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**SME Lending:
Larger microloans or smaller corporate
loans? Where is the business case?**

EFSE Annual Meeting, June 2011



Year of establishment	1980
Domicile	Frankfurt/Main
Managing directors	Gabriele Heber Dirk Haböck Dörte Weidig
Total staff	96
Staff in the field	84
Turnover 2010	EUR 11.6 million
Total equity	EUR 38.6 million



All of IPC's consulting assignments share a common orientation towards long-term sustainability and a focus on projects and target groups which are relevant in terms of achieving social aims and development policy goals.

IPC focuses on five service areas:

- ▶ in the framework of **long-term consultancy projects**, we enable commercial banks to extend credit to micro businesses and SMEs, and more generally, to strengthen their institutions as a whole;
- ▶ by furnishing **advisory services to the ProCredit group**, primarily in the fields of bank management and training, we help to establish and strengthen target group-oriented banks;
- ▶ we support financial institutions in the implementation of **environmental projects and the introduction of EE/RE finance products** for private households and SMEs (sustainable energy finance);
- ▶ we design and implement **target group-specific training** courses for financial institutions and commercial banks (i.e. classroom training, on-the-job training, train-the-trainer seminars and e-learning solutions) with the aim of building local capacity and thus ensure sustainability of partner institutions' business operations; and
- ▶ through **short-term consultancy projects** we help to enhance the operating environment for our consultancy projects by carrying out financial sector or feasibility studies



Part I: Setting the scene

1. What do we know about SMEs?
2. Where SMEs and banks meet:
A closer look at the financials of SMEs
3. How did/do banks approach SMEs?

Part II: Analyzing the past to design the future of SME finance

1. Various approaches to SME finance
2. Case study: ProCredit Albania
3. An adjusted approach: What satisfies SMEs in a responsible manner and is a business case at the same time



What do we know about SMEs?

EFSE Annual Meeting, June 2011



What do we know about small and medium-sized businesses?

THE “MACRO” PERSPECTIVE

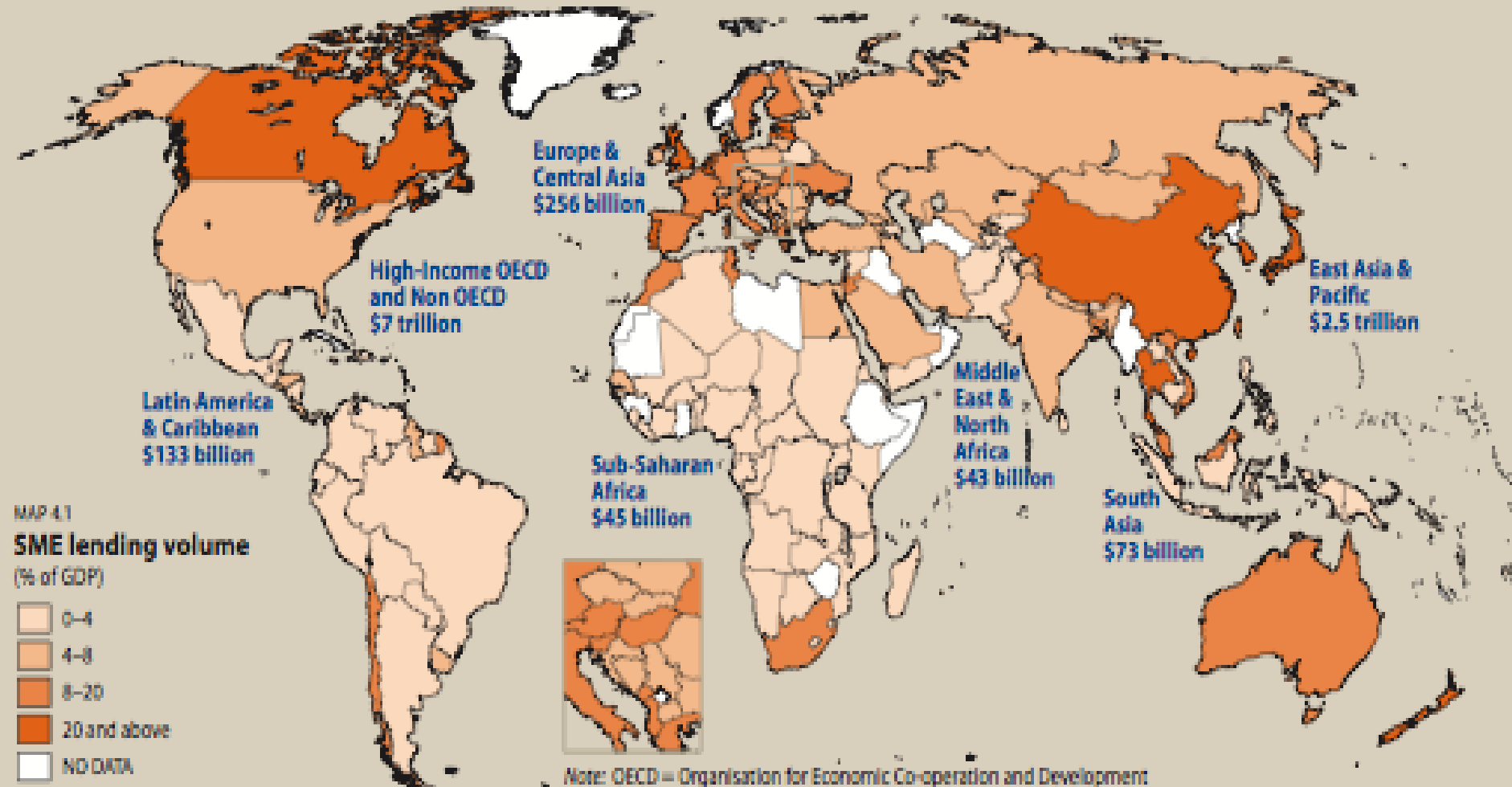


- Definitions vary greatly between countries, financial regulators and financial institutions.
- Often, the definition relies on multiple criteria and depends on the industry.
- Number of employees (threshold of 250 employees is common) and sales volume seem to be the most widely used criteria.
- Loan size is also a widely used criterion.
- **Lack of clear definition of SME**

SMEs and financial access



FINANCIAL ACCESS 2010



Note: OECD = Organisation for Economic Co-operation and Development

The map plots a ratio of SME lending volume to GDP. Actual data is presented for 50 economies that provided information. For the remainder of the economies, the ratio of SME lending to GDP is predicted by a regression model controlling for the ratio of private credit to GDP, the number of days to start a business (Doing Business database) and a dummy for offshore financial centers. See Ardic, Mylenko and Saltane (forthcoming) for detailed methodology. Data for Taiwan (China), Hong Kong SAR (China), and Puerto Rico (US) have been broken out from the national dataset.



Economy	SME definition			SME lending
	Number of employees (max.)	Sales (max.. in USD)	Loan size (max. in USD)	Value of loans (% of GDP)
<i>Albania</i>	249	2,632,185.00	-	11.30
<i>Armenia</i>	100	-	-	4.36
<i>Azerbaijan</i>	5	124,411.60	311,029.10	-
<i>Belarus</i>	-	-	-	-
<i>Bosnia and Herzegovina</i>	-	-	-	-
<i>Bulgaria</i>	-	-	-	-
<i>Georgia</i>	-	-	-	5.54
<i>Macedonia, FYR</i>	-	-	-	-
<i>Moldova</i>	249	4,500,622.00	-	-
<i>Serbia</i>	250	13,900,000.00	-	-
<i>Ukraine</i>	50	8,984,449.00	-	-

CGAP, Financial Access 2010, "The State of Financial Inclusion Through the Crisis", 2010



- SMEs are one of the pillars of Eastern European economies and are thus a crucial element for economic growth.
- They account for a major share of the total number of companies, provide a large share of employment and make a significant contribution to GDP, even though they generally account for only a limited share of exports.
- SMEs have been essential in transitions from planned to market economies in Central and Eastern European countries.¹

	Share of GDP	Share of employment	Share of total number of companies
<i>Albania</i>	72.9%	71.4%	99.6%
<i>Croatia</i>	44.0%	65.0%	99.4%
<i>Kosovo</i>			99.8%
<i>FYR Macedonia</i>	54.3%	78.4%	98.7%
<i>Montenegro</i>	60.0%	67.0%	98.8%
<i>Serbia</i>	56.7%	65.5%	99.8%

¹ Roswitha M. King, *Regional business development policy in Central and Eastern Europe: a mechanism design perspective*.



What do we know about small and medium-sized businesses ?

THE “MICRO” PERSPECTIVE





How many SMEs have managers that are not the owners ?

- a. Less than a third
- b. Less than two thirds
- c. More than two thirds



Who takes the financial decisions in an SME?

- a. The shareholders
- b. The owner
- c. The financial director



How many SMEs employ non-family members?

- a. Less than a third
- b. Less than two thirds
- c. More than two thirds





How many days does an SME need to make an investment decision?

- a. Less than 3 days
- b. Less than a month
- c. More than a month



How many SMEs have never invested in a new activity?

- a. Less than a third
- b. Less than two thirds
- c. More than two thirds



To what degree do the official financial statements of an SME reflect the reality of the business?

- a. The financial statements capture less than one third
- b. The financial statements capture less than two thirds
- c. The financial statements capture more than two thirds





How many SMEs have a bank loan?

- a. Less than a third
- b. Less than two thirds
- c. More than two thirds



How many SMEs can offer hard collateral in guarantee of a loan?

- a. Less than a third
- b. Less than two thirds
- c. More than two thirds



How much of the turnover of an SME passes through its bank account?

- a. Less than a third
- b. Less than two thirds
- c. More than two thirds





How do SMEs use the overdraft facility?

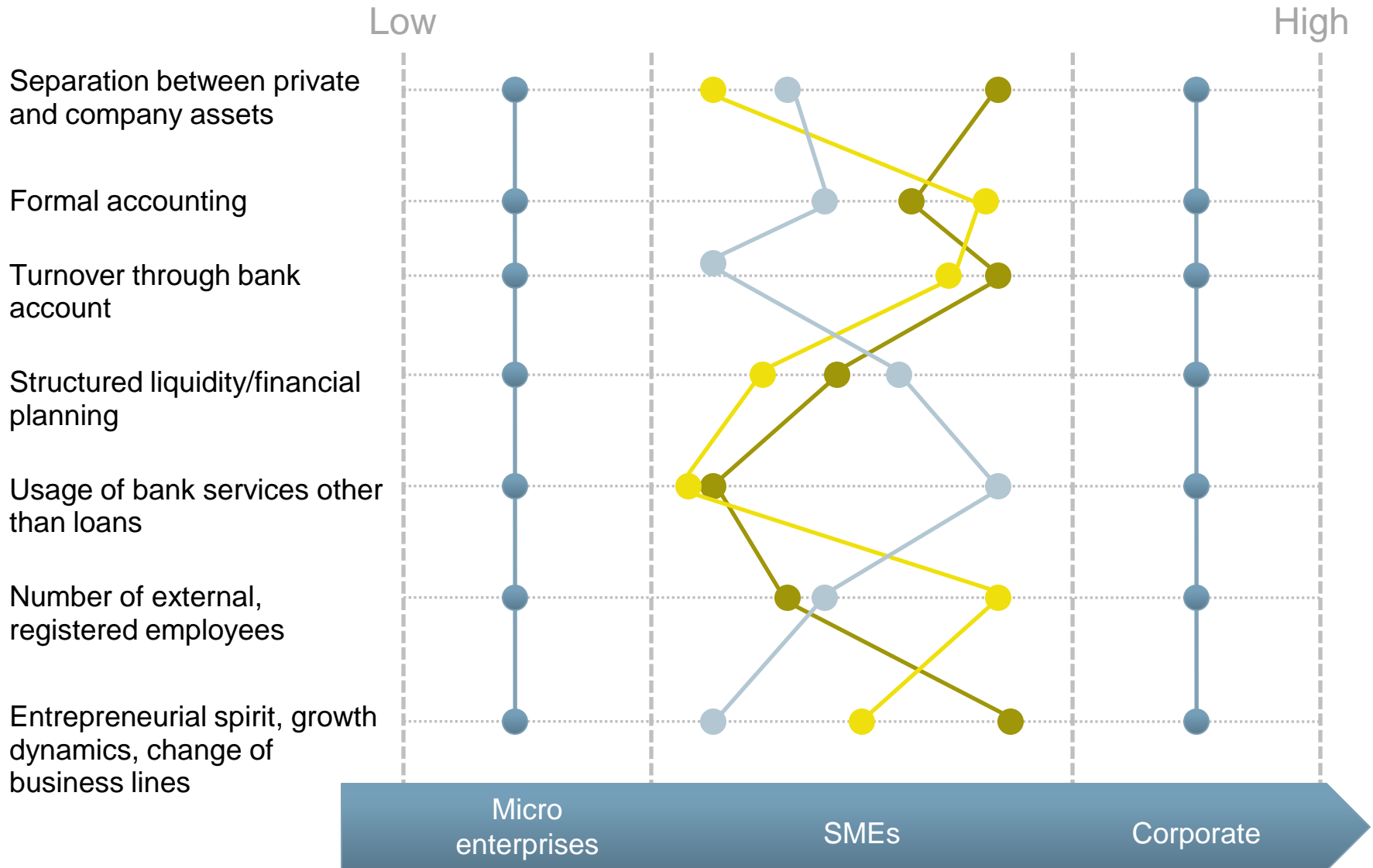
- a. It is simply a tool for back-up/flexibility that they almost never use.
- b. They use it smoothly, not more than 50% of the time.
- c. They use it intensively; the account balance is always close to reaching the limit of the overdraft.



How many SMEs decide on loan offers based on the effective interest rate?

- a. Less than a third
- b. Less than two thirds
- c. More than two thirds

A great diversity of SMEs



SME characteristics (Summary)



	Micro enterprises	SME	Corporate
Employees	< 3 (family members)	>3 (partially specialised)	≥ 250
Typical sectors	<ul style="list-style-type: none"> • Trade • Services (repairs) 	<ul style="list-style-type: none"> • Trade • Services • Manufacturing 	<ul style="list-style-type: none"> • (International) trade • Services • Manufacturing
Capital intensity	Low fixed assets	Significant fixed assets	Important fixed assets
Economic efficiency	Increasing with size		
Growth potential	Low	High	High
Owenship and scale	<ul style="list-style-type: none"> • Entrepreneurs 	<ul style="list-style-type: none"> • Growing family business • Might have several shareholders 	<ul style="list-style-type: none"> • Regional / national footprint • Ownership / management separation
Management structure & HR	<ul style="list-style-type: none"> • Non-specialised / flexible staff • No external employees 	<ul style="list-style-type: none"> • Existence of management structures • External employment 	<ul style="list-style-type: none"> • Structured management • High number of external employees
Decision-making	<ul style="list-style-type: none"> • Short-term horizon 	<ul style="list-style-type: none"> • Opportunity driven 	<ul style="list-style-type: none"> • Planning
Degree of formalisation	<ul style="list-style-type: none"> • Informal • No records • Cash-based 	<ul style="list-style-type: none"> • Partially formalised • Partial accounting • Partial use of current account and paperless means of payment 	<ul style="list-style-type: none"> • Formalised • Official financial statements • Current account utilisation and paperless means of payment
Financial literacy	Very low	Medium	High
Financial needs	<ul style="list-style-type: none"> • Instalment loans • Savings 	More than micro enterprises: <ul style="list-style-type: none"> • Overdraft • Transfers and payment transactions • Current account • Debit card • Internet banking • Electronic payment terminal 	More than small enterprises: <ul style="list-style-type: none"> • International transfers • Trade finance • Payroll services
Adapted bank approach	<ul style="list-style-type: none"> > Support growth > Basic financial education > Service quality and proximity 	<ul style="list-style-type: none"> > Support growth projects > Financial education > Increasing range of products > Formalisation > Service quality 	<ul style="list-style-type: none"> > Support growth projects > Professional financial partner > Service quality



Not much but at least we can say:

- SMEs have **specific characteristics** compared to Micro enterprises and Corporate companies.
 - There is a **large variety** of SMEs.
 - Although there are **some common characteristics**, it is difficult to cluster them all.
- ⇒ If one wants to work with SMEs, it is extremely important to **know your customer!**



Where SMEs and banks meet: A closer look at the financials of SMEs

Case study 1*)

General information



Country	Ukraine	
<i>Business activity</i>	Customised production of plywood and wooden components for doors	
<i>Business development</i>	The business was founded in 2001 and developed steadily until 2006. In 2007, driven by economic upturn, production capacities were enhanced in order to satisfy the increasing demand, followed by a series of further investments due to optimistic business projections.	
<i>Ownership structure</i>	Official: Natalia Kurkow (95%), Olga Zubenko (5%) (mother and daughter)	Real: Vladimir Kurkow (50%) , Natalia Kurkow (50%) (husband and wife)
<i>Management structure</i>	Vladimir and Natalia Kurkow lead the business. Both have a higher education level. They have 28 employees.	
<i>Turnover on bank account</i>	46%	

*) Real bank client, names changed by IPC

Case study 1

Liabilities to financial institutions



No.	Type of product	Institute	Disb. date	Total amount	Currency	Av. long-term instalments USD (acc.)	Outstanding amount, in USD	Maturity	Loan purpose
1	Instalment loan	Bank 1	Feb 07	100,000	USD	2,231	65,696	5 years	Equipment
2	Credit line	Bank 2	Mar 07	500,000	UAH	2,231	65,531	1 year	Working capital
3	Instalment loan	Bank 3	Apr 07	56,000	USD	3,172	39,333	7 years	Car (private use)
4	Instalment loan	Bank 4	Jul 07	530,000	USD	11,540	476,052	10 years	Business premises
5	Instalment loan	Bank 5	Jul 07	21,600	USD	11,912	17,400	7 years	Car (private use)
6	Instalment loan	Bank 1	Jul 07	28,000	USD	12,519	19,479	5 years	Equipment
7	Leasing	Leasing Co.	Dec 07	148,575	USD	15,950	116,968	5 years	Equipment
8	Instalment loan	Bank 1	Dec 07	50,000	USD	16,747	45,237	10 years	Equipment
9	Instalment loan	Bank 2	Jul 08	100,000	USD	18,775	92,884	7 years	Downpayment for leased equip.
10	Leasing	Leasing Co.	Jul 08	78,454	USD	21,459	61,192	3 years	Equipment
11	Instalment loan	Bank 2	Aug 08	296,000	USD	27,795	291,648	7 years	Equipment
12	Short-term loan	Bank 4	Oct 08	23,865	EUR	27,795	14,944	1 year	Equipment
13	Leasing	Leasing Co.	Jan 09	60,198	EUR	30,784	80,297	3 years	Equipment
14	Leasing	Leasing Co.	Feb 09	26,970	EUR	32,124	35,975	3 years	Equipment
					Total	32,124	1,422.635		

Case study 1

Financial statements



Balance sheet

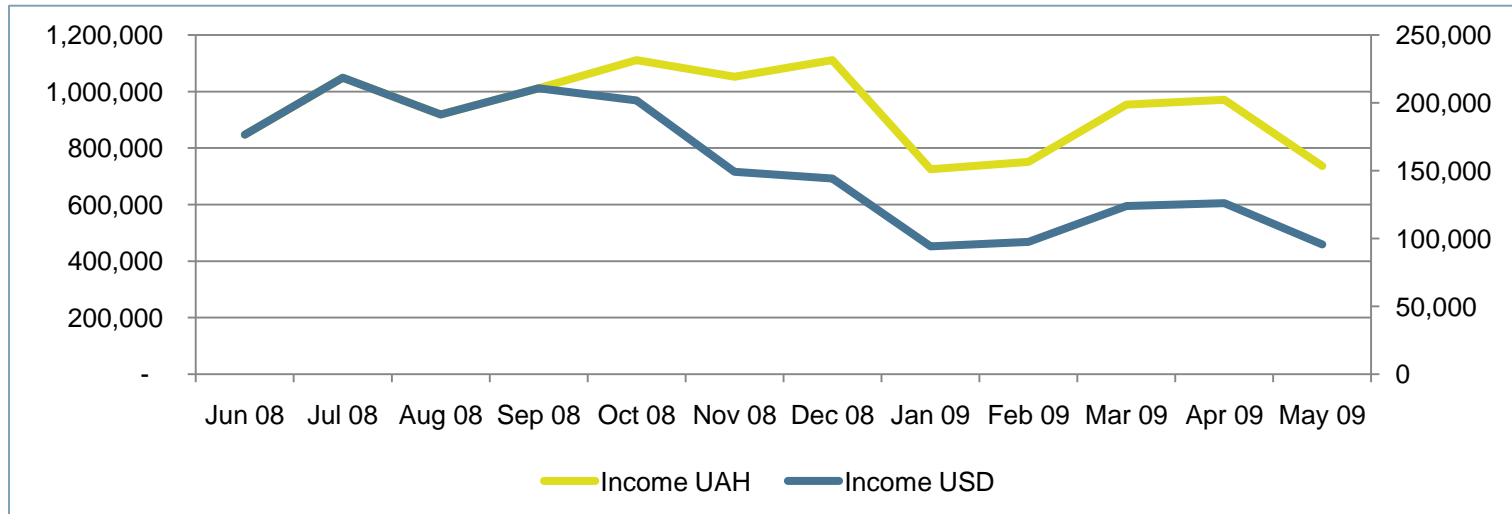
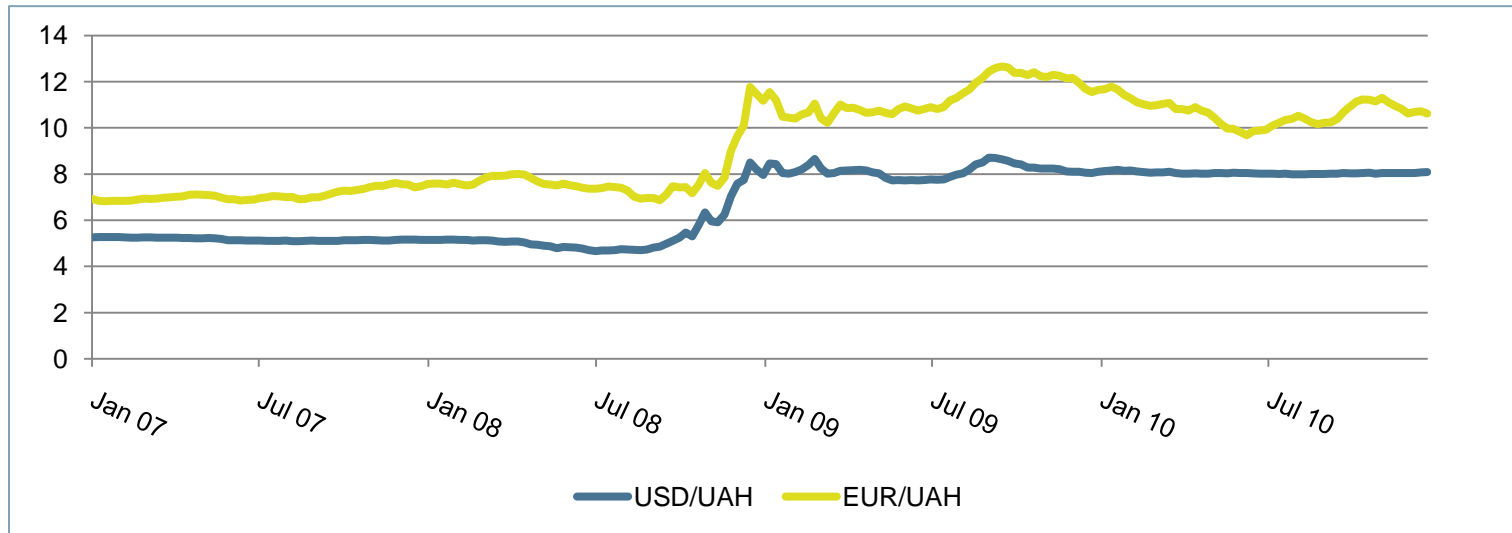
Position / Date	01.01.2008	%	01.06.2009	%
Current assets	\$481,233	41%	\$402,105	26%
Fixed assets	\$701,011	59%	\$1,126,983	74%
Total assets	\$1,182,244	100%	\$1,529,088	100%
Short-term liabilities	\$168,739	14%	\$252,571	17%
Long-term liabilities	\$809,407	68%	\$1,443,575	94%
Equity	\$204,097	17%	-\$167,058	-11%
Total L+E	\$1,182,244	100%	\$1,529,088	100%

Profit & Loss statement (monthly average)

Position / Date	01.06.2008- 31.12.2008	% of income	01.01.2009- 31.05.2009	% of income
Income	\$184,687	100%	\$107,492	100%
Gross profit	\$71,969	39%	\$64,181	60%
Disposable funds	\$47,605	26%	-\$10,147	-9%
Total instalments (lg-t)	\$32,124	17%	\$32,124	30%

Case study 1

FX-rate development and its impact





The entrepreneur has...

- ...liabilities spread over many institutions
- ...a currency mismatch
- ...very high debt/equity ratio
- ...decapitalised the business because of personal expenses

The entrepreneur should have...

- ...2-3 banks for easier communication and collateral allocation
- ...loans in local currency (or USD)
- ...analysed debt/equity ratio before deciding on further investments
- ...adapted the level of private spending to business capacities

Case study 2*)

General information



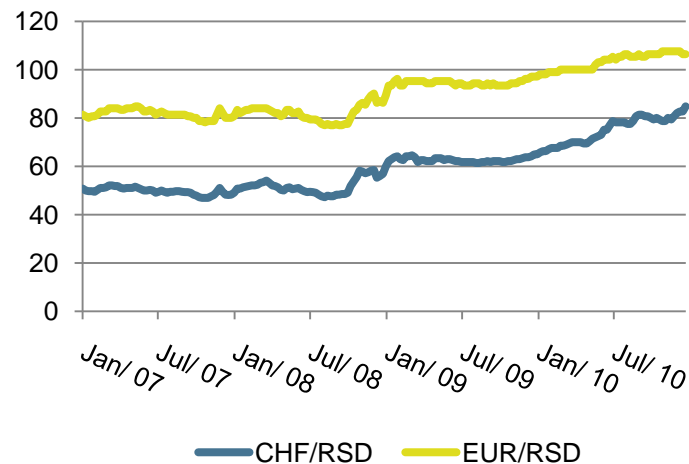
Country	Serbia
<i>Business activity</i>	Veterinary surgery
<i>Business development</i>	The business was founded 3.5 years ago and provides on-site examinations and surgical procedures for dogs and cats.
<i>Ownership structure</i>	Jelena Vidović (100%)
<i>Management structure</i>	Jelena Vidović is a veterinarian and manages all related aspects of her business.
<i>Turnover on bank account</i>	39%

Case study 2

Liabilities to financial institutions



No.	Type of product	Institute	Disb. date	Disbursed Amount, in EUR	Currency	Av. long-term instalments EUR	Outstanding amount, in EUR	Maturity	Loan purpose
1	Instalment loan	Bank 1	Jul 08	100,469	CHF	1,035	98,246	25 years	Purchase of business premises
2	Bullet repayment loan	Bank 1	Jul 08	51,299	CHF	598	51,299	10 years	Adaptation of business premises
3	Overdraft	Bank 1	Jul 08	400,000	RSD			1 year	Liquidity gap
					Total	1,633	163,777		



Case study 2

Financial statements



Balance sheet

Position / Date	31.12.2010	%
Current assets	3,714 €	2%
Fixed assets	221,300 €	98%
Total assets	225,014 €	100%
Short-term liabilities	2,000 €	1%
Long-term liabilities	150,478 €	67%
Equity	72,536 €	32%
Total L+E	225,014 €	100%

Profit & Loss statement (monthly average)

Position / Date	01.01.-31.12.2010	%
Income	5,988 €	100%
EBIT	5,011 €	84%
Disposable Funds	2,054 €	34%
Instalments (lg-t) including interest payments	1,633 € 1,606 €	27%



The entrepreneur has...

- ...a currency mismatch
- ...a maturity mismatch
- ...an aggressive investment strategy at an early stage of business development
- ...the bank as a “business partner” instead of a financing partner

The entrepreneur should have...

- ...loans in local currency (or EUR)
- ...a downpayment for investing in business premises
- ...loan amount limited to real investment need
- ...started capital service right away

Case study 3*)

General information



Country	Serbia
Business activity	Passenger transportation
Business development	The business initiated in 2002 with one bus. Currently, the client has three buses for passenger transportation to Germany, Switzerland and Austria.
Ownership structure	Borislav Vujićić (100%)
Management structure	The owner is the only decision-maker. He employs two drivers.
Turnover on bank account	44%

Case study 3

Liabilities to financial institutions



No.	Type of product	Institute	Disb. date	Total amount	Currency	Av. long-term instalments EUR	Outstanding amount, in EUR	Maturity	Loan purpose
1	Instalment loan	Bank 1	Feb 08	16,000	EUR	382	7,579	5 years	Adaptation to bus interior
2	Instalment loan	Bank 1	Dec 08	2,268	EUR	83	628	3 years	Surcharge bus
3	Instalment loan	Bank 1	Jan 09	21,380	EUR	542	15,016	5 years	Prepayment bus
4	Instalment loan	Bank 1	Dec 09	32,000	EUR	0	25,426	5 years	Adaptation to bus interior
5	Leasing	Leasing Co.1	Dec 09	35,400	EUR	556	30,086	7 years	Bus
6	Overdraft	Bank 2	May 10	1,961	EUR	0	1,961	1 year	Working capital
7	Leasing	Leasing Co.2	Aug 10	45,930	EUR	890	38,340	5 years	Bus
8	Instalment loan	Bank 3	Feb 11	2,647	EUR	70	2,592	5 years	Private
9	Instalment loan	Bank 4	Apr 11	2,000	EUR	185	2,000	1 year	Working capital
					Total	2,708	123,628		

Case study 3

Official financial statements



Balance sheet (as of 31.03.2011)

Position	Official	%
Current assets	5,544 €	3%
Fixed assets	159,477 €	97%
Total assets	165,021 €	100%
Short-term liabilities	9,184 €	6%
Long-term liabilities	120,513 €	73%
Equity	35,325 €	21%
Total L+E	165,021 €	100%

Profit & Loss statement (monthly average)

Position	Official	%
Income	6,669 €	100%
Gross profit	4,337 €	65%
Disposable funds	333 €	5%
Total instalments (lg-t)	2,708 €	41%

Case study 3

Official vs. real financial statements



Balance sheet (as of 31.03.2011)

Position	Official	%	Real	%
Current assets	5,544 €	3%	27,792 €	15%
Fixed assets	159,477 €	97%	158,187 €	85%
Total assets	165,021 €	100%	185,980 €	100%
Short-term liabilities	9,184 €	6%	3,981 €	2%
Long-term liabilities	120,513 €	73%	118,919 €	64%
Equity	35,325 €	21%	63,080 €	34%
Total L+E	165,021 €	100%	185,980 €	100%

Profit & Loss statement (monthly average)

Position	Official	%	Real	%
Income	6,669 €	100%	14,858 €	100%
Gross profit	4,337 €	65%	9,662 €	65%
Disposable funds	333 €	5%	5,408 €	36%
Total instalments (lg-t)	2,708 €	41%	2,708 €	18%

Significant disposable funds have been used for private purposes: the client owns an apartment worth approx. 80,000 €, two cars (34,000€), and one of his sons studies abroad.



The entrepreneur ...

...has assets that do not belong to him (leasing modality)

...is lucky to have found a bank that analyses his real financials

...is incurring risks because of low level of formality



Without knowing the business, loan exposures to SMEs entail high risks for banks due to...

- ...currency mismatch
- ...maturity mismatch
- ...private consumption patterns
- ...overestimation of payment capacity
- ...collateral valuation
- ...no return on capital
- ...too many co-creditors
- ...etc.

“Know your customer”

Providing appropriate financing to SMEs reduces risks for banks.



How did/do banks approach SMEs?

EFSE Annual Meeting, June 2011



- ▶ Generally positive economic climate
- ▶ Growing GDP rates
- ▶ High FDI

- ▶ Strong growth rates in banking sector
- ▶ Fast loan portfolio development



- ▶ Fierce competition among banks is increasing
- ▶ Close to all banks discover SMEs as a (new) target segment
- ▶ Banks aim to gain market share for future positioning

- ▶ Area of competition is pricing (not services, quality, etc.)
- ▶ Issue of access to financing for SMEs is (almost) solved

Banking sector environment in SEE



2007 (estimates)	Number of banks	Banking sector assets (\$/€ bn)	Total asset to GDP	Loan portfolio to GDP	Deposits to GDP	Loan portfolio growth	Deposit growth	Top five banks' mkt share	Foreign-owned equity*
Ukraine	176	103.9	79%	57%	36%	54%	39%	35%	> 55%
Romania	35	67.0	61%	35%	35%	35%	29%	59%	70%
Bulgaria	32	28.2	104%	68%	75%	57%	33%	58%	80%
Serbia	36	19.0	68%	31%	39%	28%	38%	31%	69%
Bosnia	32	8.9	95%	63%	62%	24%	29%	64%	91%
Albania	17	5.7	80%	29%	67%	36%	19%	72%	> 95%
Georgia	19	4.5	47%	28%	23%	69%	65%	84%	52%
Macedonia	18	3.7	73%	34%	52%	30%	28%	66%	54%
Moldova	16	2.9	72%	45%	56%	50%	41%	65%	< 40%
Armenia	22	2.4	31%	14%	16%	65%	49%	53%	< 30%
Kosovo	6	1.3	51%	33%	45%	26%	15%	87%	71%
Kyrgyzstan	21	1.1	32%	17%	17%	55%	30%	39%	< 30%

data sources: central bank websites, PCB's own information; partly estimates; data from between Dec-06 to Nov-07

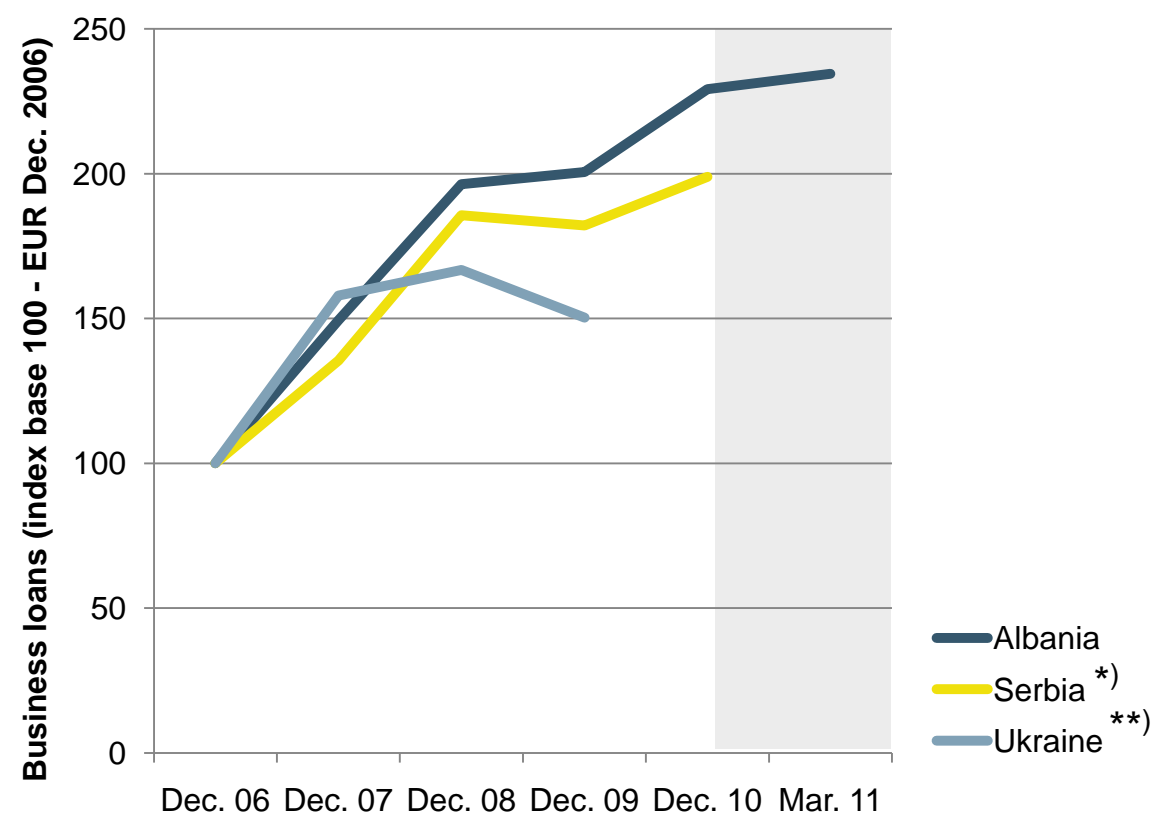
* largely estimates; ARM and KYR: excludes shares held by Kazach, Iranian and other non-Western, non-Russian parent companies

Germany: 298% 132% 176%

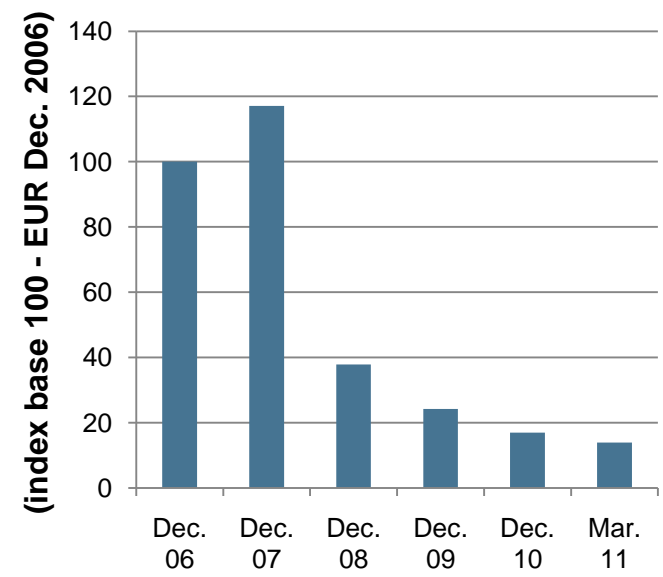
After years of rapid growth, business lending stagnates, then picks up again...



Business loans disbursed (Micro, SME, Corporate)



MSME loans (panel of Ukrainian banks)



*) Serbia: only legal entities considered

**) Ukraine: represents MSME portfolio of banks active within UMLP; in Mai 2008 one bank graduated from this programme causing steep decline in the outstanding loan portfolio

Sources: Bank of Albania, Ukraine Micro Lending Programme (UMLP), National Bank of Serbia, Bank Association of Serbia.



- ▶ Generally very negative economic climate
- ▶ GDP slump
- ▶ Stop of FDI, sudden depreciation of local currency in many countries

- ▶ Banks stop lending, call credit lines back (liquidity constraints, risk considerations)
- ▶ Loan portfolios stagnate or even decrease

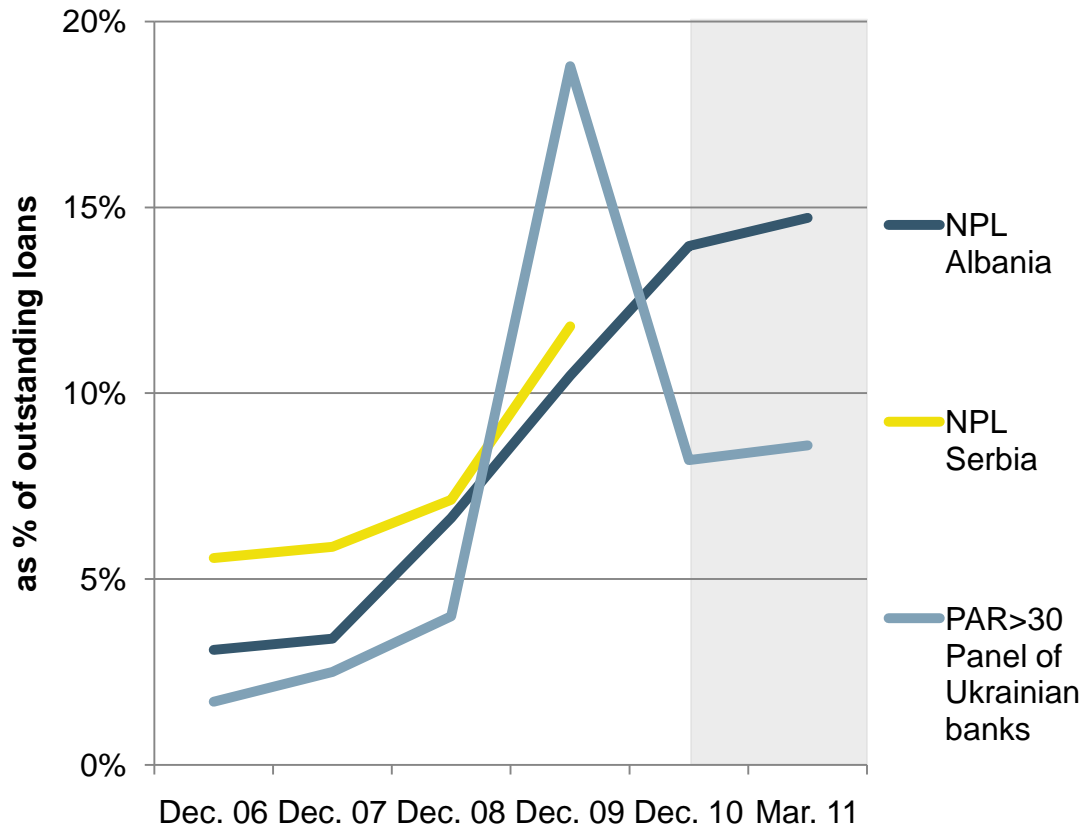


- ▶ Real sector crisis affects SMEs intensively
- ▶ SMEs with inappropriate liability structure cannot or can only hardly survive

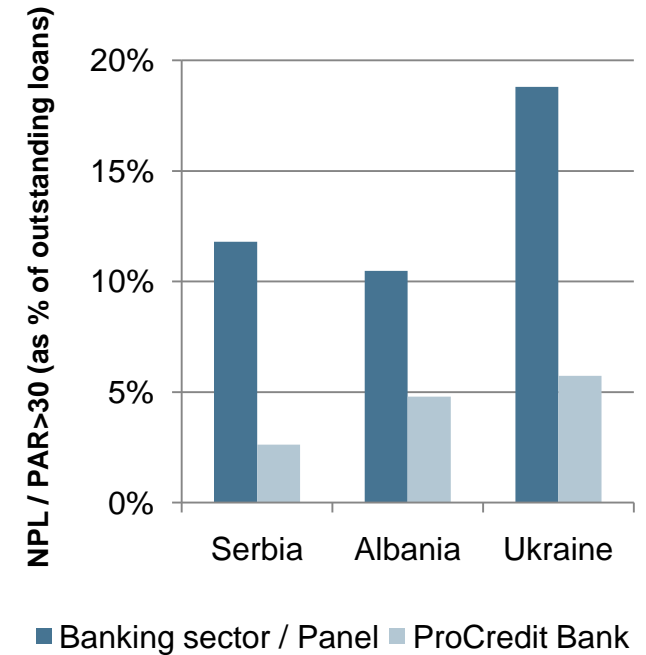
- ▶ Loan portfolio quality deteriorates rapidly
- ▶ Well collateralised loans cannot be recovered, since real estate and machinery markets are inactive



Credit risk



NPL / PAR>30 (Dec. 09)



Sources: Bank of Albania, Ukraine Micro Lending Programme (UMLP). National Bank of Serbia, Bank Association of Serbia, ProCredit Serbia, ProCredit Albania, ProCredit Ukraine



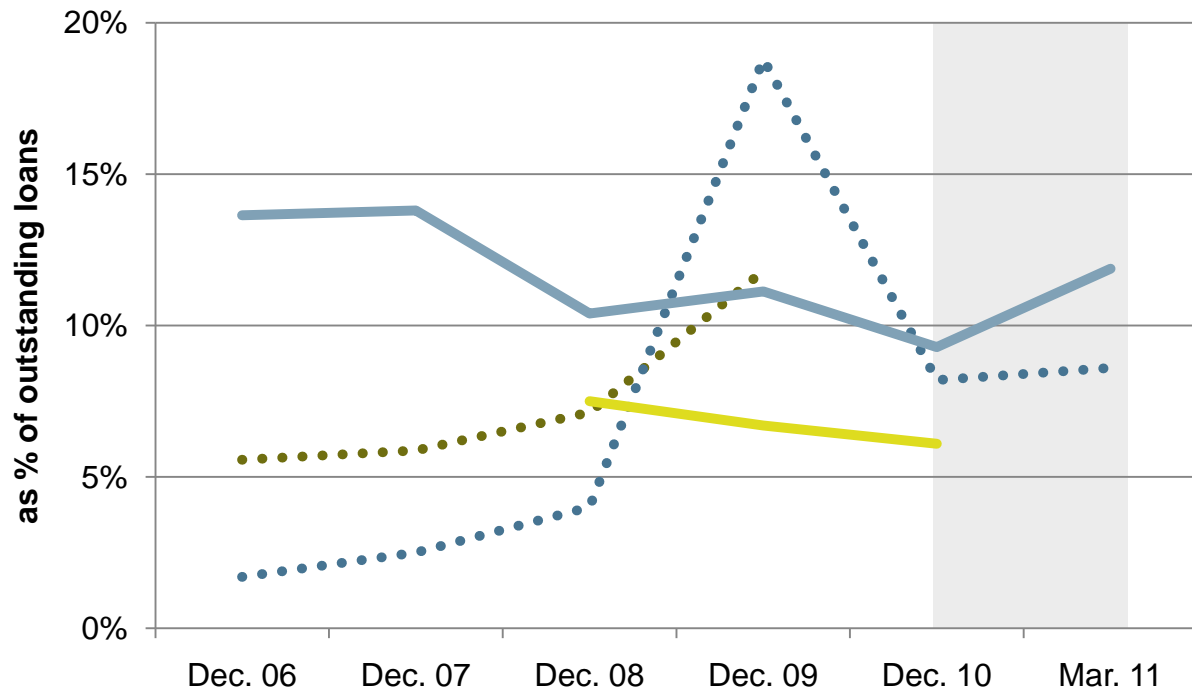
- Competition leads to margins that do not contain any risk premium and do not leave much room for administrative costs.
- Competition leads to low collateral requirements and “optimistic” collateral valuation.
- Mandatory loan loss provisioning policies do not take SME loan risk profiles into account, allowing for low levels of reserves in banks.



- Refinancing costs are low, especially if subsidised by parent banks or IFIs. Low Euribor allows a further decrease in funding costs.
- Belief in long-term stability of foreign currencies causes banks to ignore the costs of currency risks.
- Based on experience in Western Europe, many institutions accept low margins for the sake of gaining market share, because:
 - they believe in continued growth scenarios (despite alarming macroeconomic indicators),
 - they expect positive cross-selling results, i.e. fee income as a complement to interest income, and
 - they believe that SMEs are low cost loan clients.



Spread



●●●● NPL Serbia

●●●● PAR>30 Panel of Ukrainian banks

— Spread Serbia^{*)}

— Spread (panel of Ukrainian banks)^{**)}

^{*)} Spread Serbia: taking into account average passive and active interest rates of Serbian banking sector

^{**)} Spread Ukraine: taking into account average passive and active interest rates of panel of Ukrainian banks (UMLP)

Sources: Ukraine Micro Lending Programme (UMLP), National Bank of Serbia, Bank Association of Serbia



- SME loan portfolio quality deteriorates such that high risk premiums would be necessary to cover expected losses. Sudden additional LLP would be necessary.
- Non-performing loans that are not provisioned need to be written off.
- In some countries, hard collateral can be seized and legally obtained; however, the acquired real estate and machinery cannot be liquidated.
- Fee business with SMEs is generally low –it even fell during times of crisis because of lower transaction business (domestic and international transfers, documentary business).



- SMEs in general bank with at least one institution. They have had access to financing and will continue to have access.
- Reputation of banks has suffered.
- Competition is building again – initial signs show that the focus will be the same: pricing.



- In order to make SMEs a stable, sustainable and profitable client group, banks must approach SMEs in a professional way that ensures client satisfaction – and therefore client retention – as well as healthy loan portfolios.
- A combination of economies of scale, efficiency and above all client and service orientation makes SME finance a business case.



Various approaches to SME finance

EFSE Annual Meeting, June 2011



Expectations

Reality

Service approach

Highly diversified product range also with regard to banking services, increasing cross-selling potential. Individualised attention through CRM.

SMEs need relatively simple, straightforward product range. Some level of standardisation is required to make SME lending profitable.

Credit risk assessment approach

Systematic approach using audited financial statements provides quality risk assessment due to reliability of data; low risk through (over-) coverage of loans by collateral; centralised credit analysts perform related tasks.

High requirements in terms of formalisation and collateral exclude many valid cases. Assessment hardly captures soft information about the clients.

Profitability & Sustainability

Profitability assured by well controlled credit risk and cross-selling opportunities.

This restrictive approach will limit outreach, as many SME will not qualify. Limited cross-selling opportunities will also restrict profitability.



Expectations

Reality

Service approach

Standardise products in order to reach cost effectiveness. Branch based, non-customised attention.

SME clients require products tailored to their needs, a broader range of products, and specialised staff.

Risk assessment

Simple or automated credit risk assessment performed in credit factories or based on scoring models to reach high productivity through reduced loan application processing times.

SME risk assessment requires thorough analysis, due diligence and “number crunching” due to larger loan amounts and higher degree of complexity than retail. Lack of availability of historical data from a large-scale sample is another problem when establishing a model

Profitability model & sustainability

Standardisation and productivity combined with cross-selling and high volume assure profitability.

High cost of risk restricts the profitability and sustainability of the model.
Over estimation of cross-selling opportunities.



Expectations

Reality

Service approach

Medium-term financial instrument limited to financing of equipment and property. Equipment dealers in their showroom.

Partial answer to financing needs of SMEs.

Credit risk assessment approach

Secured way to provide financing through possession of the leased asset. Adapted to countries where the creditors' rights, collateral laws, registries and law enforcement are weak.

Inadequate risk assessment focus that hardly captures soft information about the client .
Subordinated to existence of second-hand market to effectively reduce risk.

Profitability model & sustainability

Well-controlled risk management through asset ownership and productivity assured by appropriate pricing.

Unsustainable model because of not all needs met by the product.
Inadequate risk assessment methodology that does not protect effectively against risk.



Expectations

Reality

Service approach

Short-term loans that can be quickly recovered. CRM.

Ability to manage and understand the product is required for products that, unlike instalment loans, do not help clients to manage their cash flow efficiently.

Credit risk assessment approach

Superficial analysis, especially for renewals of credit lines, since the products are supposed to bear the lowest risk in the credit spectrum. Credit analyst/Collateral appraisal.

Partial answer to financing needs of SMEs but often results in unhealthy financial structure of the clients (maturity mismatch).

Profitability model & sustainability

Allow to gain experience on the market and knowledge of clients (build credit history). Short-term funding cheaper and easier to acquire than LT funding. Reduced transaction cost.

Inappropriate product that does not help clients and entails high cost of risk, which prevents any success in terms of profitability or sustainability.