries were selected to participate in the second phase of the study:

- 1 Pakistan
- 2 Malaysia
- 3 Indonesia
- 4 El Salvador
- 5 Belarus
- 6 Bhutan
- 7 Tonga
- 8 Madagascar
- 9 Swaziland
- 10 Democratic Republic of Congo (DRC)

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**SME WORKING GROUP SURVEY REPORT:  
DEFINING MICRO, SMALL AND MEDIUM ENTERPRISES  
(MSMEs) IN THE AFI NETWORK**



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