

# **SME Finance: Opportunities for Banks**

***MicroSave***

**May 2015**

***MicroSave***

Market-led solutions for financial services

# Agenda

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Key Constraints Faced by Banks on SME Finance



Innovative Sales and Delivery Solutions



Novel Ways to Lend to SMEs



Business Development Services as Key Differentiator for Banks



Case Study of Implementation of Advisory Services



About *MicroSave*

# Agenda

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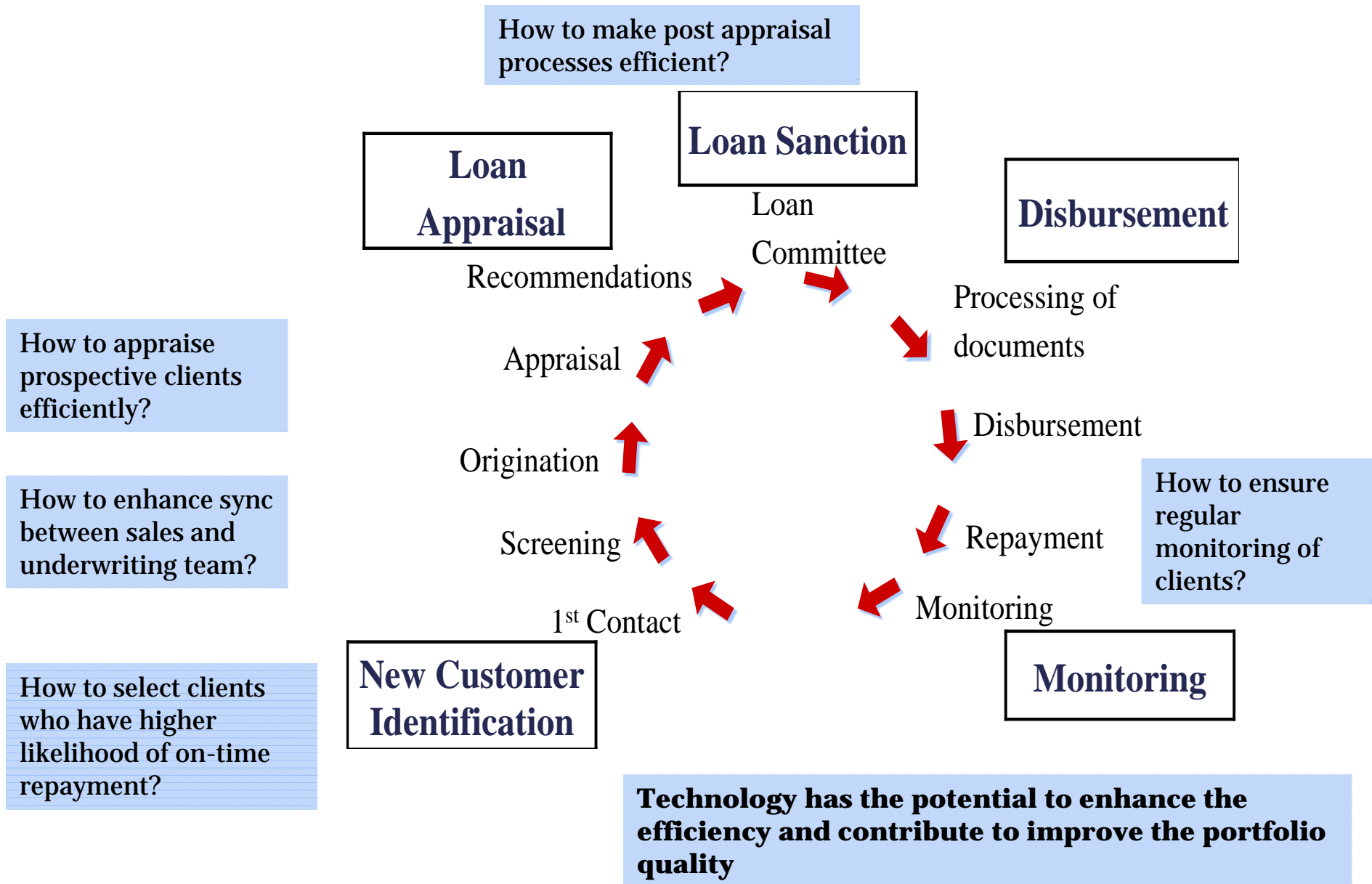


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# Challenges Faced by Banks on SME Finance



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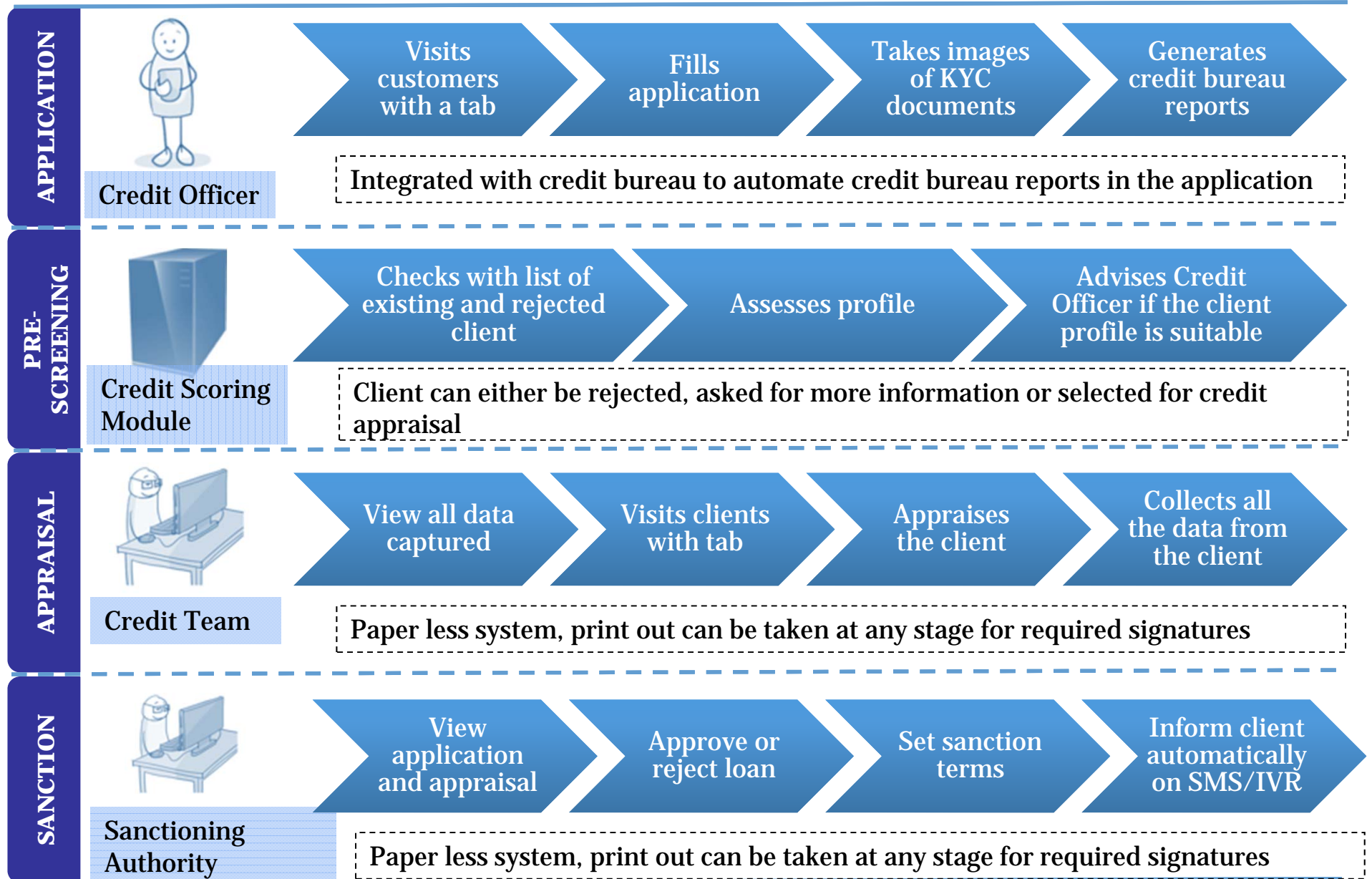


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# Remote Loan Origination System (With Credit Scoring) (1)



# Remote Loan Origination System (With Credit Scoring) (2)

## BENEFITS

### Productivity

- Productivity up by 51%
- Error reduction by 70%
- Automation reduces data entry time by 50%
- Processes 1.5x as many loans.
- Enables low-caliber field staff to perform high-quality work

### Efficiency

- TAT down by 75% as a result
- Real-time data availability & fewer iterations
- TAT is key differentiator in customer's minds.
- Borrower gets loan on time and doesn't resort to additional borrowings.

### Origination

- Origination cost per customer goes down by 60%
- Improved productivity at all levels
- Elimination of costs such as courier & data entry vendor
- Profitability, scope of delivery of loans at lower interest rate

### Portfolio quality

- Portfolio quality increases considerably
- Chances of selection of bad clients reduces significantly

## Remote Loan Origination System (With Credit Scoring) (3)

### Design aspects:

The credit scoring tool can either be designed as expert, statistical, or statistical integrated to psychometric tools

### Example of Expert Credit Scoring Tool:

#### Attributes

##### Borrower

Experience of borrower; Credit history; Savings history (Six-month average versus the loan amount); and Credit Bureau history

##### Business

Industry; Property ownerships; Level of formalisation; and Purpose of loan (for majority of the loan amount)

##### Primary Source of Repayment

Debt Service Coverage Ratio

##### Alternate Sources of Repayment

Alternate verifiable sources of income compared to instalment; Collateral coverage;

**All the attributes above are rated on the scale of 5 and a composite weighted score is calculated to determine the risk score of a prospective client.**



# Remote Loan Origination System (With Credit Scoring) (4)

## Business Credit Assessment Form

Cloud-based business credit assessment form

\*Required

Name of the prospective borrower \*

George Thomson

Borrower's residence address \*

Mwizi Road

Enterprise type \*

Micro

Small

Medium

Enterprise address \*

Westlands Area

Experience of the borrower \*

>10 years

100% repayment on time for more than 2 loan cycles \*

100% repayment on time for 1 loan cycle

Only one instalment defaulted

2-3 instalments defaulted

More than 3 instalments defaulted

No loan records

CRB history \*

Industry \*

Property ownerships \*

Level of formalisation \*

Purpose of loan (for majority of the loan amount) \*

Debt Service Coverage Ratio \*

Alternate verifiable source of income compared to instalment \*

CRB history \*

No payment in arrears for 2 or more loans from same institution

Industry \*

Services, Wholesale and retail

Property ownerships \*

Rented and operating at same location for 5 or more years

Level of formalisation \*

Registered with local authorities

Purpose of loan (for majority of the loan amount) \*

Current assets financing

Debt Service Coverage Ratio \*

3.0-3.49

Alternate verifiable source of income compared to instalment \*

120-149%

Collateral Coverage \*

180-199%

Guarantor's net disposable income (minus all obligations) compared to instalment \*

120-149%

Submit

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## **Merchant Cash Advance : A Novel Lending Mechanism (1)**

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- ❑ Merchant cash advance is a point-of-sales (POS) based loan product for merchants offered for a fixed tenure (usually less than 24 months) to meet the working capital requirements.
- ❑ Unlike working capital products of banks, it is an advance to a business in exchange for an agreed upon percentage (withholding limit) of future credit card and/or debit card sales. The loan, payable daily, deducted from the sales at the point-of-sales device itself, unburdens the SMEs from the rigour of bulky monthly repayments.
- ❑ Applies as well to a wider spectrum of future receivables, revenue and receivables factoring. The target segment for this product includes the small and medium sized retailers.
- ❑ The unique features of this loan programme are the easy procedures of underwriting and less paperwork backed by robust systems at the back end including the use of credit scoring tools.

## Merchant Cash Advance : A Novel Lending Mechanism (2)



Eligibility is determined based on the average card sales and/or overall sales over a period of time say 1-2 years

An agreement is reached between the FI and the entrepreneur on the withholding limit that determines the tenure

Advance is provided to the entrepreneurs usually in 36-48 hours after the application

FI replaces POS machine with its own, the daily sales comes to the FI first from which they pay the amount to entrepreneur after deducting the withholding

### Eligibility determination and monitoring is based on:

- Card Sales
- Settlement Days
- Chunkiness Index
- Seasonality
- Impact
- Segment

## Merchant Cash Advance : A Novel Lending Mechanism (3)

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### Differences

#### Merchant Cash Advance

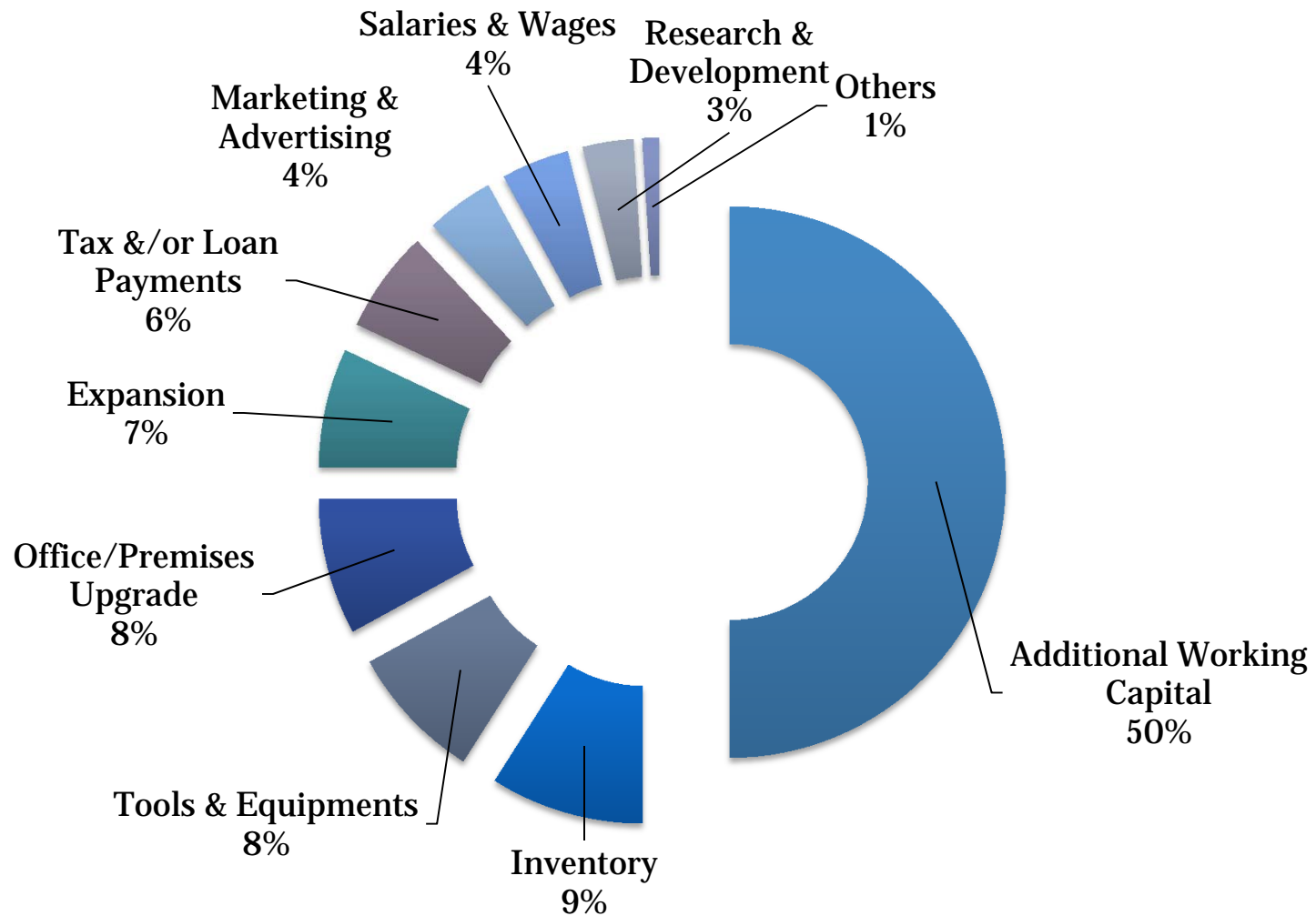
- Dependent on sales volume
- Easy application
- No collateral
- Approved in 36-48 hours
- No fixed payment
- Daily repayment
- Minimal documentation
- No penalties on late payment

#### Bank Loan

- Dependent on cash flows and credit appraisal
- Collateral required
- TAT: 1-4 weeks
- Fixed payment
- Usually month payment
- Cumbersome documentation
- Late payment penalties

## Merchant Cash Advance : A Novel Lending Mechanism (4)

### Usage of Merchant Cash Advances



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## Non Financial Services (1)

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For banks, there is a new business proposition and value in providing non-financial services (NFS) to their SME customers in order to:



Profit from the client's loyalty and continued association with the bank



## **Non Financial Services (2)**

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NFS can be aimed at strengthening the financial management, market knowledge awareness, fund raising, and productivity of their SME customers. The key issue is identifying what will work in this market and what can achieve scale.

Some of the NFS examples are:

- (a) Setting up and managing an SME Business Club
- (b) Sponsoring a TV show
- (c) Delivering training to SMEs
- (d) Setting up an internet platform for SMEs
- (e) Sponsoring the Entrepreneur of the Year contest
- (f) Developing a women focused approach
- (g) Offering sector specific services (e.g. Agribusinesses)

## **Non Financial Services – Examples of Our Work (1)**

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We have developed customised NFS products for the markets in which the banks operate. Some of our SME training toolkits include:

- Financial Management
- Accounting
- Business Planning
- HR Management
- Costing and Pricing
- General Administration
- Logistics Management
- Expanding to international markets
- Risk Management
- Debt Finance
- Presenting your business to bankers and investors
- Technology
- E-Commerce

## **Non Financial Services – Examples of Our Work (2)**

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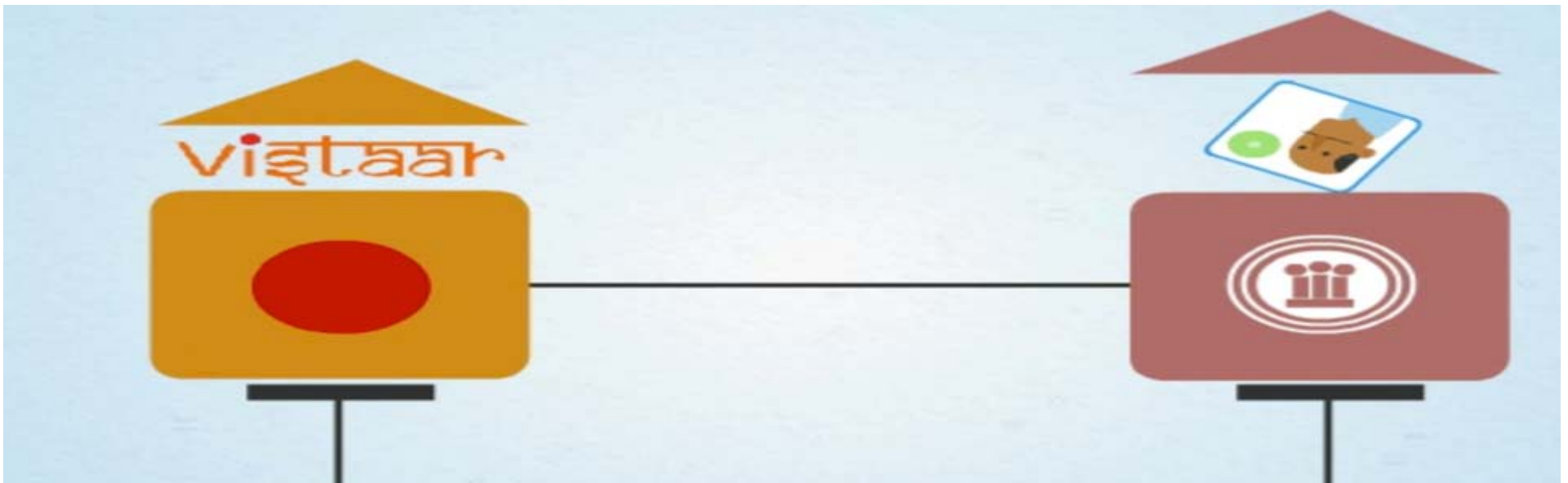
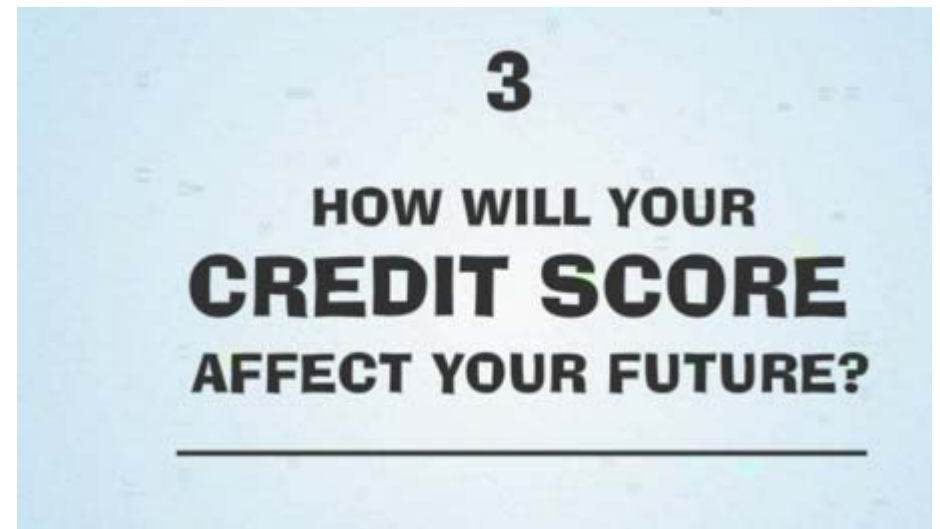
Video-based trainings to SMEs:

- ❑ Delivered through the credit officers carrying tabs
- ❑ 3-5 minutes videos
- ❑ Use of animations to allow use of any language
- ❑ Delivered every monitoring visit (usually once a month)

Feedback from banks:

- ❑ Follow-up interviews show that most customers retained the lessons in the video, resulting in a better understanding of managing their businesses well.
- ❑ The unexpected finding from the interviews was that the video left a very good impression of the firm as a whole.
- ❑ The professional looking video increased the trust in firm's capabilities, which further analysis could find led to customer word of mouth marketing and repeat customer.

## Non Financial Services – Examples of Our Work (3)



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# Approach and Impact

## Approach

- Segmentation – identification of key segments
- Market research – needs assessment for financial products/services for SMEs
- Products designed based on needs assessment - for segments/types of
- Credit scoring tool - cloud based to screen clients based on risk
- Risk pricing mechanism – higher risk translates to higher rate of interest
- Institutional capacity strengthening – modified processes, optimised systems, training of staff (emphasis on field-based training)
- Marketing collateral design

## Impact of introducing new products

### Retention

- Retain existing clients
- Avoid losing existing clients tempted to drop out because unsatisfied with credit methodology. These clients are key to any FI since they usually present higher margin

### Expansion

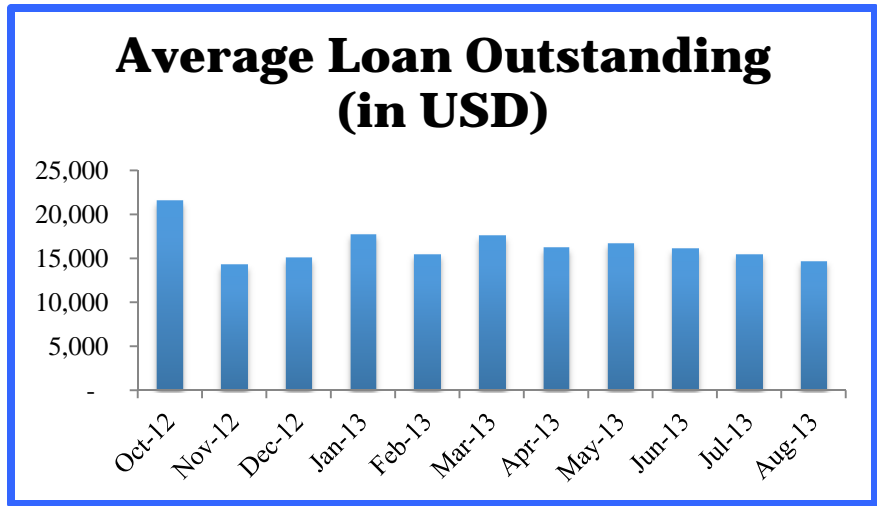
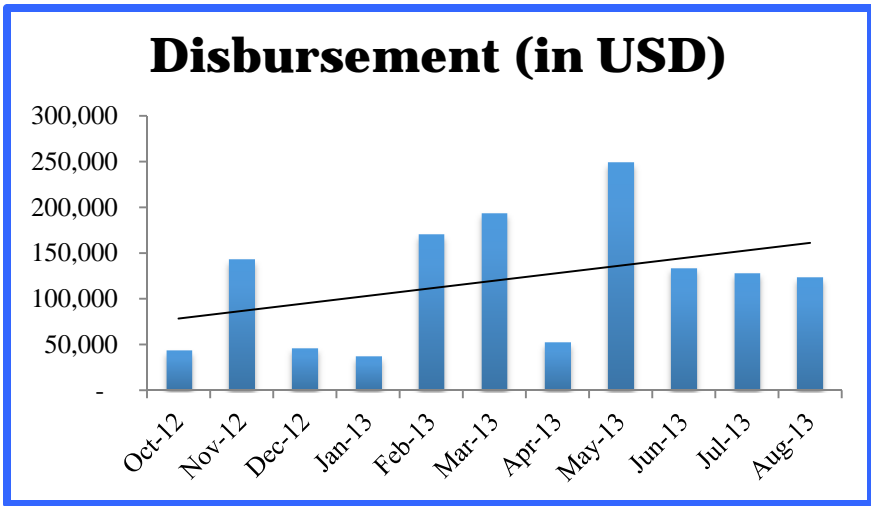
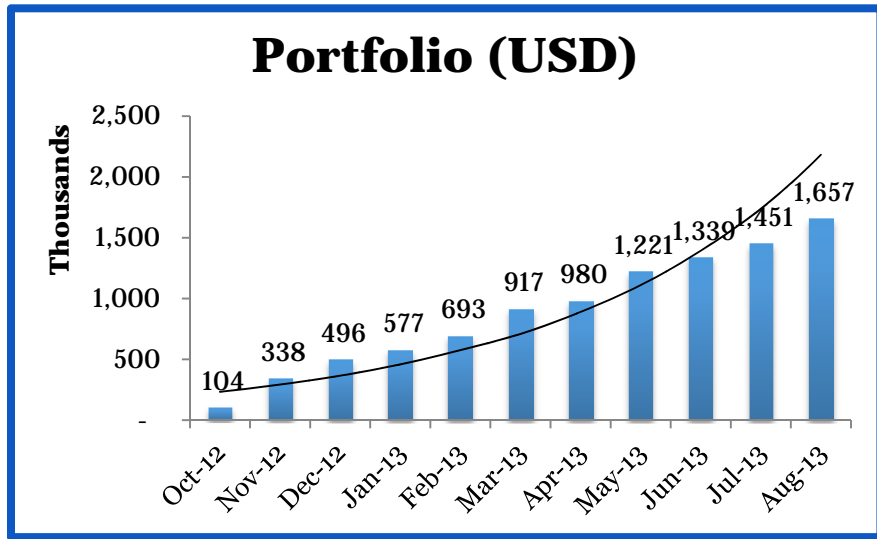
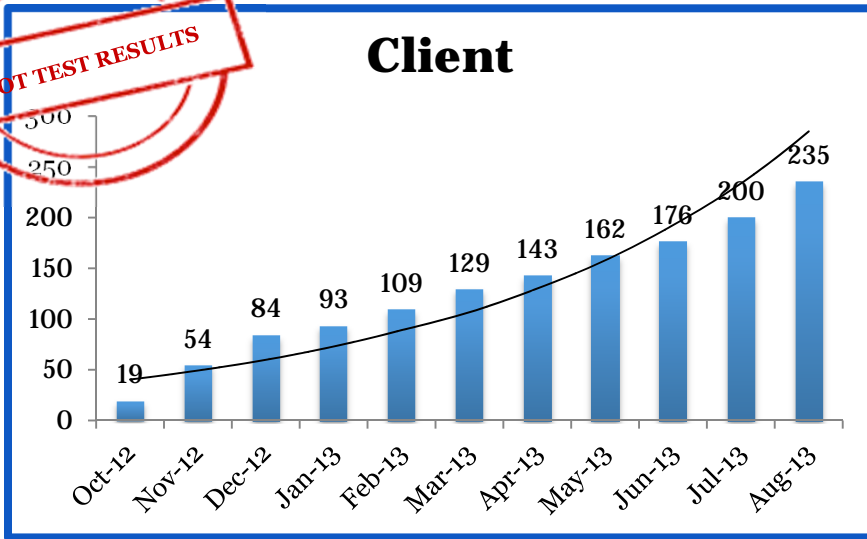
- Acquire new customers who are growth-oriented and are foreseeing a “business expansion” or higher value loan after a few loan cycles



## Segmentation - Outcome

Sectors	% of GDP	Subsectors
Wholesale and retail trade	11	Motor vehicle and motor cycle Food, Beverages and Tobacco Housing goods, clothes, footwear and leather articles Machine, equipment and supplies
Transportation	4	Other land transport Warehousing and storage
Administrative and other support services	3	Travel agency, tour operator Security agencies and support Other service activities, washing, dry cleaning, hair dressing etc.
Education	3	Private sector educational institutions
Manufacturing	2	Food processing - meat and fish; fruits and vegetables; vegetable and animal oils and fats; dairy products; grain mill and starch products, other food products; and prepared animal feed Beverages - soft drinks and bottled waters Furniture and others
Hotels and restaurant	2	Accommodation services Food and beverage service
Health	1	Private hospitals Pharmacies and related
Livestock	2	Animal production

# Results





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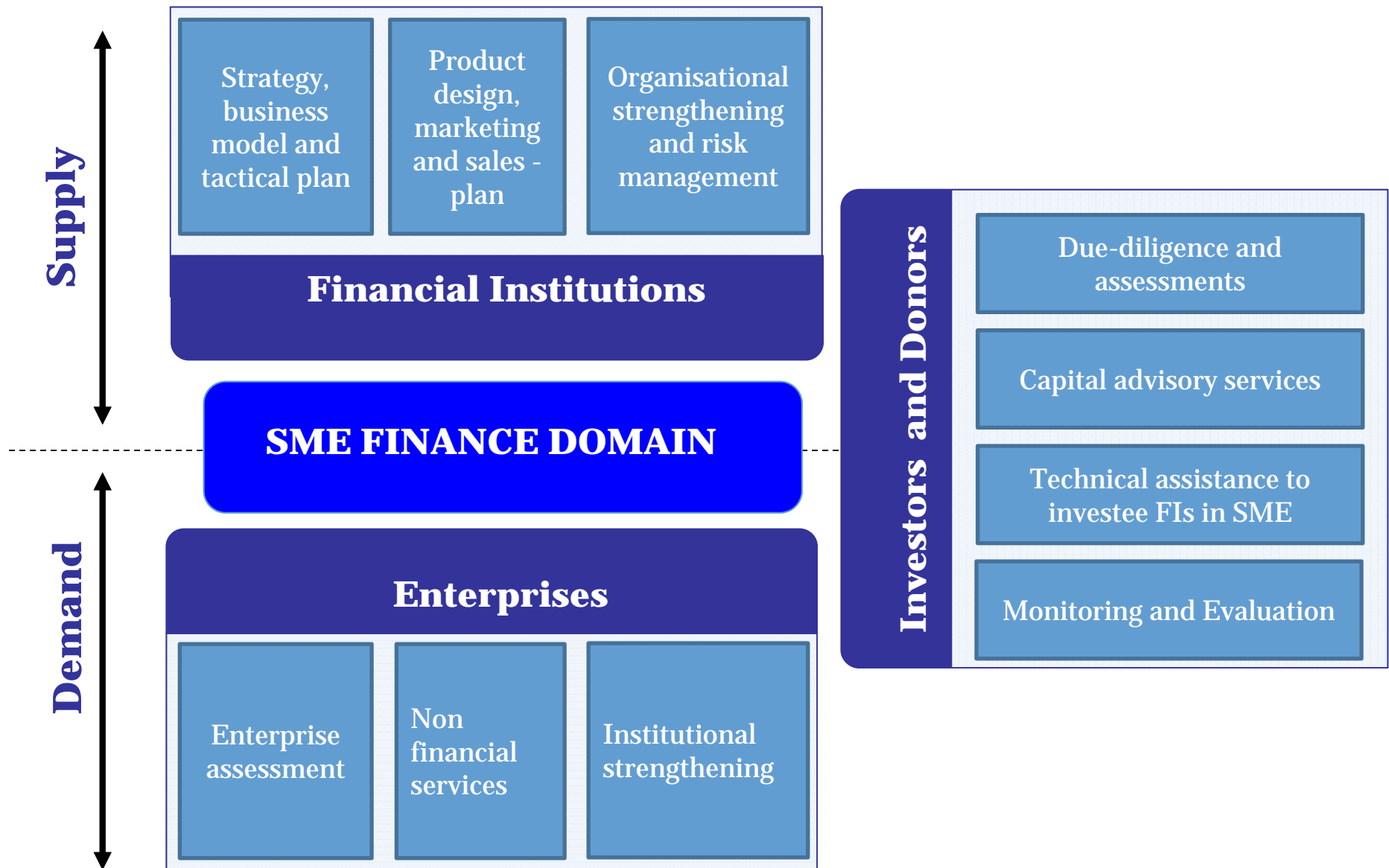
*MicroSave* is a global consulting firm committed to promoting financial access and responsible finance amongst low-and middle-income populations. We lead and support the provision of high-quality, affordable, market-led financial services. SME Finance domain at *MicroSave* supports promising interventions in SME sector through project design and implementation around strategic, financial and operational solutions development.

### Mission Statement of SME Finance Domain

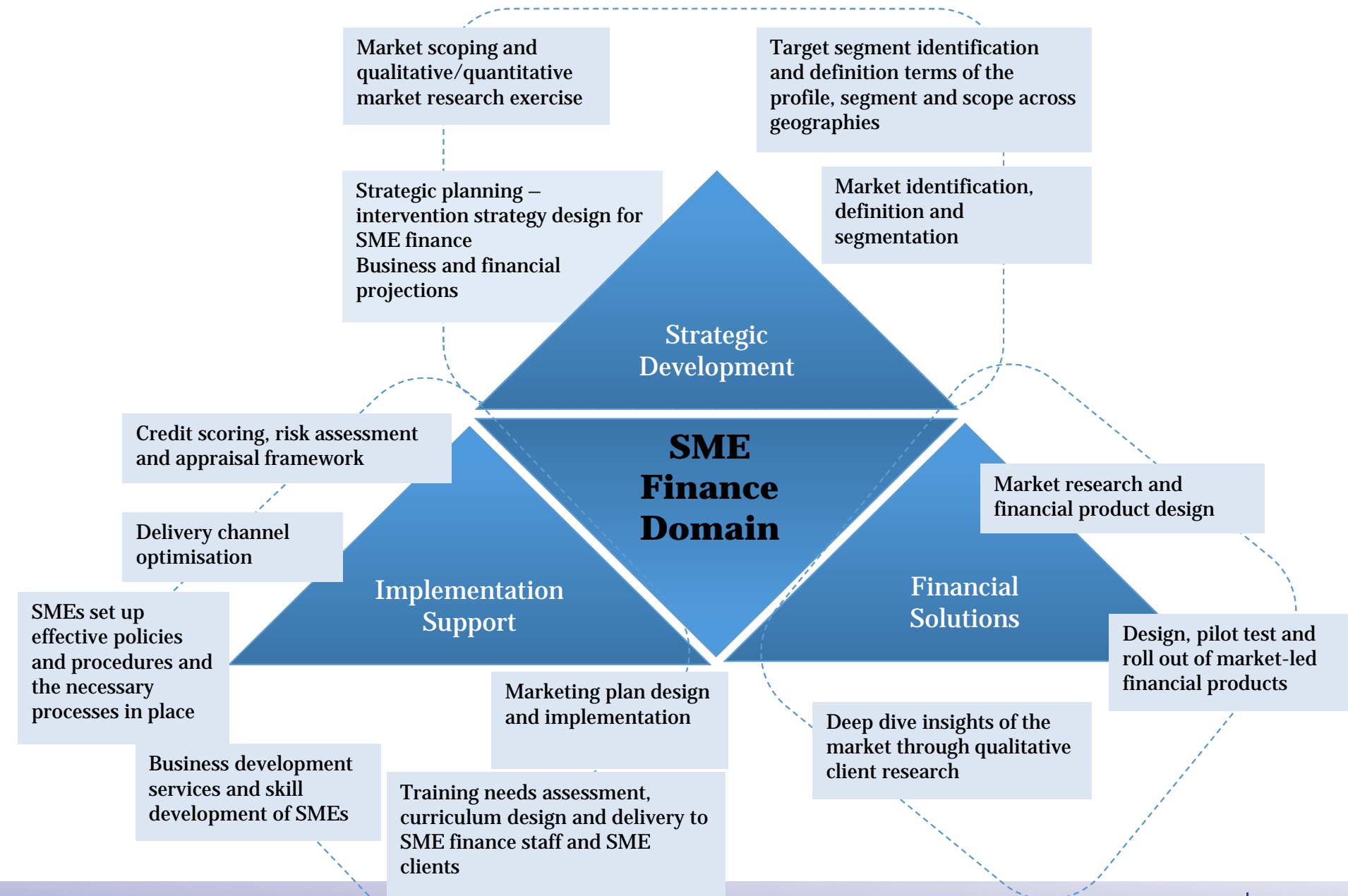
We support growth and success of small and medium enterprises through:

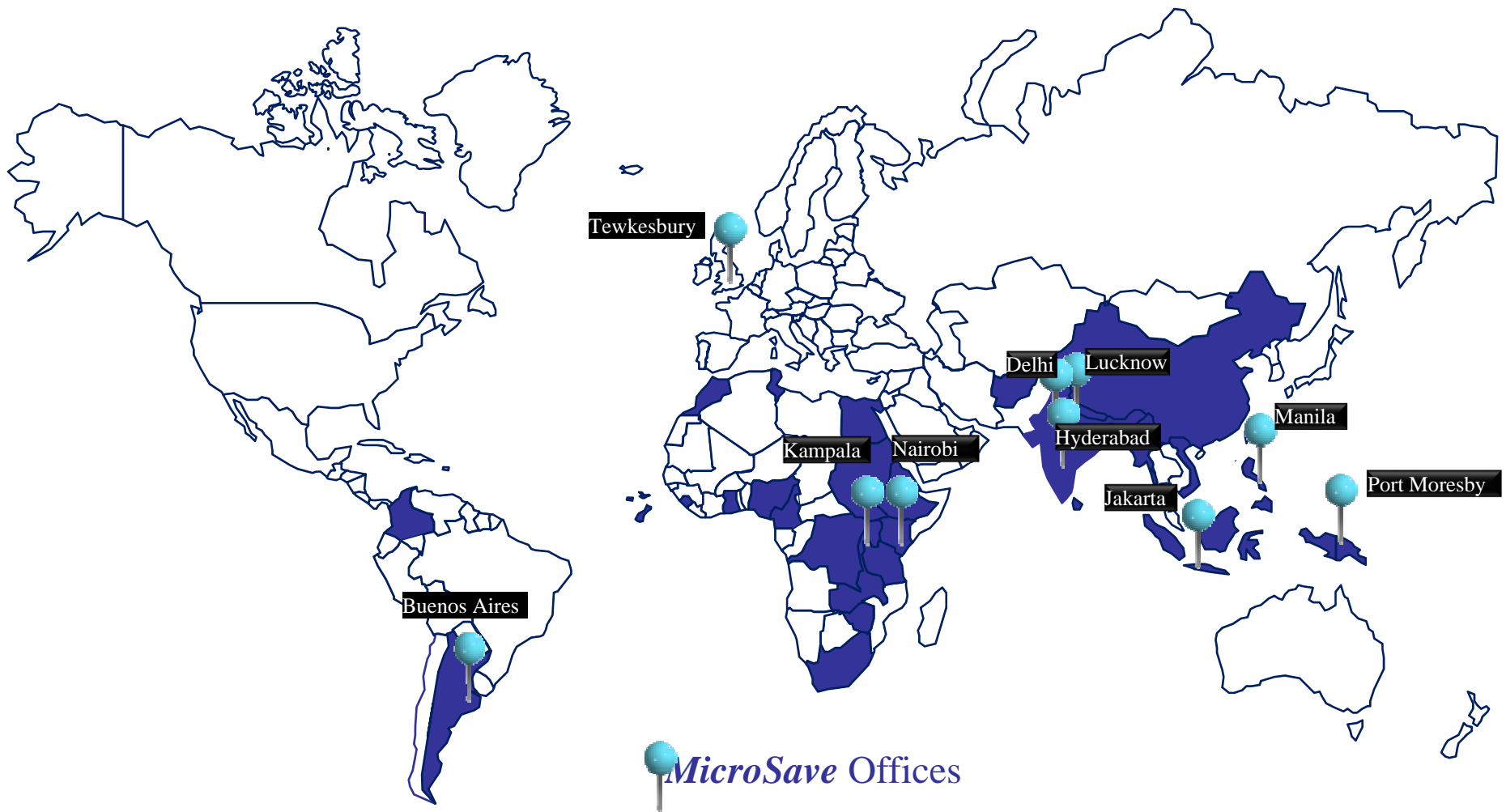
- ❑ Assisting financial institutions to deliver high-quality, market-led financial and non-financial services to enterprises
- ❑ Strengthening capacities of enterprises and enterprise financing institutions by business process re-engineering of front end sales and marketing processes and back end process including information technology, HR, accounting and finance
- ❑ Championing the effective use of investments and technical assistance funds of donors and policy makers towards enhanced access to finance and other non-financial services to enterprises

# Our Services



# Our Services





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**Thank you**

