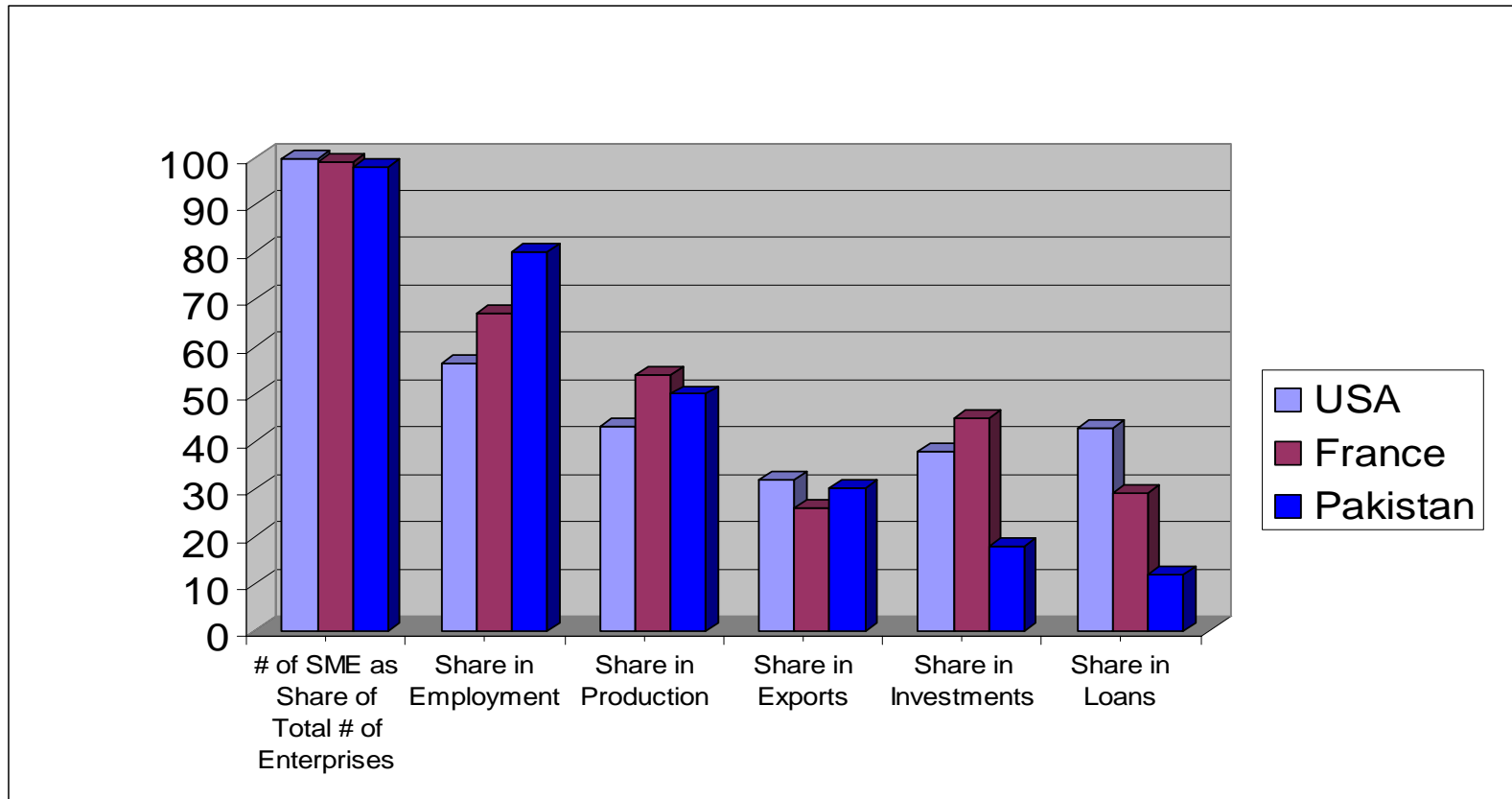

SME Lending



Importance of SME Sector



SMEs contribute significantly to the local economies but have limited access to loan funds

Why are Banks reluctant to venture into SME Lending?

- Limited or lack of audited financial statements or other documentation
- Lack of track record of SMEs in the banking sector
- Limited or lack of collateral
- Small ticket sizes



SMEs are often perceived as risky clients



SMEs are often perceived as costly clients

SME Banks Worldwide

KMB, Russia



Raiffeisen Bank, BiH

BRI, Indonesia



Universal Bank, BiH

IK Banka, Macedonia



Tutunska Banka, Macedonia



Micro Enterprise Credit, Moldova

XAC Bank, Mongolia



ProCredit Bank
Serbia

ProCredit Bank, Serbia

People`s Bank, Sri Lanka



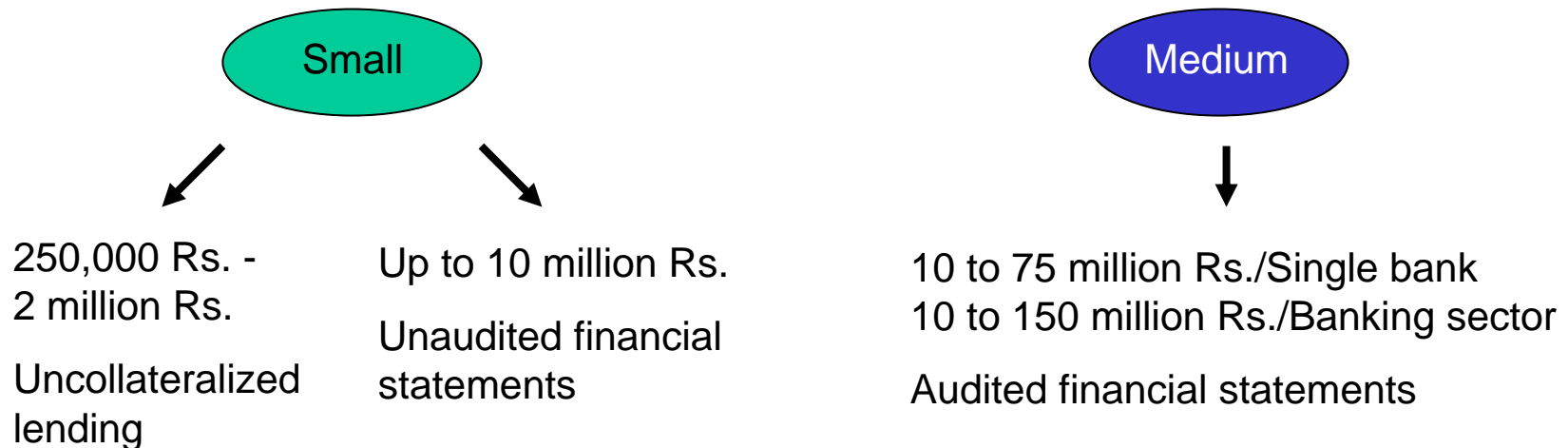
UPI Banka, BiH

BAAC, Thailand

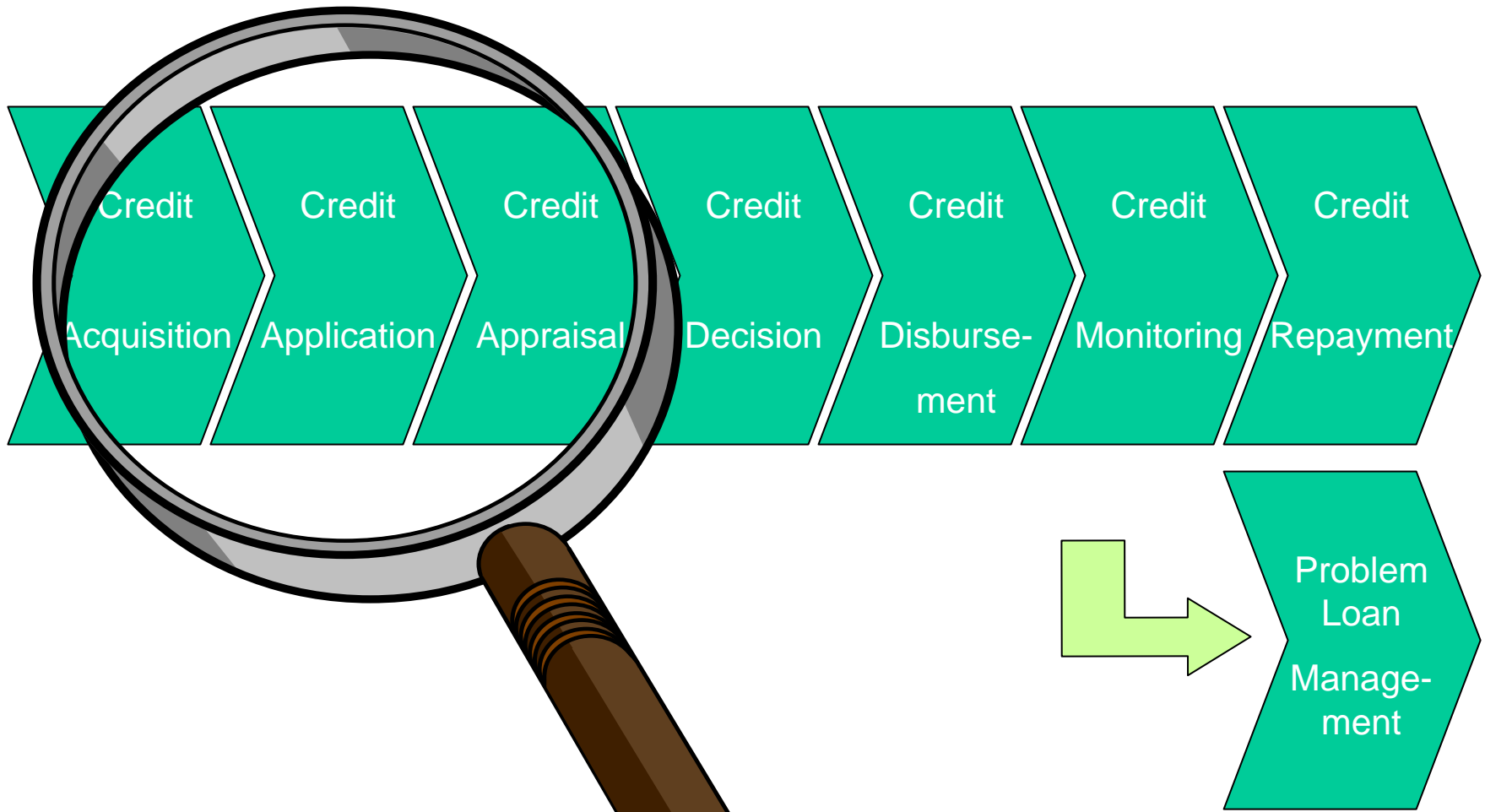


Focus on Small Lending

- ❑ Large number, huge market potential
- ❑ Less price sensitive compared to medium-sized enterprises
- ❑ Greater customer loyalty - „house bank“ principle
- ❑ Greater cross-selling potential
- ❑ Better repayment performance as they do not want to endanger access to bank services



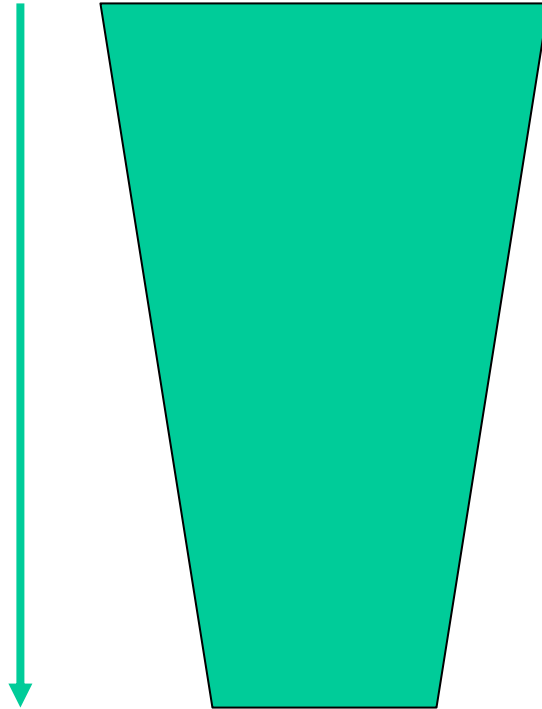
Loan Cycle: 7 Phases



Costs associated with Borrower Selection

Loan Origination

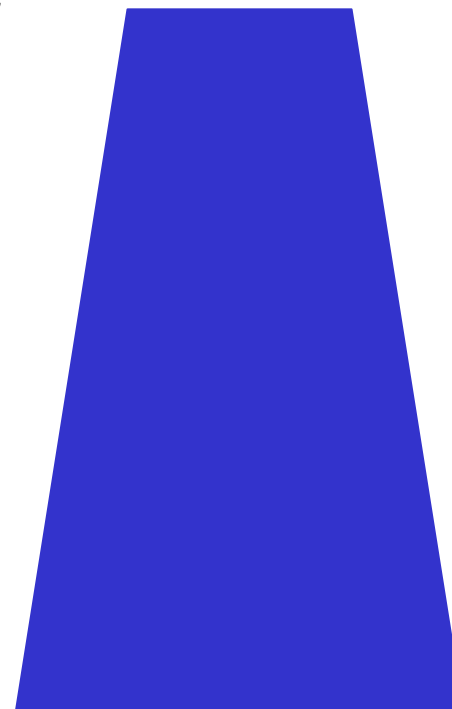
Credit Decision



**Number of
(potential)
borrowers**

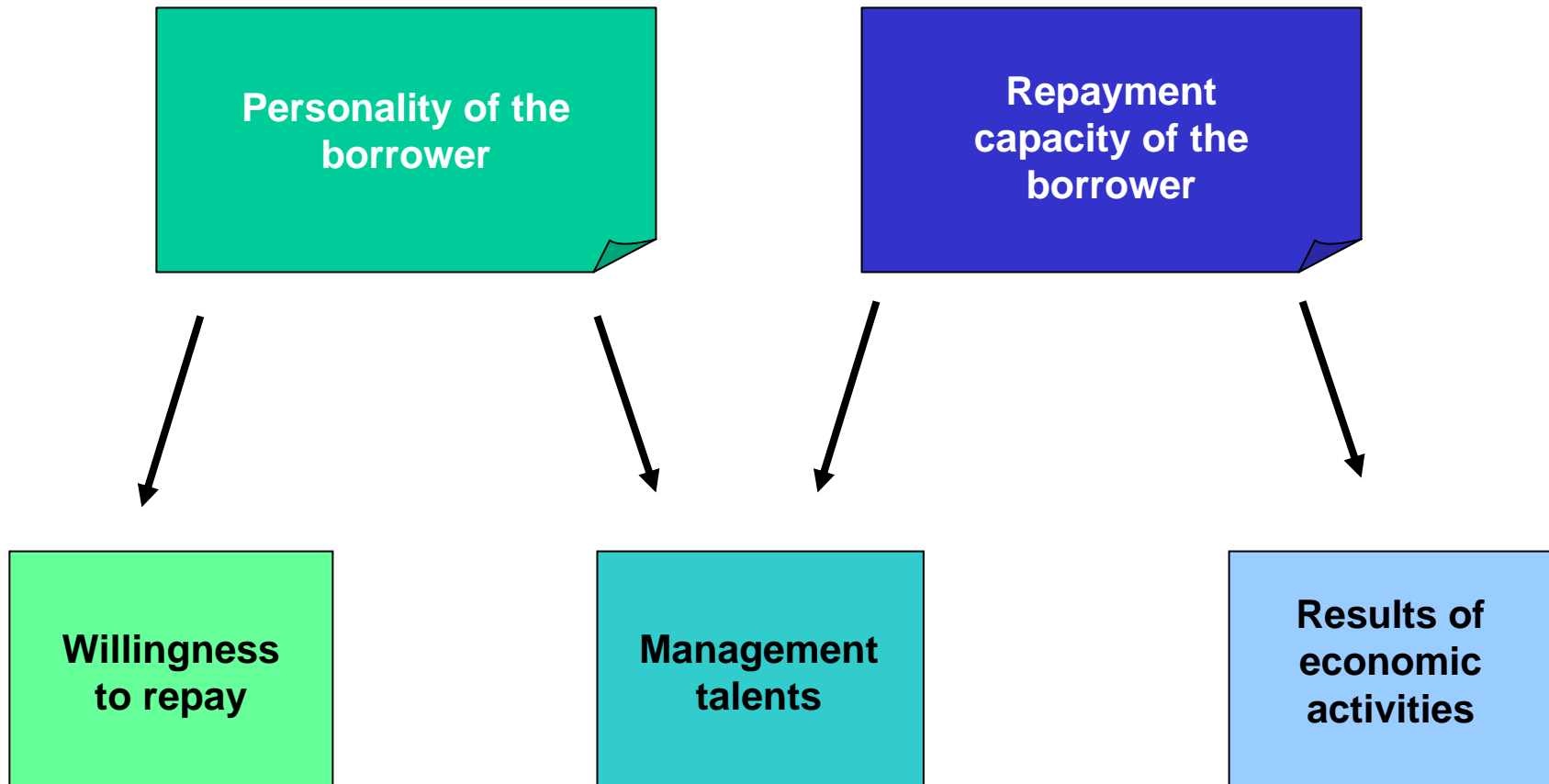
Loan Origination

Credit Decision



**Accumulated
operational
costs**

Dimensions of Creditworthiness



Loan Acquisition and Application

- ❑ Marketing efforts to directly capture good SME credit risks
 - Contacts with Chambers of Commerce
 - Contacts with high-quality suppliers
- ❑ Filtering mechanisms prior to loan application by determining simple eligibility criteria
 - Exclusion of certain sectors and business activities
 - Minimum number of years in business or minimum turnover
- ❑ Filtering mechanisms during loan application
 - Simple scorecard of 5-10 key indicators
 - Possible actions: Immediate loan objection - for higher risk categories requirement of risk mitigating measures - implications for subsequent loan analysis
 - First check on personal character of the potential borrower

Loan Appraisal - Classic

Corporate Lending Practices

- ❑ Focus on formally registered SMEs and, hence, on corporate structure
- ❑ Emphasis on official business documents, particularly past and future balance sheet and P&L, business and investment plans
- ❑ Borrowers are required to submit these documents upfront prior to starting the loan process
- ❑ Focus on ratio analysis and credit rating based on official business documents
- ❑ Focus on collateral, both in terms of
 - quantity - often 150-200% of loan amount
 - quality - mortgages

Loan Appraisal - Best Practice

Small Lending Practices

- ❑ Assessment of the behavior and personality of the potential borrower is critical
- ❑ „True“ balance sheet, P&L as of today and future cash-flow statement are jointly developed between borrower and loan officer
- ❑ Cash-flow statement is the core instrument to assess the repayment capacity of a potential borrower



Cash-flow reveals what funds have been raised and how they have been used



Loans must be repaid from cash



Projections of future cash-flows may include a sensitivity analysis if needed (e.g. for borderline borrowers)

Structure of Cash-flow

Cash from Operations:

- Profit generated by the production & sales of goods and services
- +/- Adjustments for the expansion and tightening of working assets
- +/- Adjustments for non-cash income and expense items

Cash from Investments:

Cash generated by changing the asset base

Cash from Financing:

Cash associated with borrowings, dividends paid and private withdrawals

+ Consideration of opening cash balance

Detailed Structure of the future Cash-flow

	Net profit from actual P&L	}	Cash from Operations
+	Depreciation Expenses		
-	Taxes actually paid		
-/+	Changes in Receivables		
+/-	Changes in Payables		
-/+	Changes in Inventory		
<hr/>			
	-/+ Investments in Fixed Assets	}	Cash from Investments
<hr/>			
	+ Bank Loans and other Borrowings	}	Cash from Financing
-	Repayments on Bank Loans and other Borrowings		
-	Dividends		
-	Private Withdrawals		
<hr/>			
=	<u>Net Cash Flow</u>		
+	Cash on Hand and Bank Accounts at the Beginning of the Period		
=	Cash on Hand and Bank Accounts at the End of the Period		

Information Sources for determining future Cash-flow

- ❑ On-site interview of the potential borrower
- ❑ Documents that sustain cash-flow information, e.g. cashbook, personal notes, invoices from suppliers, bank statements on current and savings accounts etc.
- ❑ Physical assessment of the inventory of finished, semi-finished goods and raw materials
- ❑ Physical assessment of fixed assets, e.g. machinery
- ❑ Use of informal information sources: family members, neighbours, reputable members of the local community
- ❑ Comparison with peer family households and SMEs

Future Cash-flow Projections

- ❑ Minimum period: following 12 months
- ❑ Monthly basis if strong seasonal variations are expected
- ❑ As an input, forecast of balance sheet and P&L
- ❑ Special attention to the following:
 - Forecast of expected tax payments - increasing the envisaged official tax payment by a safety cushion
 - Forecast of likely private withdrawals
 - Forecast likely changes of payment patterns
 - Forecast likely changes in inventory turnover
 - Forecast likely changes in fixed assets
 - Forecast likely borrowings (own loan and others) under different conditions



Loan to be approved if there is a sufficient liquidity cushion after loan repayment

A12		Shpenzimet për zyre	
	Periodha	12	muajt
	Periodha e kaluar	%	
Parashikimet për një vit të plotë			
Bilanci i Suksesit			
QARKULLIMI		115,000	100%
Shp për mallin e shitur	92,000	80.0%	
Pagat nga prodhimi	0	0.0%	
BRUTO FITIMI		23,000	20.0%
Pagat administrative	6,000		
Giraja	0		
Transporti	6,000		
Marketingu	0		
Kamata për kreditë	0		
		7,739	
Totali i shpenzimeve fikse		18,000	15.7%
FITIMI PËR AMORTIZIMIT&TA		5,000	4.3%
Amortizimi	0		
FITIMI PAS AMORTIZIMIT		5,000	4.3%
Bilanci i gjendjes sipas	10/06/04		10/06/05
	Fillëstare	Koeficientët e llogarit	Dikët
Paratë e gatshme dhe në bankë	10	0%	0.0
Llogaritë e arkëtueshme	100	0%	0.3
Lënda e parë	20		
*Pjesë në vlerë			
*Produktet(mallrat) e gatshme	1,000		
Totali i Produktëve	1,020	SHD/S	90.2 4.0
Totali i mjeteve likuide	1,130		55,028
*Fajisjet	200		32,200
Totali i mjeteve fikse	32,200		32,200
Mjete tjera	0		0
TOTALI I MJETEVE	33,330		87,228
*Kreditë afat-shkurtë	0		9,388
*Kreditë afat-gjatë	0		37,444
Totali i kredive në bankë	0		46,832
Llogaritë e pagueshme	2,000	SHMSHLLP.	46.0 7.9
Obligimet tjera	0		0
TOTALI I OBLIGIMEVE	2,000		49,637
KAPITALI	31,330		37,591
Parashikimet e rrjedhës së parase			
Fitimi i planikuar para amortizimit			6,261 nga parashikimet e Bilancit të Suksesit
Tatimi (minus)			0

B22		Shpenzimet komunale	
	Numri i muajve të analizuar	12	Data e fillimit të analizave
			01/01/04
Parasyra e Rrjedhës së Parase			
No			
1 QARKULLIMI TOTAL		18,000	14,000
Qarkullimi I	100%	18,000	14,000
Qarkullimi II	0%	0	0
Të llogaritur nga biznesi	0%	0	0
2 SHPENZIMET TOTALE PËR MALLIN E SHITUR	82%	14,760	11,480
Shpenzimet për mallin e shitur I		14,760	11,480
Shpenzimet për mallin e shitur II	0.0%	0	0
Shpenzimet tjera variable		0	0
3 BRUTO FITIMI	18%	3,240	2,520
TOTALI I SHPENZIMEVE FIKSE	7%	1,551	1,551
Pagat (përfshirë edhe kontabilistin)		700	700
Sigurimi social		24	24
Giraja		300	300
Shpenzimet për transport		150	150
Kamata për kreditë tjera		137	137
5 FITIMI PËR TATIMIT	11%	1,689	969
Tatimi në fitim		0	350
6 NETO FITIMI PAS TATIMIT	11%	1,689	969
7 BUXHETI FAMILJAR		275	275
Të llogaritur në familje		400	400
Shpenzimet e rregulluara të familjes		125	125
8 RRJEDHA E PARASE pas Familjes		1,364	1,244
POZICIONET E RRJEDHËS SË PARASE			
TOTALI I ANUITETEVE NË BANKA		2,143	2,143
Anuitetet për kreditë tjera		833	833
Anuitetet për kreditë të rrjedhës së parase (përfshirë kamatën)		1,310	1,310
10 RRJEDHA E PARASE pas kredive në banka		-179	-899
Të llogaritur (neto) nga bilanci (përfshirë miratimin e fitimit)		0	0
Shpenzimet shpesh të familjes (përfshirë pushimet)		0	0
11 NETO RRJEDHA E PARASE PAS TË GJITHAVE		-179	-899

Kommentet mbi Pasqyrën e Bilancit të Suksesit	
Shuma e kredisë	40,000
Afati(muajt)	36
Kamata(në vit)	11.00

Mechanisms to improve operational Efficiency

- ❑ Set of streamlined, simple standard forms
- ❑ IT support systems critical - high level of automation
 - From loan application to loan repayment all forms automatically tied together
 - Use of innovative technical features, e.g. palm pilots during onsite visits
 - Daily automatic reporting on loan portfolio performance
 - Storage of all current and historic data
- ❑ High start-up investment in building the relationship with a new borrower will later be offset by simpler procedures for repeat borrowers
- ❑ Incentives for borrowers to repay through appropriate „carrots and sticks“
- ❑ Incentives for loan officers to ensure efficient and effective loan analysis

Principles of Best Practice Small Lending

- ↪ Various filtering mechanisms to screen out bad credit risks as early as possible in the loan cycle
- ✦ Establishment of a close relationship with the borrower, e.g. on-site visits to the workplace and home
- ✦ Joint development of „true“ financial statements
- ⌘ Focus on cash-flow projections
- ⌘ Focus on personal character and behaviour
- ⌘ Assessment of the repayment capacity of the SME household economy
- ⌘ Triangulation of information using informal sources
- ⌘ Keeping transaction costs for the borrowers at a minimum through streamlined and automated procedures

Implications for Commercial Banks when implementing Best Practices Small Lending

- ↪ Preparation of well-experienced loan officers that establish close relationship with the borrowers
- ✦ High level of automation of lending procedures
- ✦ Creation of a comprehensive database of customer information to facilitate determination of filter mechanisms/scorecards and speed up processing repeat loans
- ⌘ Decentralisation of decision-making, empowering branch level
- ⌘ Adjustments of internal control systems due to highly decentralised operations
- ⌘ Enhancing operational efficiency and maintaining high loan portfolio quality by providing a combination of „carrots and sticks“ to loan officers and borrowers alike