



# Lessons Learned in Improving Replicability of Successful SME Banking: Opportunities and Challenges

4th Annual SME Banking & Financing  
17th and 18th November 2009  
Sheraton Imperial, Kuala Lumpur

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# **Chapter One**

## **Introduction**

Global Economic Crisis and Opportunities

Challenges in SMEs Sector

ASA: An overview

ASA International in Other Countries

# Global Economic Crisis

## A global financial and economic crisis

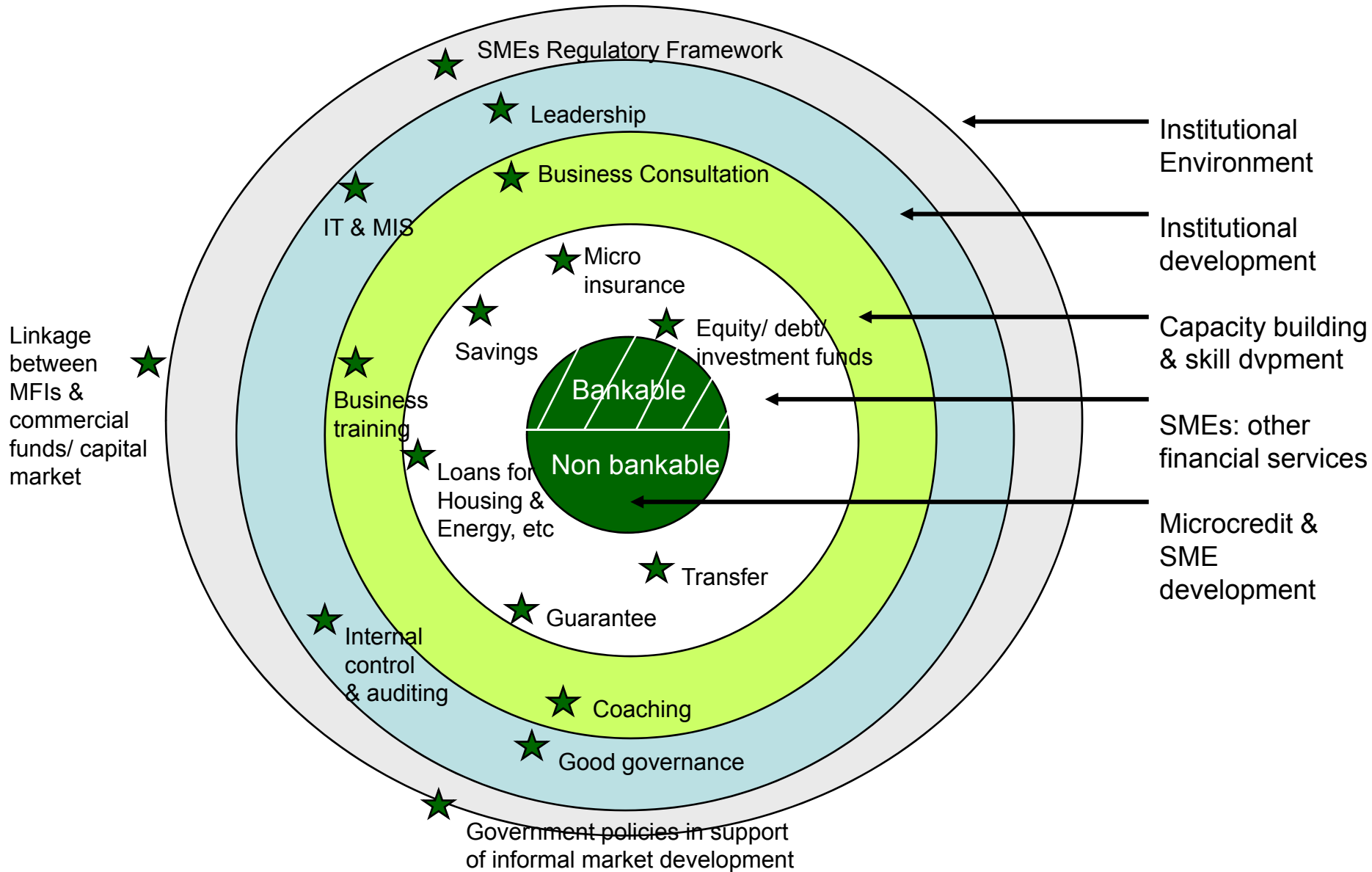
- 30 000 billion dollars lost on the world stock exchange
- 210 million people will be unemployed by the end of 2009 according to ILO (raise of 20 million people since 2007)

## Difficulties to meet basic needs

- 2,5 billion inhabitants live with less than \$2 a day
- 20% of the world population owns 80% of resources
- 1,3 billion inhabitants have no access to drinkable water
- 2,6 billion inhabitants have no access to a sanitary system
  - 2 billion inhabitants have no access to electricity
- 4 billion people out of the banking system/ no access to credit

## Global crisis leads to new ways of thinking for SMEs, Microfinance & Social business development

# Challenges in SMEs Sector



# ASA: an Overview

ASA means hope established as an NGO in 1978 and started microcredit in 1991

## Objectives of ASA

- To serve larger numbers of poor.
- To maintain institutional self sufficiency.
- To alleviate poverty and improve the quality of life of poor people by offering microfinance services.

Organizational Profile					
Number of Members		7 276 677			
Number of borrowers		5 877 440			
Average loan size (total)		132 \$			
Percentage of women clients		71%			
Financial Profile (USD) in Mill			Key Financial Performance Indicators		
	2007	2008		2007	2008
Portfolio size	360\$	468\$	FSS	128%	100%
Savings	130\$	166\$	ROA	5,63	7,32%
Avg. Portfolio Yield	26,15%	24,32%	ROE	9,10%	12,18%
Operating Cost	10,48%	12,10%	Leverage Ratio	62%	58%
Avg. Cost of Funds	7%	7%	PAR>=30 days	4,34%	6,10%
Net Income	43\$	31\$	Write-off Ratio	0,28%	0,52%
			Clients per LO	451	482

# ASA International in Other Countries

## South Asia

Country	No. Branch	No. of Depositors	No. of borrowers	No. of LO	No. of borrowers per LO	Loan disbursed (Cum. Prin.) US\$	Avg. Outstanding per borrower US\$	Portfolio per LO
<b>India</b>	50	82,201	76,264	175	436	10,814,625	83	35,982
<b>Pakistan</b>	10	-	4,254	45	95	534,810	104	9,868
<b>Sri Lanka</b>	46	45,707	39,425	154	256	13,193,326	90	22,932
<b>Afghanistan</b>	2	534	53	3	18	10,181	192	3,394

## Asia

<b>Philippines</b>	30	39,538	39,384	158	249	8,454,801	71	17,600
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## Africa

<b>Ghana</b>	16	16,100	14,070	75	188	3,930,369	80	15,047
<b>Nigeria</b>	3	725	288	14	21	48,312	-	3,451

# ASA Innovations in Microfinance & Small Business

- Credit for income generating activities
- Flexibility of group formation & no bindings on group guarantee
- Weekly group meetings
- Simplicity and transparent system
- Strong collection disciplines
- Exponential growth
- Flexible loan products
- Decentralization & delegation of authority in the field level
- Savings withdrawal facilities
- Insurance coverage
- Innovative staff recruitment & on the job training
- Simple and shorter loan processing, less waiting period for clients
- Written operational manual
- Strong monitoring and Supervision system
- Standard and low cost structure on furniture, fixture and over all management costs
- Increasing product range

SL NO	NAME OF STAFF	CREDIT		SAVINGS		TOTAL		LOAN
		REALIZABLE	REALIZED	REALIZED	REALIZED	REALIZED	REALIZED	
1	AFROJA	2478	2000	3478	3478	3478	3478	3478
2	SODRO	3800	3000	4800	4800	4800	4800	4800
3	RTA-UR	3825	2000	4825	4825	4825	4825	4825
4	HOSNA	5497	4000	6497	6497	6497	6497	6497
5	LAL THAK	6580	200	6780	6780	6780	6780	6780
TOTAL		15340	12200	15340	15340	15340	15340	15340



## **Chapter Two**

### **Introduction to Small Business Lending Technology**

Purpose & background

Basic Factors of Credit

Definition of SMEs

Typical characteristics of SMEs

General characteristics of Small business

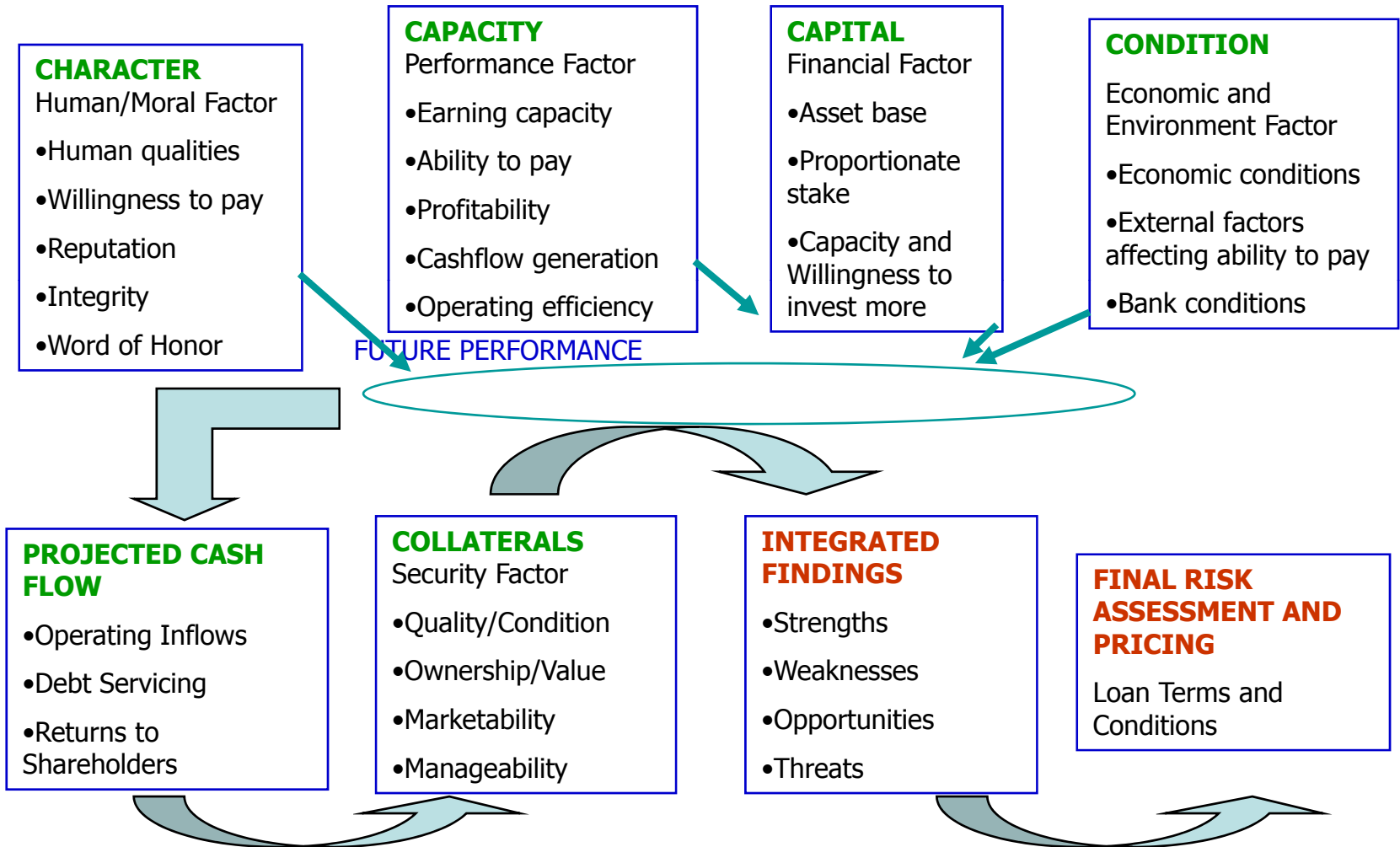
Small Business Lending / Corporate Lending

Profitability of Small Business Lending

# Purpose and Background

- Small Enterprise (SME) contribute significantly to economic growth and employment
- Lack of funding is a key constraint for Small Business growth and development
- Publicly funded Small Business lending has proven unsuccessful
- International experience calls for a commercial approach to Small Business Lending

# Basic Factors of Credit



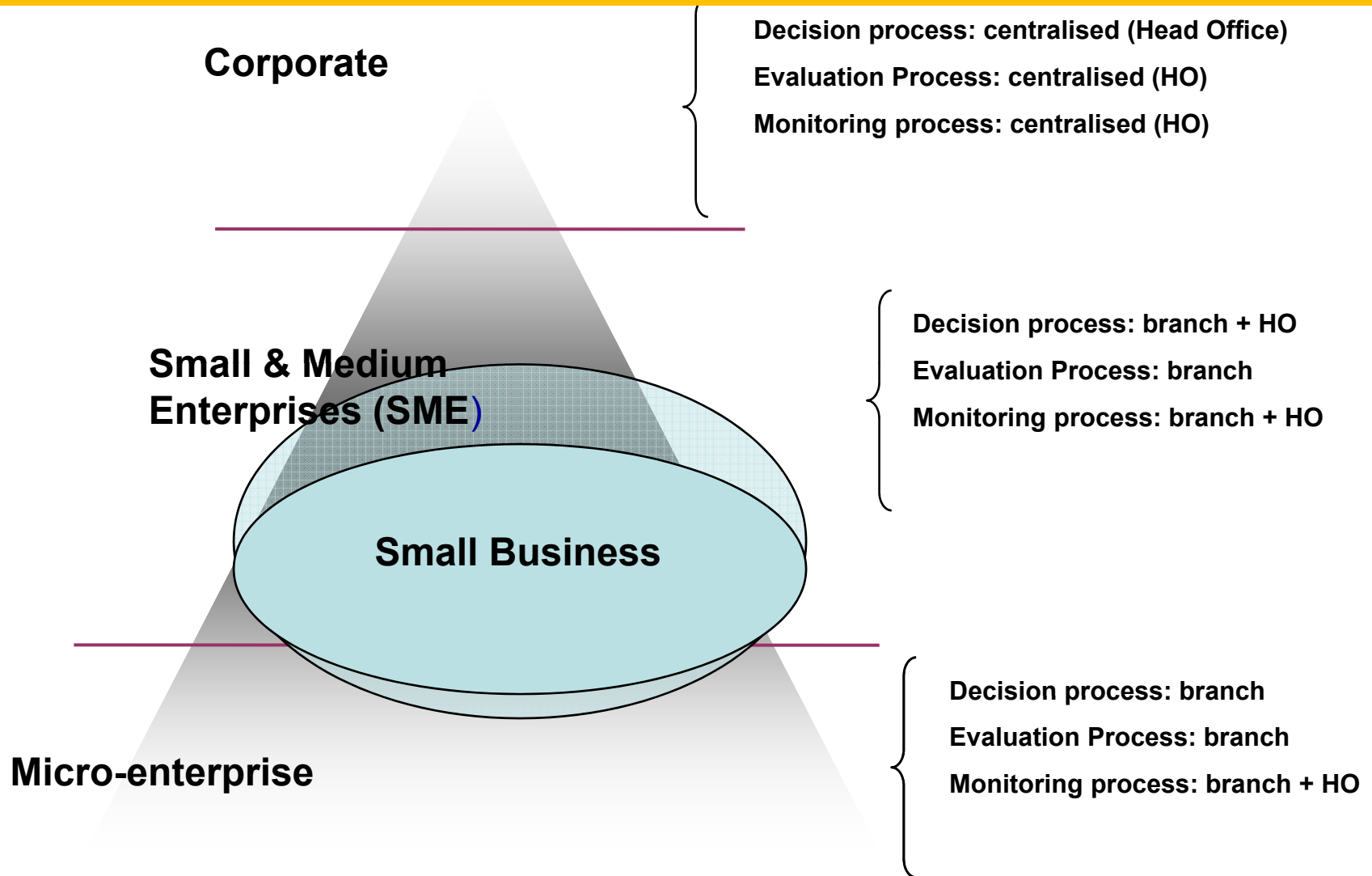
# Definitions of SMEs

- No general definition of “Small Business” exists.
- Micro-enterprises (benefiting from micro-credits) are individual or family-based entrepreneurships. They may employ a few additional workers.
- Characteristics of Small and Medium Enterprises (SMEs) are defined by international institutions i.e. IFC or EBRD. Usually, they have a staff up to 500, assets up to 2.5 million Euros.
- We can assume that Small Businesses include the largest micro-enterprises and the smallest SMEs.

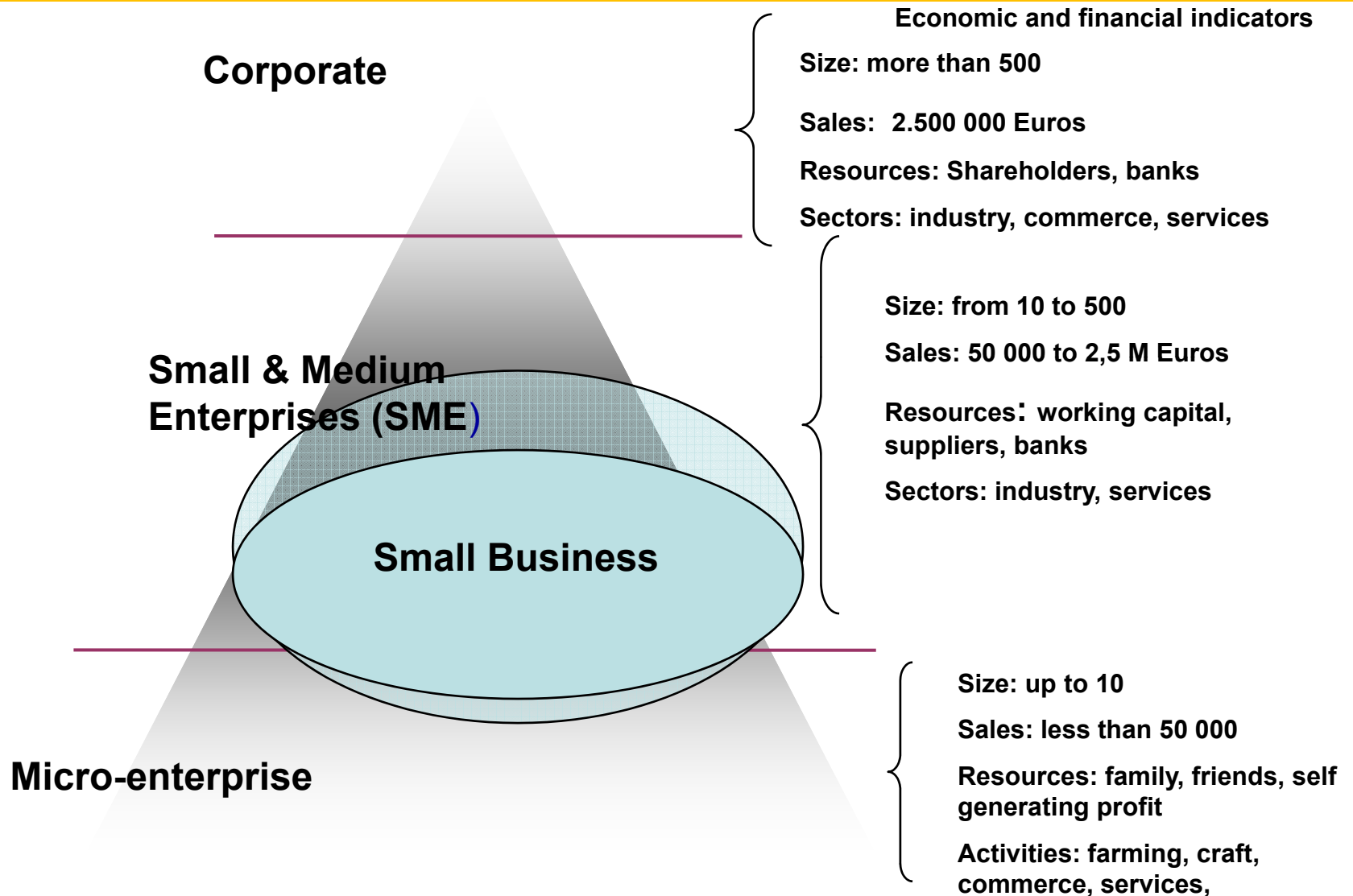
# Typical Characteristics of SME

- ✓ Owner-managed
- ✓ One-man management (A lack of balanced managerial skills)
- ✓ Multi-tasked employees
- ✓ Verbal instructions widely relied upon and minimal recording and records-keeping
- ✓ Quick response to identified opportunities
- ✓ Close contact with workers, suppliers, customer
- ✓ Fast decision making and implementation
- ✓ Key functions held by family members
- ✓ Low capital base (Often inadequate capital)
- ✓ Major funds sources are relatives, friends, informal sources
- ✓ Flexible production process & low level of technology
- ✓ Limited product lines
- ✓ Limited marketing know-how

# General Characteristics of SMEs (Continued)



# General Characteristics of SMEs



# **Chapter Three**

## **Small Business Products and Lending Cycle Process**

### **SMEs Product and Diversification**

Small Business Lending phases

Decomposition of the Small Business Lending process

# SMEs Product and Diversification

**Banks offer a variety of products and services to clients, but the emphasis must be on fast services to maximise the outreach and loan portfolio**

## **SME Products**

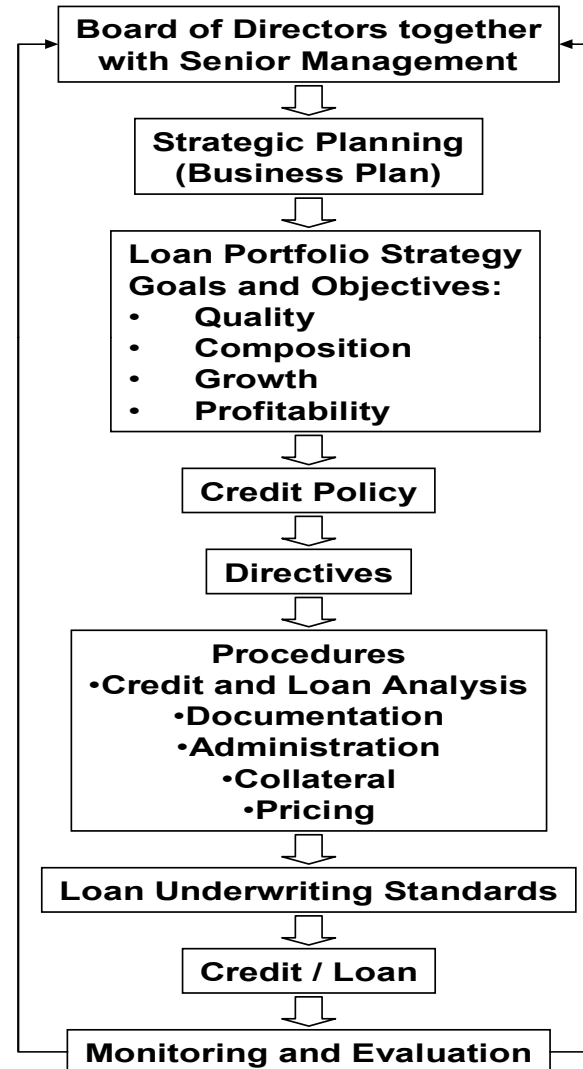
- Micro leasing for Agro equipments and machineries
  - Shop Keepers Loan
  - Small Business Development Loan
  - Short Term Loan
- Installment Loans against FD / Govt. Securities/Bonds
  - Overdraft – Secured
  - Trade/Working Capital Loans
  - Deposit Products
  - Letters of Credit
  - Guarantees

# SMEs Segment Details

Professionals	Service Companies	Trading	Manufacturing industry
<p>Doctors, Dentists Private Medical Clinics &amp; diagnostics centre; Architects, Consultants, , Engineers, Surveyors</p>	<p>Travel Agency, Advertisement firm Shipping Agents Transport / container mover Gas stations Real Estate Contractors Non Profit Org Clubs</p>	<p>Supply chain – Distributors of Multinational Company (MNC) / Large local Corporate (LLC), Supplier of MNC / LLC Importer – Food &amp; Grain, Dyes &amp; Chemicals, Milk Powder, Motor parts, Bi –Cycle parts, Motor Car, Electrical and Electronic goods, Hardware &amp; machinery, Poultry feed, Construction materials, Water pump and generator, Cotton Yarn, seed distributor, Steel Sheet, Jewellery, edible oil and crude oil Retail &amp; Whole seller– Retailer of readymade garments and boutiques, Restaurant &amp; fast food, Super market , Stationary items, Furniture &amp; wood seller, drug &amp; medicine, Scrap – shipping</p>	<p>Packaging Flour Mills, Suppliers to MNC / LLC Printing &amp; publishing, Garments accessories Furniture Pharmaceuticals</p>

# Small Business Cycle Process

**For  
Small  
Business  
Lending  
Process  
at the  
board  
level**



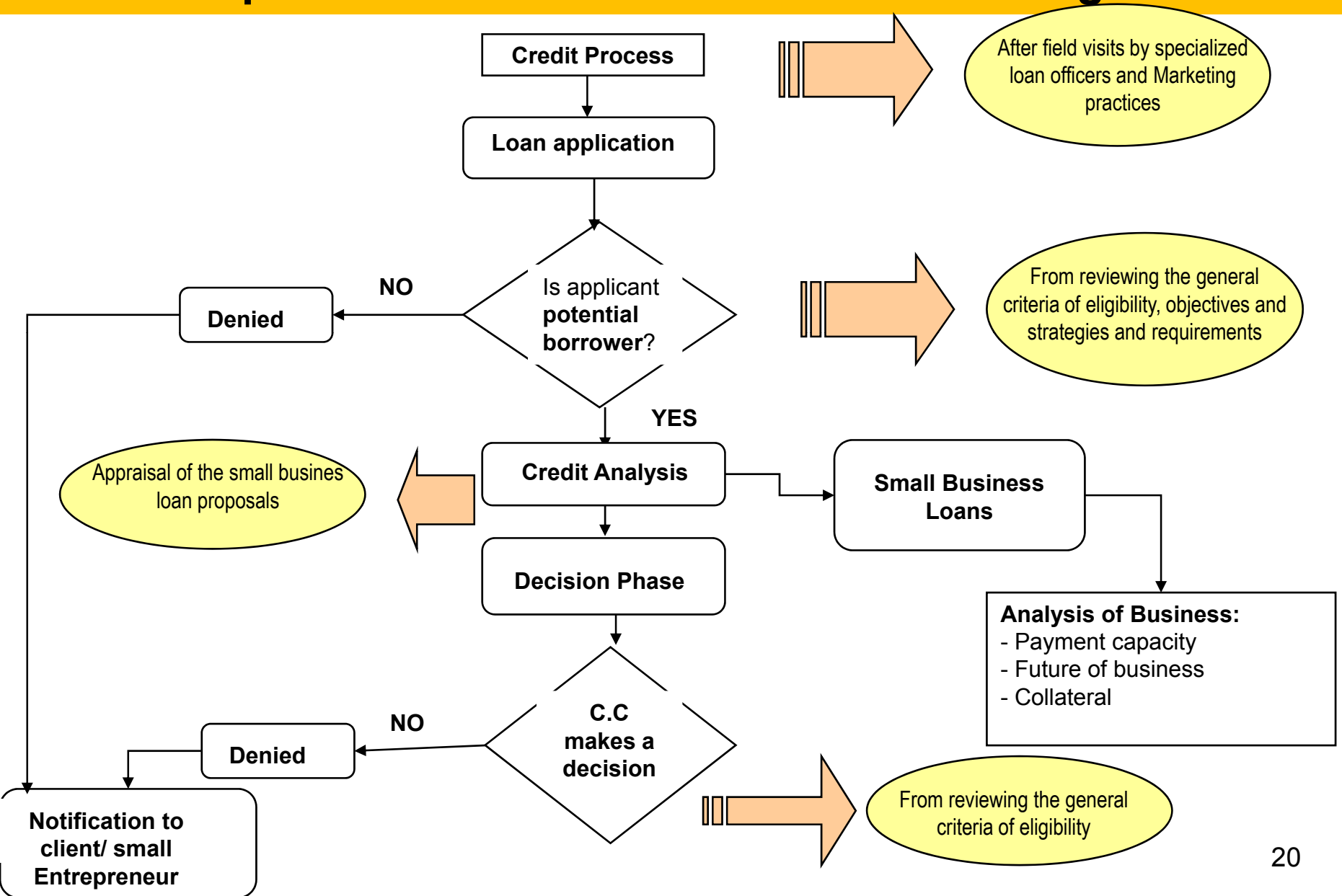
# Small Business Lending Phases

## The Different Phases of the Small Business Lending Process

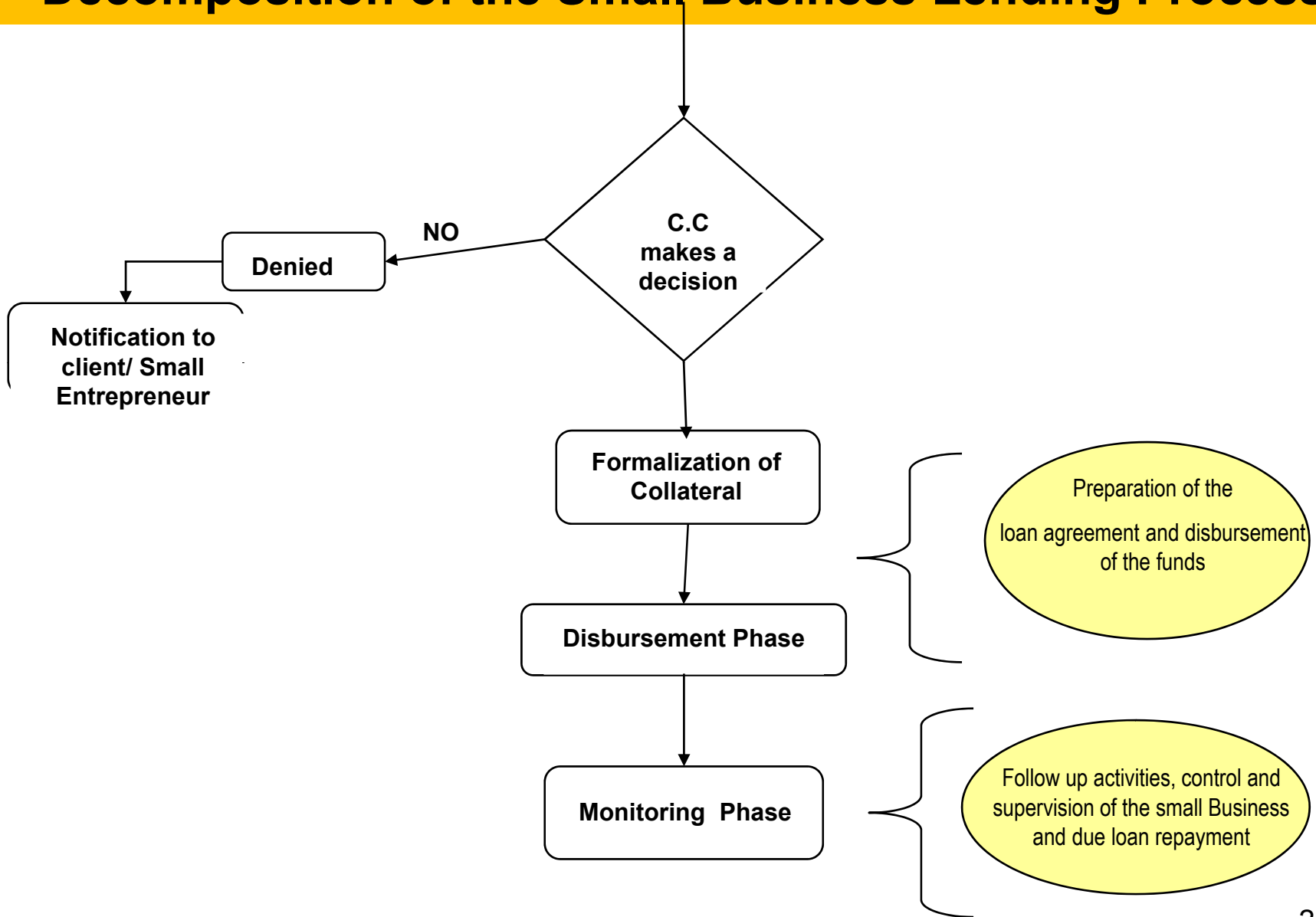
After field visits done by specialized credit officers aiming to assess the needs of Small businesses and according to the objectives and strategy of the Bank the following steps should be undertaken to implement the small business lending program.

- Small Business loan Application
- Small Business loan Appraisal
- Decision of the credit committee through the delegation system
- Formalization of collateral and loan agreement
- Disbursement phase
- Monitoring and supervision phase

# Decomposition of the Small Business Lending Process



# Decomposition of the Small Business Lending Process



# **Chapter Four**

## **Market Development**

Prerequisite for Marketing Small Business lending  
Strategic challenges  
Check List of Documents for Loan Origination

# Prerequisites for Marketing Small Business Lending

- Before launching Small Business program Banks should determine if the conditions are favorable for Small Enterprise lending, following aspects should be analyzed:

## **Supervisory Environment**

- Depositors protected by bank
- Effective and functioning monitoring structure

## **Macro-environment**

- Appropriate legal and regulatory environment
- Political stability
- Suitable demographic conditions

## **Capability & Performance of Bank**

- Bank must be capable to respond to changing demands of rapidly expanding client base
- Bank should already have demonstrated consistently good management of its own funds

# Strategic Challenges

- **The Bank's Management will define a strategy for Small Business Lending and allocate resources, especially Specialists in the Branches doing Direct Marketing in the field (through market immersion). An adequate Training Program will be essential to succeed.**

## Strategy for Small Businesses

- Targets (eligibility criteria)
- Products (loans, savings, services)
- Specific financial plan

## Direct Marketing

- Credit Officers in the field
- Regular field visit to Small Businesses

## Bank Traditional Marketing Channel

- Integrate Small Business Lending Activity into the traditional marketing channel of the bank:
- Use the Small Business Lending Program to do Cross Marketing

# Check List of Documents for Loan Origination

Documents requested to the applicant :

## 1. legal Documents :

- **Business registration**
- **Decision taken by the board to apply for a loan**
- **Official license to conduct business**
- **Registration of properties**

## 1. Financial Information

- **3 last year financial statements** : balance sheet, off-balance sheet, P/L
- Business Plan including **financial plan**.
- **Global funding** including the expected loan

## 2. Others

- **Organisation Chart**
- **Credit record**
- **List of clients and suppliers**
- **Possible collateral and guarantor**

# **Chapter Five**

## **Appraisal of Small Business Loan Proposals**

Guide for performing analysis of small loans  
Appraisal of Small Business  
Delegation system of the credit decision

# Guide for Performing Analysis of Small Loans

## Guide for Performing Analysis of Small Loans

In analysing small loans we have to consider the following:

- the enterprise is a legal entity
- the small enterprise's ownership and the liability with official documents.
- A small enterprise's most-productive-assets-based analysis
- the analysis of the investment plan in the case of larger loans and its effects on the enterprise's development
- the current enterprise's payment capacity
- collateral is important when larger amounts of loans are involved.

# Guide for Performing Analysis of Small Loans

## General steps to follow analysing SMEs

- Visiting the enterprise on site and having several interviews with all the shareholders
- Building up the enterprise's financial statements (and/or cash flow projections) comparing them with the official financial statements (which normally do not reflect the whole picture of the business)
- Analysis of the enterprise's ownership aspects, and review the business plan ( either documented or by interviewing directly the Small Business owner
- Analysis of the enterprise's current management
- Investigation of the personal references of owner(s) and guarantors (what is there behind the business?)

# Appraisal of Small Business

## General steps:

The evaluation of a small business loan proposal requires general and specific information. The appraisal is a step by step method directed on the following phase:

- **General analysis of the Small Business**
- **Business plan and Cash flow analysis** (Background about the business, Ownership and management, Production methods , Sales and delivery, Financial records, Future prospects and plan etc.)
- **Collateral review and evaluation**
- **Preparation phase for the submission to the credit committee**
- **Credit committee decision**
- **Delegation of the credit decision**

# Loan Agreement

**The Loan Agreement prepared, finalized and registered by the Legal Department, is the essential document which regulates the legal relationship between the entrepreneur and the bank.**

**It usually includes :**

- **Characteristics of the loan (each facility) : beneficiary, amount, term, disbursement schedule, grace period if any, interest rate, fees, re-payment schedule, ...**
- **Covenants : information to be supplied by the borrower during the life of the loan for a proper monitoring, minimum Debt Service Coverage ratio, restrictions regarding re-organisation, change in share-holders' capital, sale of assets, commitment to third party, minimum Debt Service Coverage ratio, allocation of profits, ...**
- **Guarantee : collateral, guarantor, insurance policy, ...**
- **Penalty : when the borrower cannot meet obligations stipulated in the Loan Agreement.**

# Loan Agreement

## Check List of information to be included in the Loan agreement

- **Amount** - specifies the amount of the approved small business loan.
- **Purpose** - brief description of purpose(s)
- **Security** - description of securities offered and required
- **Availability** - when the loan becomes available
- **Draw down** - sometimes draw down by tranches; also last date for draw down.
- **Interest** - rate above bank's base rate or relation to relevant money market rate.
- **Arrangement fee** - arrangement fees, legal fees etc. in connection with the loan and security
- **Repayment** - repayment details - by instalments etc.; also arrangements for early repayment
- **Financial information** - undertaking for customer to provide financial information.
- **Default** - list of conditions which constitute default; this would include liquidation of the company
- **Representations & warranties** - that the agreement does not contravene any other agreements or laws & no pending actions.

# **Chapter Six**

## **Loan Monitoring**

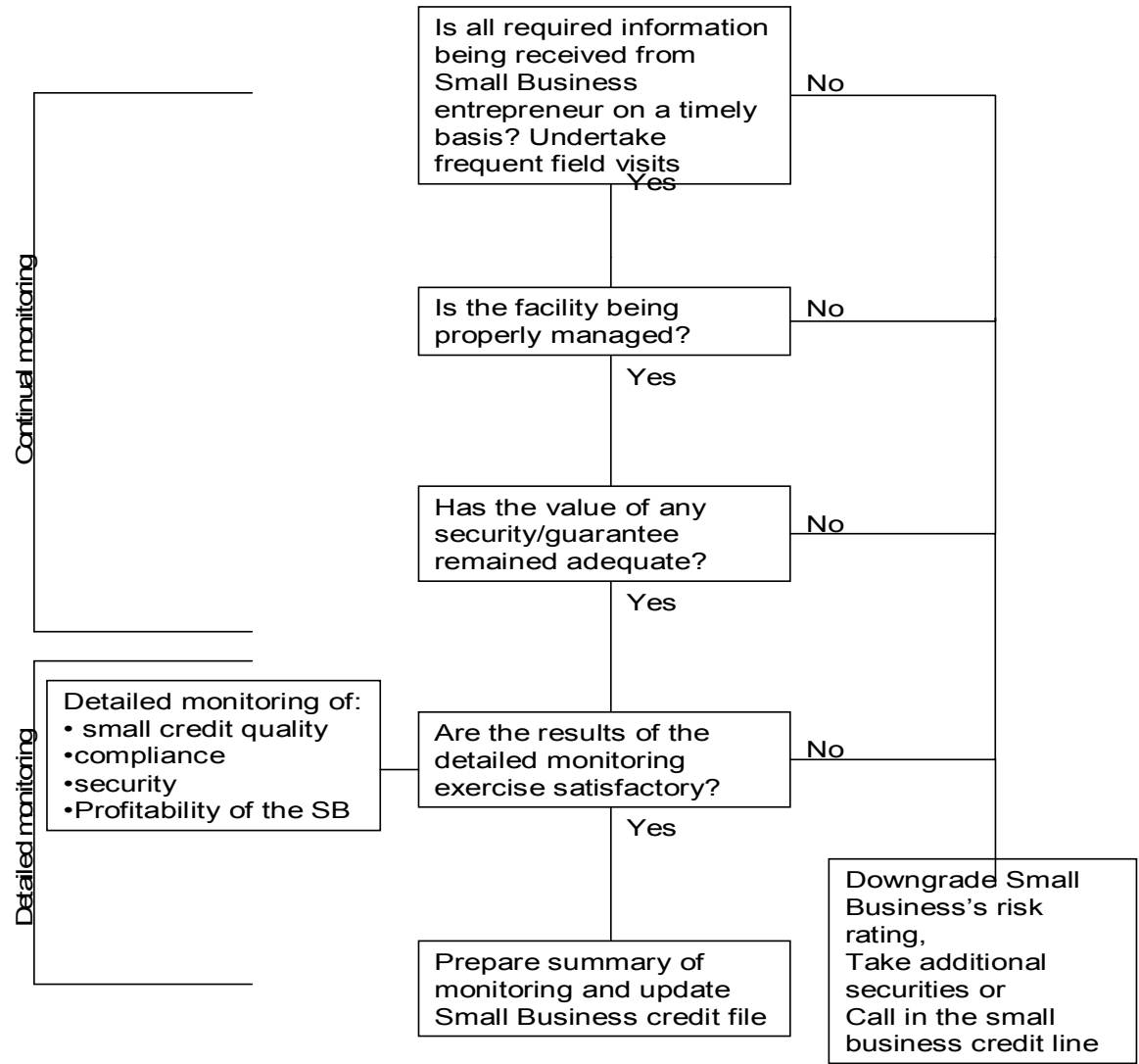
**Different Stages of the loan monitoring process  
Responsibilities in monitoring  
Check List of monitoring items**

# Stages of Loan Monitoring

## STAGES IN THE SMALL BUSINESS CREDIT MONITORING PROCESS

1. Continual Monitoring

2. Detailed Monitoring

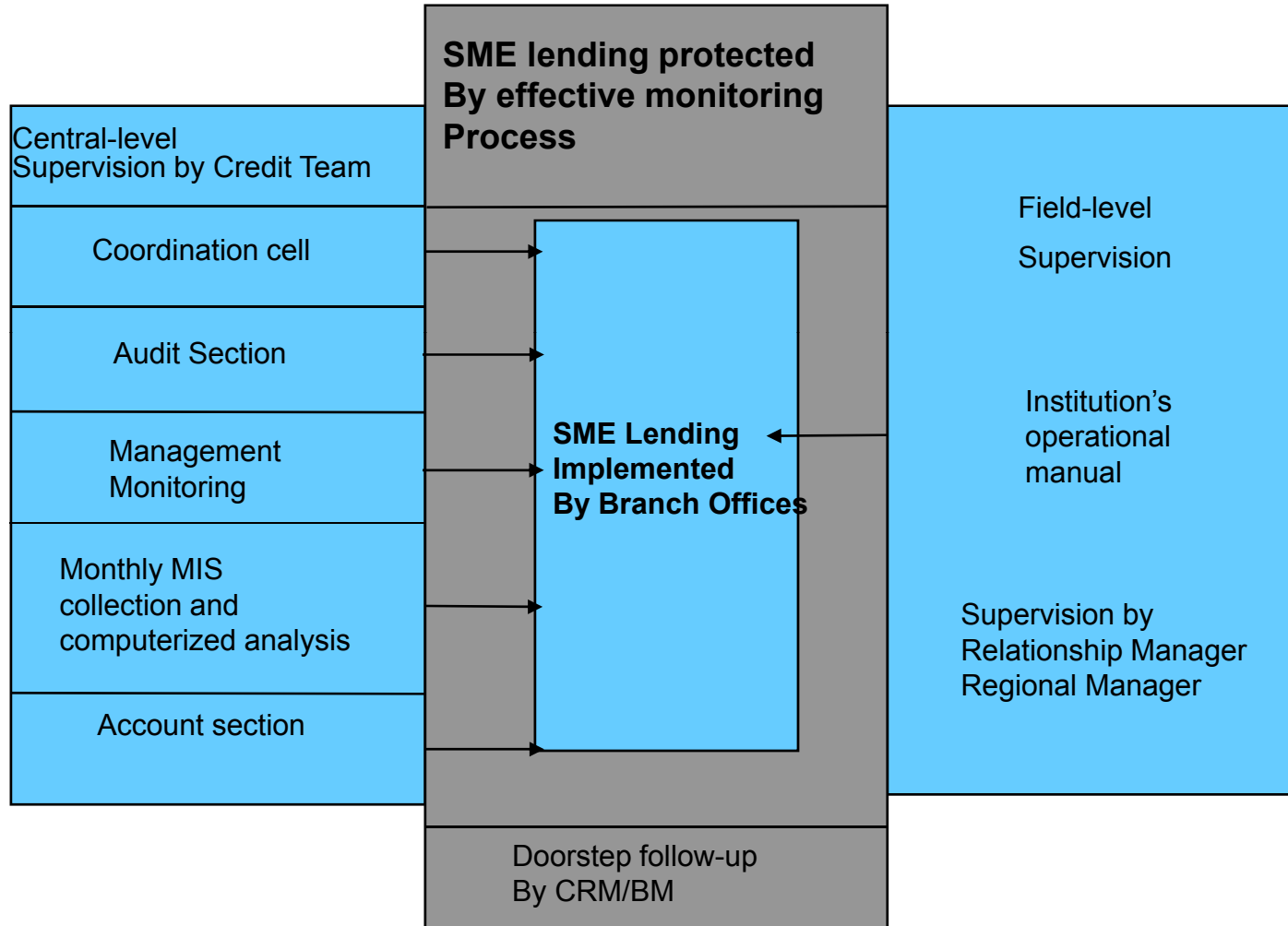


# Check List of Monitoring Items

## Check List of items to be included in the Monitoring File

- **Follow-up of Covenants included in the Loan Agreement** : periodical provision of financial documents, financial ratios, changes in organisation or in share-holders, ...
- **Valuation of guaranties**
- **Re-payment record** : late re-payments, penalties, ...
- **Internal risk rating** : from good to loss
- **Reserve for Loan loss**

# Multi-way Monitoring System



# **Chapter Seven**

## **Cost / Risk Analysis of Small Business lending**

Risks related to small business lending  
Internal control

# Risks Related to Small Business Lending

**Risks are usually defined by the adverse impact on profitability of several distinct sources of uncertainty.**

**Risk measurement requires that both the uncertainty and its potential adverse effect on profitability are captured:**

- 1. Credit Risk**
- 2. Liquidity Risk**
- 3. Interest Rate Risk**
- 4. Market Risk**
- 5. Solvency Risk**
- 6. Operational Risk**
- 7. Technical Risks**
- 8. Risk Inherent In Organisation**

# Internal Control

**The Internal control Department plays an important role in loan monitoring.**

The periodic checking of the borrower's files which include borrower's business and collateral documentation is one of the Management's instrument of loan control and supervision.

**Regular Monitoring visits** should invariably take place to Small Business location

1. to review the the borrower has lost an important customer or supplier
2. to keep watch on any change in the management and organizational aspects which could influence negatively the repayment behaviour of the small enterprise

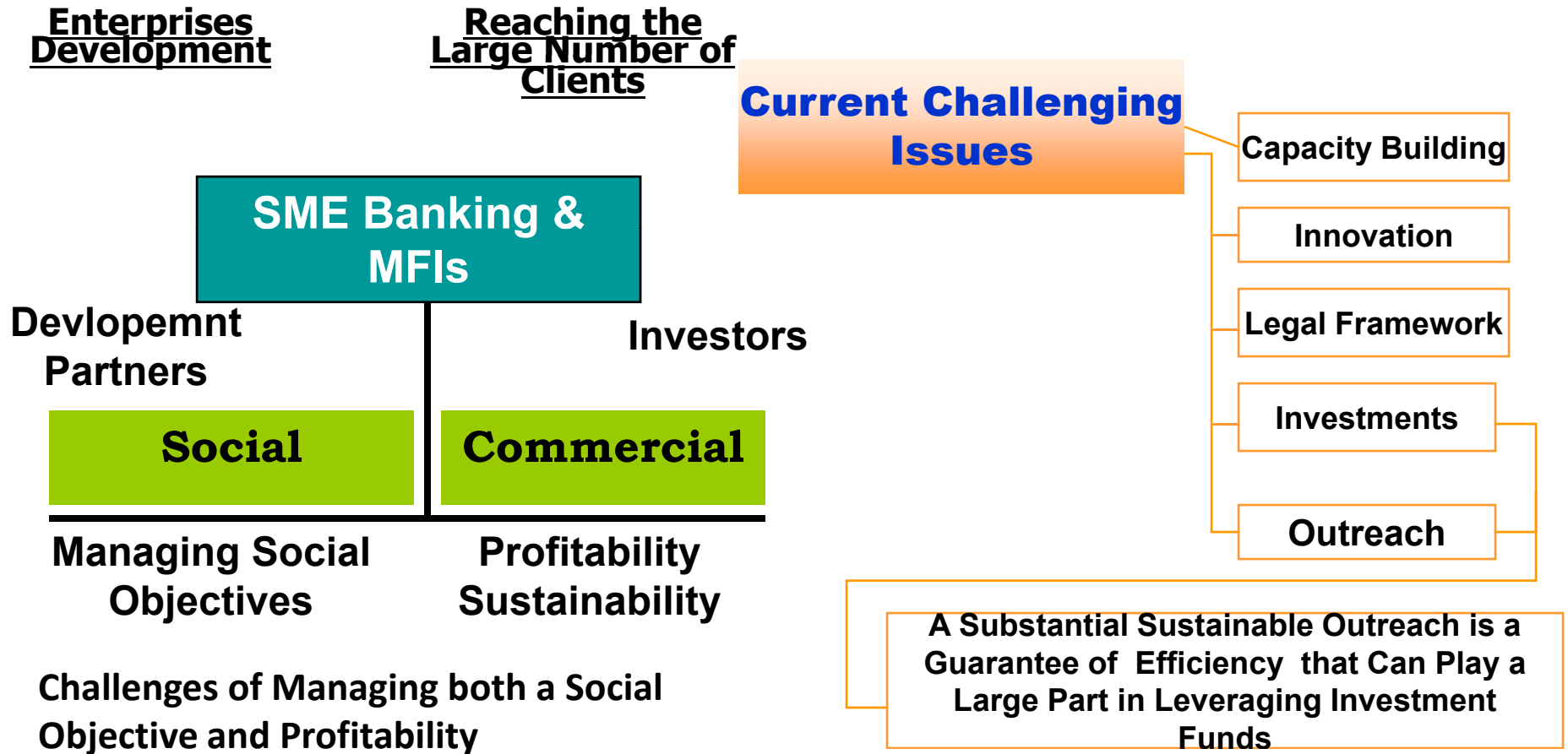
After lending staff have determined how serious the problem is, they must notify the Branch Manager and depending on the size of the loan the Management, so that a decision can be taken on specific measures that should be initiated.

## **Chapter Eight**

### **SMEs Constrains and How to Overcome**

Major challenges in SME Business Model  
Financial Constrains  
Bad and Good Practices Practices

# Major Challenges in Current SME Business Model



# SMEs Funds Constrains

## ■ **Problems Faced when Starting the Business:**

- Financial constraints
- *Men Tend to Receive more Credits from Banks than Women*

## ■ **Problems Currently Faced:**

- Financial constraint (lack of operating funds, lack of investment funds, unpaying customer credit)
- Marketing (not enough customers, low prices received, market problems)
- Others (electricity, road conditions, access to finance, water availability, transportation to markets, crime and corruption)

# Good and Bad Practices of SMEs

## Good

- ✓ Knowledgeable of various aspects of their operations (and strives to know even more)
- ✓ Good track record of borrowing experience
- ✓ Sensitive to opportunities and problems
- ✓ Live simple lifestyles
- ✓ Grow by manageable levels

## Bad

- ✓ Too much capital in fixed assets
- ✓ Poor credit practices (in granting credits and in managing own borrowings)
- ✓ Poor cash management
- ✓ Taking too much out of the business
- ✓ Improper management of too much success
- ✓ Failure to delegate (lack of succession program)

# How to Overcome Challenges

- **Capacity Building:** Banks and MFIs must conduct skills-development training to build capable individuals to serve sector. Banks and MFIs should therefore develop strong internal training programs, and engage in knowledge sharing, and networking with other banks & MFIs to benefit from synergy. Reducing the knowledge gap in a new country can be achieved through field training;
- **Flexible Legal Framework:** Banks & MFIs should build lobby groups in countries where laws are unfavorable for SME operations. This lobby would work with the government to create SME policies favorable to the micro and small enterprises;
- **Funding:** Build the confidence of international leasing companies to invest in SME; lobby countries to develop apex institution to finance banks and MFIs; lobby state bank to change the legal structure of outgoing cash and open their eyes to the opportunities available with a new SMEs and microfinance business model;
- **Innovation:** Focus on product diversification to address the needs of the low income people. Build the capacity in skill development and training to create professionals and encourage educated individuals to join the SMEs and microfinance sector. More research and technology transformation can ensure replication of best practices and influence professionals to go ahead to next practices;



# Closing Remarks

## For Further Information and Communication

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