SME Finance: Opportunities for Banks

MicroSave

May 2015
Agenda

- 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

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
Challenges Faced by Banks on SME Finance

How to make post appraisal processes efficient?

Loan Appraisal
- Recommendations
- Appraisal
- Origination
- Screening
- 1st Contact

Loan Sanction
- Loan Committee
- Processing of documents
- Disbursement
- Repayment
- Monitoring

New Customer Identification

How to appraise prospective clients efficiently?

How to enhance sync between sales and underwriting team?

How to select clients who have higher likelihood of on-time repayment?

Technology has the potential to enhance the efficiency and contribute to improve the portfolio quality
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About MicroSave
Remote Loan Origination System (With Credit Scoring) (1)

**Application**
- Credit Officer
  - Visits customers with a tab
  - Fills application
  - Takes images of KYC documents
  - Generates credit bureau reports

  Integrated with credit bureau to automate credit bureau reports in the application

**Pre-Screening**
- Credit Scoring Module
  - Checks with list of existing and rejected client
  - Assesses profile
  - Advises Credit Officer if the client profile is suitable

  Client can either be rejected, asked for more information or selected for credit appraisal

**Appraisal**
- Credit Team
  - View all data captured
  - Visits clients with tab
  - Appraises the client
  - Collects all the data from the client

  Paper less system, print out can be taken at any stage for required signatures

**Sanction**
- Sanctioning Authority
  - View application and appraisal
  - Approve or reject loan
  - Set sanction terms
  - Inform client automatically on SMS/IVR

  Paper less system, print out can be taken at any stage for required signatures

Source: Artoo Analysis
Remote Loan Origination System (With Credit Scoring) (2)

**BENEFITS**

<table>
<thead>
<tr>
<th>Productivity</th>
<th>Efficiency</th>
<th>Origination</th>
<th>Portfolio quality</th>
</tr>
</thead>
</table>
| - 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 | - 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 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 increases considerably  
- Chances of selection of bad clients reduces significantly |

Source: Artoo Analysis
**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:**

<table>
<thead>
<tr>
<th>Attributes</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Borrower</strong></td>
<td>Experience of borrower; Credit history; Savings history (Six-month average versus the loan amount); and Credit Bureau history</td>
</tr>
<tr>
<td><strong>Business</strong></td>
<td>Industry; Property ownerships; Level of formalisation; and Purpose of loan (for majority of the loan amount)</td>
</tr>
<tr>
<td><strong>Primary Source of Repayment</strong></td>
<td>Debt Service Coverage Ratio</td>
</tr>
<tr>
<td><strong>Alternate Sources of Repayment</strong></td>
<td>Alternate verifiable sources of income compared to instalment; Collateral coverage;</td>
</tr>
</tbody>
</table>

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

- 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.
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
<table>
<thead>
<tr>
<th>Merchant Cash Advance</th>
<th>Bank Loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Dependent on sales volume</td>
<td>• Dependent on cash flows and credit appraisal</td>
</tr>
<tr>
<td>• Easy application</td>
<td>• Collateral required</td>
</tr>
<tr>
<td>• No collateral</td>
<td>• TAT: 1-4 weeks</td>
</tr>
<tr>
<td>• Approved in 36-48 hours</td>
<td>• Fixed payment</td>
</tr>
<tr>
<td>• No fixed payment</td>
<td>• Usually month payment</td>
</tr>
<tr>
<td>• Daily repayment</td>
<td>• Cumbersome documentation</td>
</tr>
<tr>
<td>• Minimal documentation</td>
<td>• Late payment penalties</td>
</tr>
<tr>
<td>• No penalties on late payment</td>
<td></td>
</tr>
</tbody>
</table>
Merchant Cash Advance: A Novel Lending Mechanism (4)

Usage of Merchant Cash Advances

Source: Merchant Cash Advance Usage Analysis
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Non Financial Services (1)

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

- Enhance client loyalty
- Expand portfolio reach
- Gain competitive advantage
- Profit from the client’s loyalty and continued association with the bank
Non Financial Services (2)

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)

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)

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)

3

HOW WILL YOUR CREDIT SCORE AFFECT YOUR FUTURE?

- Image 1: Two people discussing documents in front of an image of a truck.
- Image 2: Text on a card reading "viśtaar" and "MicroSave: Market-led solutions for financial services".
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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

MicroSave
Market-led solutions for financial services
### Segmentation - Outcome

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

Client

Portfolio (USD)

Disbursement (in USD)

Average Loan Outstanding (in USD)
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About MicroSave

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

Financial Institutions
- Strategy, business model and tactical plan
- Product design, marketing and sales plan
- Organisational strengthening and risk management

SME FINANCE DOMAIN

Enterprises
- Enterprise assessment
- Non financial services
- Institutional strengthening

Investors and Donors
- Due-diligence and assessments
- Capital advisory services
- Technical assistance to investee FIs in SME
- Monitoring and Evaluation

Supply

Demand
Our Services

Strategic Development

Market scoping and qualitative/quantitative market research exercise
Target segment identification and definition terms of the profile, segment and scope across geographies

Strategic Planning – intervention strategy design for SME finance
Business and financial projections

Market identification, definition and segmentation

Implementation Support

Credit scoring, risk assessment and appraisal framework
Delivery channel optimisation

SMEs set up effective policies and procedures and the necessary processes in place

SME Finance Domain

Deep dive insights of the market through qualitative client research
Marketing plan design and implementation

Market research and financial product design
Design, pilot test and roll out of market-led financial products

Financial Solutions

Training needs assessment, curriculum design and delivery to SME finance staff and SME clients

Business development services and skill development of SMEs
Thank you