Financial Markets & Institutions

Evaluation of The SME Banking Sector of Pakistan

Submitted to: Sir Haroon

Moeeza Saeed & Zain Malik (BBA 2k5)

1/23/2009

1. Abstract

The SME sector is important in terms of contribution to the economy and this is likely to be a characteristic of SMEs across the world. It acts as the backbone of every growing economy and therefore plays a pivotal role in terms of providing employment, poverty elevation as well as contributing to the GDP of the economy. Keeping in view the significance of this sector it is essential that the banking system of the country extends the required support for its growth. This paper has been undertaken to analyze and evaluate the overall performance of the SME Banking sector of Pakistan taking into account the credit advanced by specialized as well as commercial banks of the country. The SME specific financing products of the banks have been explored. At the same time, the constraints being faced by the SMEs in Pakistan has been highlighted as well as insecurities of the crediting Banks have been taken into consideration. These challenges become a hindrance in the way of access to SME finance. Therefore probable solutions to these have been proposed through this paper.

2. Introduction

Small and medium enterprises role in the economies of developed and developing countries has been of utmost importance. This sector runs the lifeline of economies of countries. Employment generation, poverty alleviation, accelerated growth, bridging the income inequality etc are some of the special features of SME sector in countries who are especially passing through an economic transition phase from developing status to developed one.

A dynamic SME sector has played a key role in the successful economic growth of many countries. A synopsis of major developed and emerging economies reveal that SMEs have been serving as respirator in achieving the high standards of economic development. The contribution of this sector towards GDP, value addition, export earning and employment has been of immense importance in carrying forward the economic objectives of developing countries.

There exists strong evidence that SMEs expansion boosts employment more than large firm growth because SMEs are more labor intensive. But this fact has not been put to its best use because of the reason that banks traditionally focused on serving the financing needs of corporate sector and larger firms with absolutely no focus on the medium and smaller sized firms due to perceived high risks, information asymmetries, high transaction cost and no or limited understanding of the sector. The sector thus, despite contributing significantly in the country's economic development and employment creation, could not fetch due attention of the bank's senior management and as such the banks' capacity to effectively serve the sector remained limited. Hence, it was felt that if this sector is encouraged and provided with the right opportunities in Pakistan, it can even contribute more than it already does.

In Pakistan, the SME sector contributes 30 percent towards the country's GDP, along with agriculture provides 90 percent of the jobs, accounts for 35 percent of the value added in the manufacturing industry and generates 25 percent of manufacturing sector export earnings. Given its huge potential for generating employment, the Government has identified the SME sector as one of the leading sectors along with agriculture and construction sector and therefore promotes its efforts towards generating employment to alleviate poverty in the country.

3. Methodology

The methodology adopted for this paper is that of research with the use of secondary data available about the SME Banking sector of Pakistan. Reports on the SME sector by the Government's body, i.e. State Bank of Pakistan, has been analyzed. Different archival records on the SME related information has also been explored. No first hand information has been used because of the constraint of the availability of the data related to SME Banking Sector of Pakistan. Graphical and tabular representation of statistical data has been used to give a quick and clear picture of the industry.

4. Scope of Work

The purpose of this paper is to analyze the SME Banking Sector of Pakistan by better understanding the dynamics of the overall SME sector of Pakistan. The paper aims to:

- Understand the issues faced by SMEs causing hindrances in its way of growth.
- Review the position of the SME Banking Sector.
- SME products offered by Financial Institutions.
- Recommendations for the improvement of the sector.

5. Literature Review

There is growing worldwide appreciation of the fact that Small and Medium Enterprises play a catalytic role in the development process of most economies. This position gets reflected in the form of their increasing number and rising proportion in the overall product manufacturing, exports, manpower employment, technical innovations and promotion of entrepreneurial skills. Therefore, a lot of work has been done on the SMEs across the globe considering their supreme significance for the flourishing of the economy. In Thailand, SMEs account for more than 90% of the total number of establishments, 65 per cent of employment and 47 per cent of manufacturing value added while in Philippines, SMEs comprise 99 per cent of the total manufacturing establishments and contribute 45 per cent of employment and 18 per cent of value added in the manufacturing sector. Across the South Asia, the contribution of SMEs to the overall economic growth and the GDP is high. It is estimated that SMEs contribute 50% of Bangladesh's industrial GDP and provides employment to 82% of the total industrial sector employment. In Nepal, SMEs constitute more than 98% of all establishments and contribute 63% of the value-added segment. In India, SMEs' contribution to GDP is 30%.[1] In Korea the number of SMEs is approximately 3 million. SMEs account for 99.9% of the entire enterprises and 88.1% of the total employment (10.77 million employees). SMEs are of varying size, sector and form in Korea. About 88.3% of total SMEs are smaller enterprises (with less than 10 employees), 8.5% are small enterprises (with 10~50 employees) and 3.1% are medium enterprises (with 50~300 employees).[2] SMEs in Indonesia account for more than 90% of all firms outside the agricultural sector, and thus, they are the biggest source of employment, providing livelihood for over 90% of the country's workforce, especially women and the young.[3] In the Philippines, SMEs account for 90% of registered business enterprises, contribute about 25% to the gross national product and provide jobs to roughly half of our labor force.

[1] "Corporate Governance and Business Ethics for SMEs in Developing Countries: Challenges and Way Forward", By Shahnawaz Mahmood, Islamabad, Pakistan

[2] "SME Finance" quarterly review report, 2008 by SBP

[3] "SME development, economic growth, and government intervention in a developing country: The Indonesian story", 22nd Aug, 2008

Because of their significant contributions to income and employment generation, they are regarded as a lead sector in stimulating economic development, particularly in the countryside, and eventually helping in poverty alleviation.[4]

For this reason, SME Finance is gaining importance day by day especially in the developing countries. SME Finance was provided special attention by the private and public sector due to its peculiar nature and important contribution to the economy. Usually the SMEs are characterized with such features that extending finance to this sector is not an easy task for the bankers since the commonly used yardstick for corporate finance by banks is not appropriate for SME finance criteria. In many countries the banking industry diverted towards innovative approaches for exploiting the potential of SME sector through designing of specific SME products, risk criteria, SME Financial reporting standards and special lending techniques. Likewise, the public sector has also played an instrumental role in provision of a hassle free business environment in the form of effective policies, conducive regulatory framework and institutional support in designing out a sustainable macroeconomic SME supportive framework in many of developed and developing countries of the world.[5]

Similarly in Pakistan also, SME sector is one of the major contributor to the national exchequer. SMEs contribute more than 90% of business in Pakistan, all of which function within the private sector and mostly operate in un-documented informal part of the economy. They represent a significant component of Pakistan's economy in terms of both value addition and employment generation. As they predominantly provide employment to lower income groups, they are also considered an important vehicle for poverty reduction.

[4] "Innovative Financing for Small and Medium Enterprises: The Philippine Experience" by Ambassador Jesus P. Tambunting Chairman, Planters Development Bank International CEO Forum Kuala Lumpur, Malaysia 13 August 2004

[5] "SME Finance" quarterly review report, 2008 by SBP

SMEs in particular, play a key role in manufacturing sector by providing 80% to total employment contributing over 30% to GDP and generating one-fourth of the sectors export earnings.[6] Like other developing countries across the world, SME sector, in Pakistan also does not have adequate access to financing from formal sector. SMEs have been relying primarily on the credit facilities from the informal sector. Cost of finance from informal sector is higher than the cost of finance from formal sector like banks.

6. Small and Medium Enterprise (SME)

SME means an entity, ideally not a public limited company, which does not employ more than 250 persons (if it is manufacturing / service concern) and 50 persons (if it is trading concern) and also fulfills the following criteria of either 'a' and 'c' or 'b' and 'c' as relevant:

(a) A trading / service concern with total assets at cost excluding land and building up to Rs 50 million.

(b) A manufacturing concern with total assets at cost excluding land and building up to Rs 100 million.

(c) Any concern (trading, service or manufacturing) with net sales not exceeding Rs 300 million as per latest financial statements.

An Individual, if he or she meets the above criteria, can also be categorized as an SME.[7]

7. SME Sector in Pakistan

[6] "Financing the Small and Medium Scale Enterprises in Faisalabad (Pakistan)" KASHIF HAMID1 AND ABAIDULLAH

[7] Prudential Regulations for Small and Medium Enterprises Financing by SBP.

In Pakistan, the SME sector contributes 30% towards the GDP of the country, and along with agriculture provides for 90% of jobs, accounts for 35% of value added in the manufacturing industry and generates around 25% of manufacturing export earnings ($ 2.5 billion). [8]

This sector has been recognized as having the potential to serve for the growth of the economy and thus a number of initiatives have been taken both by State Bank of Pakistan (the central bank) and the government. In Pakistan the SME sector is confronted with a number of demand and supply side constraints blocking the way for a smooth growth of this sector. SME sector issues related to demand side includes lack of book-keeping at SMEs, missing succession planning, strategic objective or business planning, low level of financial literacy, unskilled human resource etc. On the other hand, supply side obstacles constitute, Non aggressive lending strategies by Banks, absence of specific products offered for SMEs, perceived to be high risk area by banks etc.

As of September 30, 2007, the total number of SME borrowers stood at 184,798 while total outstanding loans to them were Rs409.86 billion. It may be mentioned here that the SME sector, which contributes about a third of total Gross Domestic Product, comprises 99 per cent of total 3.2 million business enterprises in the country. Among these SMEs, 96.37 per cent employ 1-5 persons, 2.69 per cent have employment size of 6-10 persons, while only 0.95 per cent establishments have an employee base of 11-50 and above. The total outreach of the banks to SMEs has shown an annualized growth of around 11 per cent but there is huge scope for increase given the potential size of the market.[9]

[8] *"SME financing: Issues and Strategies"* by Ishrat Hussain, 2005

[9] Article "Shamshad directs banks to promote SME financing**"**, Friday, February 29, 2008

SMEs are also believed to be a major breakthrough in eliminating poverty and unemployment because SMEs are mainly labor intensive and require unskilled labor.

8. Constraints on SMEs

- **Access to credit facilities**

The first and the foremost problem faced by SMEs is obtaining credit. Banks in our country still haven't realized the actual worth and growth potential of this sector. Till now, the requirements to be fulfilled for obtaining credit are quite stringent and not many SMEs can qualify for obtaining loans. Many banks require proper books of accounts to be presented before they extend loan to a business. Now obviously these SMEs are not very big in size and they are not often being run by very literate people either because of which the concept of maintaining proper accounting records is not there. Due to this, the banks often refuse to extend credit to such SMEs. This constraint is acting as the basic deterrent to the growth of the SME sector in Pakistan.

- **Lack of specialized organizations for SME development**

There is a lack of specialized organizations such as SMEDA and SME bank which work solely for the purpose of developing and enhancing the SME sector of the country. SMEDA also provides trainings to SMEs in areas of business management, inventory management and business accounting practices. Such services improve the performance of the SMEs as well as their chances of getting credit for their operations or expansion. This is because when SMEs are trained on the accounting practices, they maintain better accounting records of their business and when they need loans, they can present proper books of accounts to the banks to show their performance. But the problem is that SMEDA is the only specialized organization providing such services while there is a huge number of SMEs in the Pakistani market to be catered to. This limits the performance of SMEDA and gives rise to the need for more such organizations to provide developmental services to this sector. Same holds true for organizations like the SME bank. There is a need for more such banks in order to cater to the needs of the SME sector in a more proper way as the commercial banks do not specialize in SME banking and deal in it just as another area of their operations and so not many innovative SME financing products are developed.

- **Excessive Regulations**

SMEs consider excessive government regulation as one of the key impediments in the growth and expansion of their businesses. Several Government Departments survey their factories and often demand undue considerations. Despite a series of reforms in taxation policies over the past few years, the SMEs are highly uncomfortable with the terrifying attitude of the tax officials. Most SMEs consider the tax system complex and ambiguous that forces them to engage lawyers for preparing the required tax documents and returns. At times the lawyers mislead and exploit the SMEs due to their lack of knowledge about the taxation system and laws that further complicates the issue. Another issue is the withholding tax on cash withdrawals from banks. Most SMEs consider it unfair and have already started maintaining larger cash balances with them to avoid the tax.

- **Lack of infrastructure**

SMEs are also uncomfortable with the facilities being provided to the tax payers; even the basic infrastructure of the industrial zones is not only inadequate but also in bad shape.

The transport and the communication systems are totally disrupted and these obviously are two majorly important basics for any business to run efficiently.

- **Rising competition from Chinese products**

Chinese products are giving our manufacturing sector a tough time as they are less costly and have better designs and finishing. It could be argued that the government should take steps to protect the local market but because of the implementation of the WTO, protectionism cannot be applied on imports. Therefore, the SMEs have no other option but to improve their efficiency and quality but for this, they obviously need a lot of government support.

- **Difficulty in marketing and selling the products**

SMEs also face problems in marketing and selling their products as their owners usually do not have the required skills in this regard and the small size/nature of their business does not allow them to hire specialized professionals for this purpose. In most cases, the owners themselves are the managers, accountants and marketers. The limited support from SMEDA and the absence of more such institutions is also responsible for this issue being faced by the SMEs.

- **Lack of information about the financing facilities available**

This issue suggests that banks are not doing a good job in marketing their SME financing products to the target customers. Apart from not knowing about the products available, many SME owners don’t even know about the procedures to apply for the loan. The ones wjho have a little idea about the financing being provided by the banks think that the procedure for obtaining loans are quite complex and time consuming.

9. Government Initiatives

The government of Pakistan realizes the growing importance of the SME sector as this sector contributes greatly to the country's GDP and is a major source of employment as well. As the production of this sector forms a major part of the country's exports too, this sector can also said to be one of the main foreign exchange earners for Pakistan. Its because of this undeniable significance of this sector that the government has been taking several measures for the enhancement of the SME industry. Governor State Bank of Pakistan, Begum Shamshad, has directed the banks to promote SME financing: "The SME sector offers a huge potential which can be tapped through collective wisdom of all stakeholders," she underlined and further said that the development of this sector would immensely contribute to employment generation and economic growth of the country.

SBP has created several credit facilities for SMEs to get financial assistance and also for capacity enhancement and promotion. A separate SME department has also been set up within SBP to monitor the problems and provide solution to them. A guarantee scheme is also on its way to implementation with which the Government will be asked to share the credit risk of the banks in providing loans to SMEs. A new set of prudential regulations have been issued for SME sector and the previous "one size fits all" approach has been abolished. According to this, SMEs can now enjoy financing on the basis of cash flows and programs carried out rather than collaterals. The government has also facilitated this sector by giving tax relaxations.

9.1 SMEDA

The government has formed this organization, Small and Medium Enterprises Development Authority (SMEDA), whose function is to work for the development of the SME sector. It does researches in different business fields and prepares feasibility reports of various projects in order to assist new star-ups in the SME sector. It also provides services such as managerial training to the SMEs for the management of their business activities. SMEDA can also train employees of the small firms regarding the maintenance of accounting records of their operations, simplified and standardized book keeping, inventory management etc, if the SME's request this service. This helps the small firms in the preparation of their financials which in turn helps them in getting easy access to credit. SMEDA looks for the potential opportunities in the SME sector and helps investors to exploit these opportunities. Thus SMEDA is playing an important role in the development of SME sector.

According to SBP's governor, "SMEDA could help SMEs in enhancing their entrepreneurial skills and making them bankable for availing financing from banks".

9.2 SME Bank

As part of financial sector restructuring program of Government of Pakistan, Regional Development Finance Corporation (RDFC) and small Business Finance Corporation (SBFC) were amalgamated into SME Bank Ltd effective January 1, 2002.

Government of Pakistan created SME Bank to cater to the needs of the most important segment of the economy. The main purpose of this bank is to help the SME sector to get access to credit. The financing amount ranges from Rs 0.1 million to Rs 75 million. The average loan in most of the cases amounts to Rs 0.5 million. The bank intentionally goes for smaller loans because it reduces the risk. There is always a chance of default, and in case of small loans, the effects are low as compared to default on big loans.

This is the only specialized bank in Pakistan which deals solely in SME financing. The bank's loan portfolios consist purely of lendings to SMEs. This bank also has a major share in the overall SME credit portfolio of the SME banking industry.

10. SME Banking Sector

The banking industry's exposure towards the SME sector is the second largest after corporate finance. In Pakistan corporate sector takes away the major chunk of credit extended by the banking system; SME finance follows by constituting second largest share of the total credits.

For the last two years the SME sector has been witnessing a consistent low growth in SME finance due to a variety of factors such as higher inflation, economic instability, low level of banking industry eagerness to penetrate into this market, capacity constraints of banks to tap the potential market, and major demand side obstacles which are hindering the growth of SME sector in Pakistan.

10.1 Benefits for Banks

- By lending to SMEs, the banks will have diversified portfolio across sectors and will be able to manage their risks more prudently.
- Building the new customer base of SMEs will earn relatively higher margins for the banks.

- Enable SMEs to acquire new technology and improve the quality of their products to meet the growing demand of the market. They will reposition themselves through the new financing facilities to earn more profits and expand their businesses. Some of them will make the transition to large enterprise sector.
- As SMEs account for 30-40 percent of employment in the country and are labor intensive the consequential rise in productivity and efficiency would make a significant contribution in accelerating employment generation, GDP growth and poverty reduction. SMEs also contribute to exports and assimilation of new technology in the production processes would make their products competitive in the international markets.

It may thus be seen that lending to SMEs is a win-win situation as banks will earn good profits in this line of business, depositors will earn higher returns, the SMEs will be able to upgrade the quality and range of their products and the national economy will benefit from higher GDP growth and employment generation.

11. Current SME Banking Status

11.1 SME Number of Borrowers

The outreach of banking industry has increased incredibly in the SME sector. The number of borrowers has shown promising momentum in past few years. At the end of December 2007 SME borrowers stood at 185,039, while at end of March 2006 the number of borrowers remained at 161,008. Though the increase in the number of borrowers may not be highly impressive however it is still satisfactory keeping in view the overall SME financing scenario in Pakistan. Almost 14.93% growth in the number of borrowers was recorded from the period March 2006 to December 2007.

11.2 Bank-wise distribution of SME Finance

- **Big Five Banks**

The share of five big banks i.e Habib Bank Limited, Allied Bank Limited, MCB Bank Limited, National Bank of Pakistan and United Bank Limited; constitutes about 45.07% of the total SME finance portfolio at the end of December 2007. In absolute terms, the total amount advanced by these banks stood at Rs.197 billion of the total Rs.437 billion at the end of the same period. (Figure 1)

Of the five big banks, HBL has the biggest share of about 16.15% of the total SME finance extended by the banking sector till the end of December 2007. While NBP, ABL, UBL and MCB follow with that of 8.16%, 7.75%, 6.98% and 6.03%, respectively.

- **Private Banks (excluding Big Five Banks)**

Private Banks have been doing well in SME finance area for the last two years. The share of the private banks was about 46.06% of the total SME finance portfolio at the end of December 2007. Among the private banks, NIB retains 9.33% of the total share of the SME finance portfolio at the end of December 2007. It has shown impressive performance by increasing its SME portfolio from 9.3 billion to 40.7 billion during the period of December 2006-December 2007. It has shown a growth of 337% in its SME portfolio. In private banks category, Bank Alfalah, Askari Bank and Faysal Bank, each has a share of 8.14%, 5.84% and 3.01% respectively of the total SME credit by the end of December 2007. For the last quarter of 2007, private banks have recorded a growth of 6.6% where as a growth of 7.11% was recorded for the period December 2006-December 2007. (Figure 2)

- **Public Sector Banks (excluding NBP)**

Public sector banks have third largest share in the SME finance after five big banks and private banks. This category is composed of Bank of Punjab, Bank of Khyber and First Women Bank Limited. Public sector banks constitute about 5% of total SME finance by the end of December 2007 while in absolute terms these banks had advanced 21.8 billion by December 2007. Analysis of this category reveals that BOP leads by 3.5% share followed by BOK at 1.09% of the total SME credit finance by end of December 2007. However, public sector banks have shown a relative decrease in the growth of SME finance by 1.4% for the period December 2006-December 2007. (figure 3)

- **Foreign Banks**

The share of Foreign Banks in the total SME finance is very small i.e. about 0.44%. Their total amount outstanding by the end of December 2007 was Rs.1.9 billion. A 3.9% reduction has been recorded in the SME finance portfolio of Foreign Banks during the period December 2006-December 2007. The leading Banks in this category are Al-Baraka and Citi Bank having a share of 0.19% and 0.17% respectively. These two Banks covered the major portion in the contribution of the portfolio of the Foreign Banks operating in Pakistan, i.e. about Rs.1.5 billion. However, over the years, share of Foreign Banks have been very low since these Banks do not actively participate in targeting SMEs.

- **Islamic Banks (excluding Al-Baraka)**

Islamic Banks contribute about 5% in the total SME finance portfolio. Their outstanding amount stood at 21.8 billion by the end of December 2007. For the past two years, no significant improvement has been shown by the Islamic Banks in capturing SME finance market since their market share has been more or less around 5%. Under this category Meezan Bank has the largest outstanding amount of Rs.3.7 billion followed by Dubai Islamic and Dawood Islamic Bank jointly forming Rs.1.37 billion in the SME finance portfolio by the end of December 2007.

- **Specialized Banks**

The absolute amount dispersed by the specialized banks to the SME sector was about Rs. 10 billion by December 2007. This constitutes about 2.27% of total banking portfolio of SME finance. SME finance performance of the specialized banks displays that their portfolio has been floating at around Rs. 10 billion for the last few years. SME Bank has the largest portfolio of Rs.7 billion making about 1.84% of total SME finance outstanding credit by the end of December 2007. Specialized banks portfolio has reduced by 5.3% during the period December 06 - December 07.

11.3 Sectoral Distribution of SME Finance

- **Manufacturing**

Manufacturing Sector receives the largest amount of SME finance forming about 42% of total sectoral distribution of SME finance. By end of March 2008, it has received an amount of Rs. 166.2 billion as SME Finance. While Rs.168.2 billion was extended to this sector as of March 2007. Manufacturing SMEs have been one of top credit availing sector over the last four to five years. Out of the total, Big Five banks have advanced Rs. 84.4 billion; Private Banks Rs.70 billion and Public sector Banks (Excluding National Bank) have advanced Rs.5.4 billion to the manufacturing sector by the end of March 2008. For the first quarter of

2008, manufacturing sector's SME finance growth has declined by 12.6%. Likewise, the growth in this sectors financing has also declined slightly by 1.14% during the period of March 2007-March 2008. The outstanding share of Foreign, Islamic and specialized banks is very nominal towards this sector under SME finance. (figure 4)

- **Commerce and Trade**

Commerce & trade is the second largest sector receiving the major portion of SME finance. In total this sector has availed Rs.132 billion out of total Rs. 403.4 billion of SME finance by end of March 2008. This sector constitutes 32.7 % of the total sectoral credit availed by SMEs. In this category the private sector banks lead with a portfolio of Rs.68.7 billion followed by big five banks with Rs.47.4 billion by the end of March 2008. The public sector banks (excluding NBP) have maintained an amount of Rs. 9 billion which is more than extended to the manufacturing sector by them. This sector has also witnessed a reduced growth of 2% for the first quarter 2008. However, the growth of commerce & trade has moved upward by 5.4% for the period of March 2007-March 2008. (figure 5)

- **Real Estate, Renting and Business Activities**

The total outstanding credit advanced to this sector stands at Rs. 11.2 billion of the total SME finance portfolio by the end of March 2008. This forms about 2.8% of the total sectoral credit distribution at the end of March 2008. SME finance in this sector has recorded a reduction in its growth of 25.3%, for the first quarter of the 2008; while a 14.7% negative growth has also been recorded for the period March 2007-March 2008. Distribution of credit extended to this sector shows that Private sector banks (other than big five banks, Islamic Banks, and Specialized Banks) have advanced an amount of Rs. 6.5 billion followed by big five banks 4.2 billion at the end of March 2008. This relatively slow growth of real estate business may be attributed to the fact that after the booming of this sector five years back it has become less active due to tight economic conditions of the country.

- **Transport, Storage and Communications**

The share of this sector in total sectoral distribution of SME finance stands at 3% by the end of March 2008. Total outstanding amount in this sector was recorded at about Rs.12 billion by end of first quarter of 2008. This sector has recorded a florshing growth of 24.64% for period March 2007-March 2008. Private sector banks share in this sector stands at Rs. 8.7 billion followed by big five banks with Rs. 2.5 billion by the end of March 2008. (figure 6)

11.4 SME Product Offerings by Different Banks

As has been shown above, many banks have extended their operations in the SME industry lately. It is obvious that commercial banks could not have brought their same product offerings to this sector too. So to tap this market effectively, banks have developed various product offerings specifically for the SME market. The bank wise product offering of some of the main banks contributing heavily in the total SME credit has been attached in the annexure. (table 1-13)

12. Conclusion & Recommendations

Before drawing any conclusion, it should be noted that this paper has limitations as no first hand study has been done rather evaluation and analysis has been done on the already available data, therefore results may vary. Despite this, it can be derived after the above study that SME is one of the growing sectors in Pakistan and so needs to be cashed on for the betterment of our economy. And for that the most important point is to have smooth and encouraging access to SME Finance. For this, we have come up with few of the probable solutions and or recommendations to gain maximum benefit from this growing opportunity of SME Banking.

- **Supportive policies**

The government and the SBP need to provide a conducive environment for the SMEs to operate and obtain credit. The regulatory system should be supportive and the legal system should be able to enforce contracts and property rights. There should be an even playing field for the small and the large entrepreneurs. Currently, often the bigger players are preferred over the smaller players and so the credit facilities are also often extended to the bigger parties rather than the smaller ones. Sometimes, political factors also come into play and loans are extended to parties who are supporters of the ruling part. Such differences should be done away with and a uniform set of policies should be brought about for all.

- **Development of zones by provincial governments**

Provincial governments should allocate land for setting up industrial estates and deliver the infrastructure facilities in these estates. Clusters of same industries should be relocated in the same vicinity; the suppliers of raw materials and components, and providers of services and marketing of output also move to the same areas. The logistics management and reduction in transportation cost reduce the unit cost of production and distribution for a single enterprise and also improve the reliability and timeliness in the delivery of products. In many countries such zones and clusters have worked very well and helped small and medium enterprises to become more competitive

- **SMEDA should enhance its efforts**

Organizations such as SMEDA have to play a critical role in the business developments support, advisory services and managerial training of SMEs. For example, most small enterprises do not maintain proper accounting of their operation and do not have a trained accountant on their staff. This impedes their ability to access credit from commercial banks. SMEDA can organize training courses in accounting and assign these certified trainees to work on a part–time basis with a number of enterprises. Simple accounting software packages are now available for small businesses and these can be profitably used in a large number of SMEs. SMEDA can design simplified standardized book keeping, inventory management and ledger forms which can aid in the preparation of financials.

- **Relaxing the stringent lending criterions**

Currently banks are very particular about the accounting records of the SMEs whenever they apply for credit. As has been mentioned earlier in the above research, small businesses often do not maintain proper accounting records due to their lack of knowledge in this area. Therefore, they are often not able to present proper and audited books of accounts when they apply for bank credit. This often becomes the basis for the rejection of their loan request. Such stringent policies should be reworked and it should be realized that small businesses obviously will not have proper accounting records because of their size and literacy rate of the owners. A better option here is providing cash flow based lending. Also, banks should show greater confidence and eagerness in lending to smaller businesses leaving aside the common misconception that a smaller business is more prone to defaulting.

- **Relationship management and customer retention**

There needs to be effective relationship management between a bank and the borrowing customer in order for a successful lending/borrowing contract as well as customer retention for the future. Without the existence of an effective relationship between the bank and the customer, the bank will not be able to extend credit to a borrower with comprehensive trust. To develop this relationship of trust, the bank will have to incur some extra costs such as carrying out a comprehensive research about the customer in order to determine his credit worthiness. Once the bank will be sure about the customer, it will not hesitate in extending credit and from there, this relationship will take a start. The benefit to the bank of incurring these slightly higher costs will be the future business with that customer. Currently banks do not carry out a comprehensive study about the customers to avoid the research costs and therefore they are often apprehensive towards extending credit to them.

- **Knowledge of customer's industry and business**

The banks should work more on finding out every aspect of all the sectors of the SME industry in order to know the industry inside out. This gives banks a knowledge advantage and when they review a business feasibility being proposed by a customer, they can easily judge whether his business is realistic and will it be probably profitable or not. Here, the banks can also provide a value adding service of suggesting improvements in the customer's business idea/feasibility. When the banks will be themselves informed about the customer's business sector, it will be easier for them to judge the business idea. Sometimes a business idea fails to attract funds because the banks are not very informed about the concerned SME sector and so they do not feel confident about lending to such a customer. Therefore, when the banks tighten up their SME departments and they work more on gathering information about the SME sectors, the probability of banks funding the business ideas will also increase.

- **Implementing international practices**

The major practice to be focused here is the credit rating for providing finances to the SMEs. When banks have to extend credit, they rate the borrower in terms of his riskiness. For this there are different ways, one of which is the credit scoring model. In this model, the borrower can be assigned points for various aspects of his previous business performance and then, if he obtains a satisfactory/predetermined score, credit should be extended to him. Often for many businesses, the lack of financial data availability makes it difficult to use this model. For this, a judgment based credit rating model can be used in which qualitative factors can be used to rate the credit worthiness of the borrower. The qualitative factors here can be management quality, practicality of the business feasibility, market awareness, business experience, number of employees, etc. This model can be used for credit rating when the previous financial data is not available. After a few years of operations, this model can be converted into statistical credit scoring model in which the then available financial data can be used to determine future credit ratings.

Apart from using these models for credit rating and then extending credit to SMEs, banks can also practice program based lending and cash flow based lending. In program based lending, banks can basically carry out extensive market research and develop bench marks regarding the financing needs in various SME sectors and the quality of the proposed business feasibility. Credit decisions can then be made based on these benchmarks. In cash flow based financing, the basic idea is the same that when proper books of accounts are not available, credit decisions can be made based on the cash flows of the SMEs as cash flows are an accounting record which is maintained by every business in raw or refined form.

- **Increasing the number of players and branches**

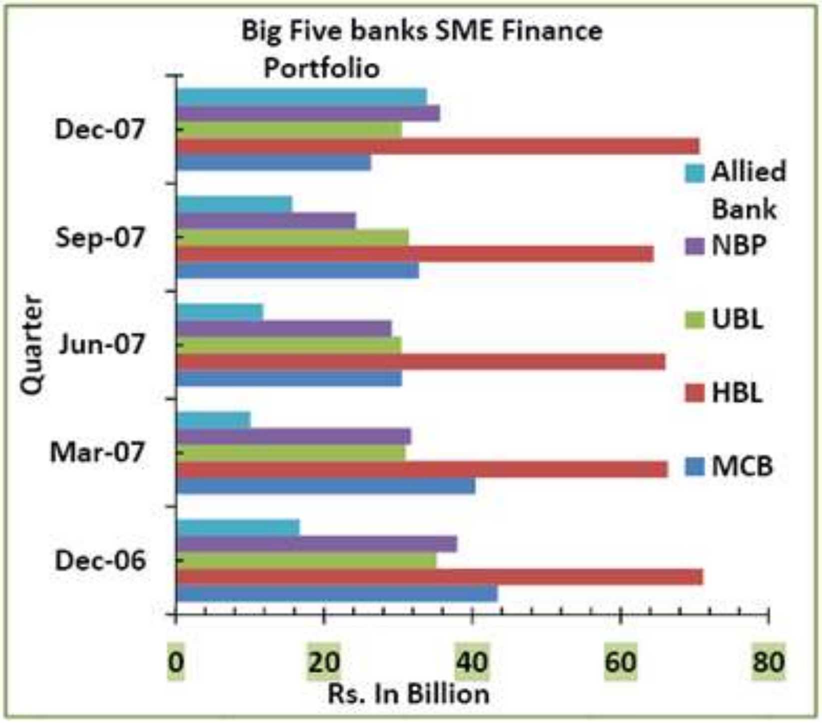
The number of institutions providing finances to the SME sector should be increased in order to increase the availability of credit to this sector and also increase competition so that innovative SME financing products are developed. The existing specialized institutions such as SME Bank and SMEDA should increase the number of their branches in order to increase their reach to more areas and more customers.

13. References

- SME Finance Quarterly Review-first quarter 2008 by SME Department of SBP
- Corporate Governance and Business Ethics for SMEs in Developing Countries: Challenges and Way Forward By Shahnawaz Mahmood, Islamabad, Pakistan
- Economic Survey of Pakistan, 2007-2008, 2005-2006
- “why lend to SMEs?” by Ishrat Hussain
- “SME financing - issues and strategies” by Ishrat Husain
- A research study “why are Pakistan’s SME banks shy” by A Project of Pakistan Financial Services Sector Reform Programme (PFSSRP)
- “Innovative Financing for Small and Medium Enterprises: The Philippine Experience” by Ambassador Jesus P. Tambunting, Chairman, Planters Development Bank--International CEO Forum Kuala Lumpur, Malaysia, 13 August 2004
- SBP, SME Financing products by SME department
- “Financing the Small and Medium Scale Enterprises in Faisalabad (Pakistan)” by KASHIF HAMID1 AND ABAIDULLAH, Department of Business Management Sciences, University of Agriculture, Faisalabad–38040, Pakistan
- SME Policy 2007
- SMEs’ Survey of Gujranwala district
- SME development, economic growth, and government intervention in a developing country: The Indonesian story by Tulus Tambunan, Published: 22 August 2008

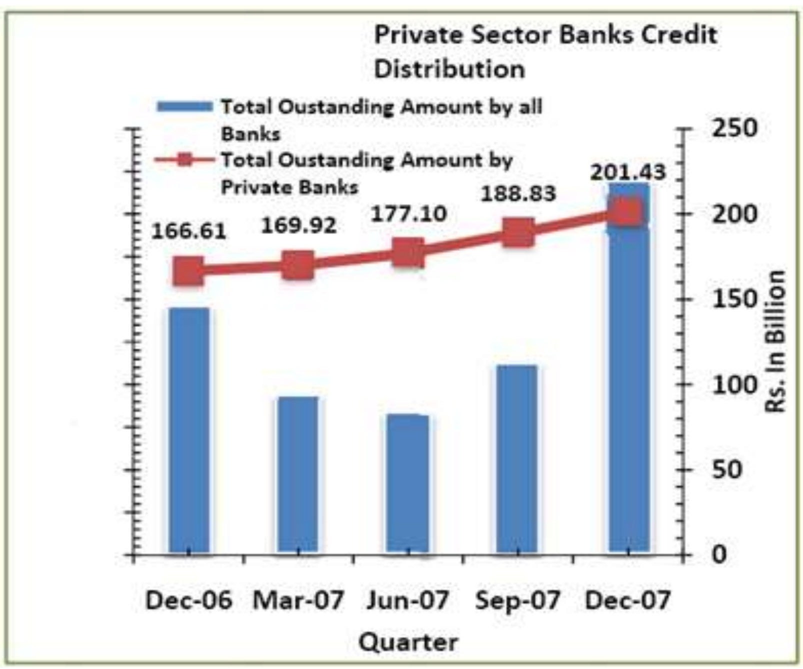
14. Annexure

Figure 1



[10]

Figure 2



[10] All these graphs have been taken from the SBP's SME Finance quarterly review report-2008

Figure 3

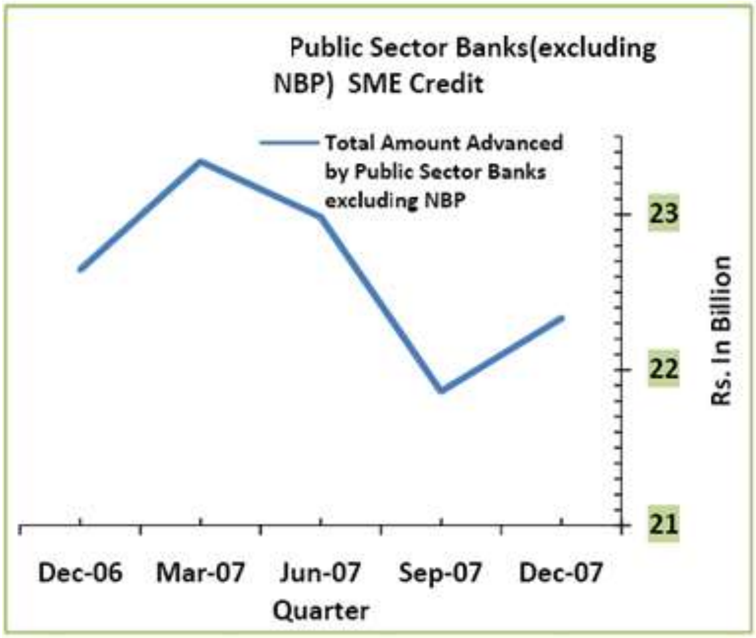


Figure 4

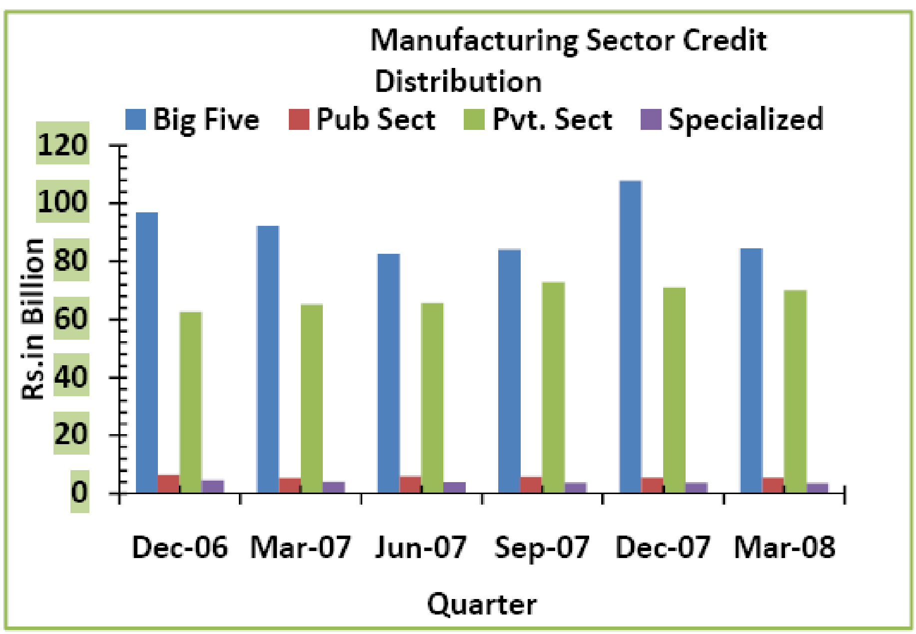


Figure 5

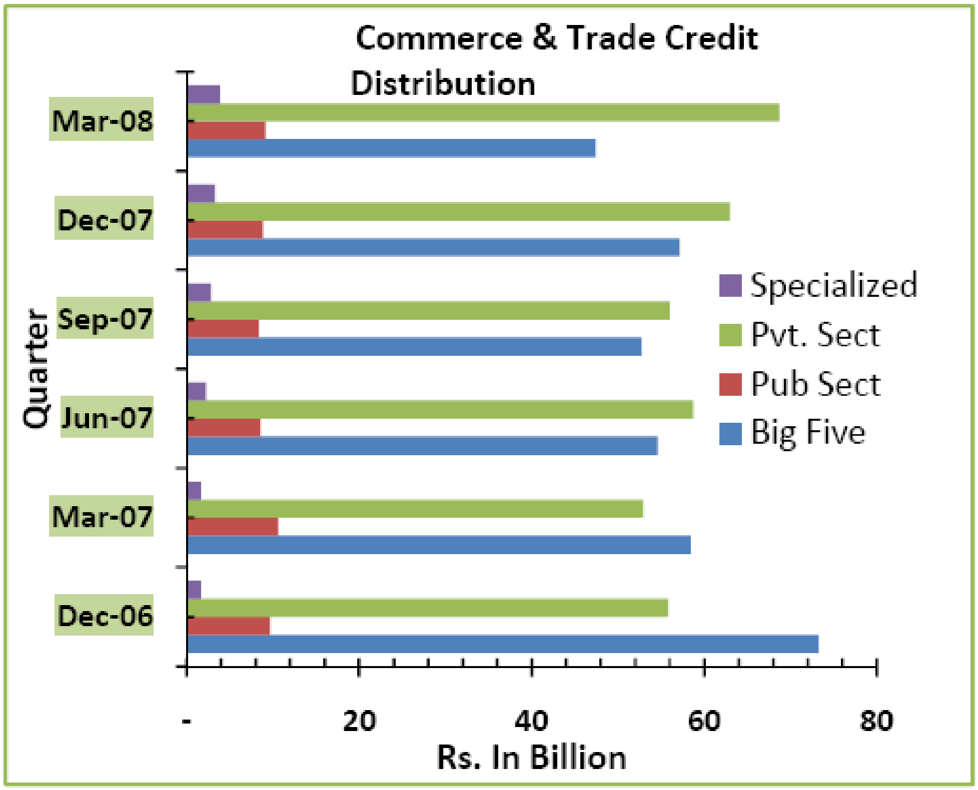


Figure 6

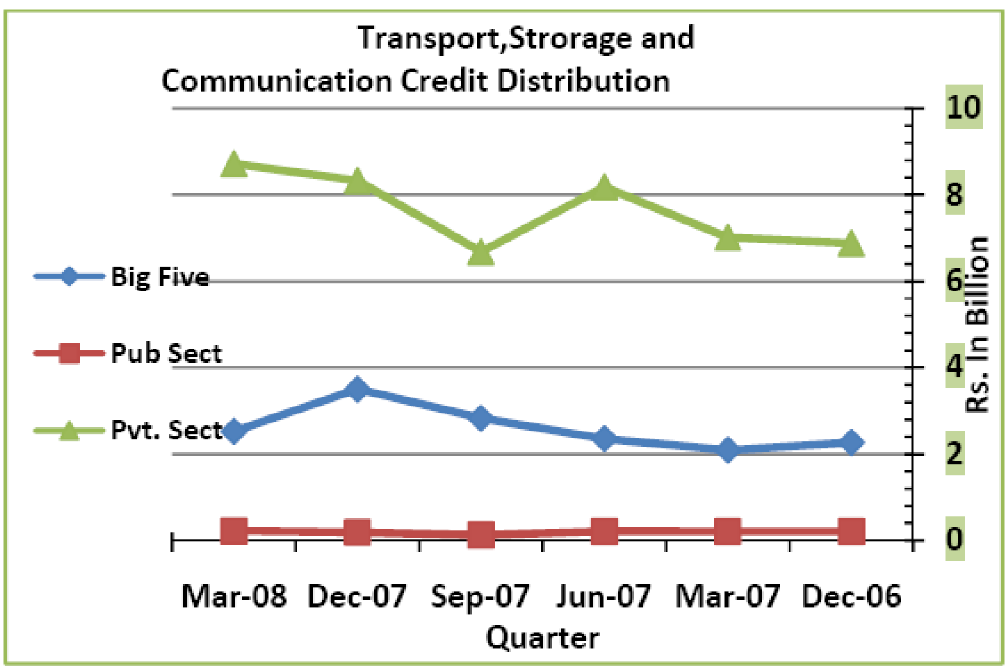


Table 1 HABIB BANK LIMITED[11]

Product	Running Finance	Demand Finance	Cash Finance
Type of Product	General	General	General
Targeted Sector	All Sectors	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns	All Business Concerns
Amount	Min:0.5M-Max: 75M	Min:0.5M-Max: 75M	Min:0.5M-Max: 75M
Tenure of Loan	One Year (max)	One Year (max)	One Year (max)
Product Specification	Cash flow based, collateral based	Cash flow based, collateral based	Cash flow based, collateral based
Repayment Mode	Quarterly, flexible modes	Equal installments, monthly, quarterly	Revolving Basis
Time of Loan Approval	9 Days	9 Days	9 Days

Table 2 MCB BANK LIMITED

Product	Demand Finance (for expansion/new units)	Working Capital Facilities	Lease Financing
Type of Product	General	General	General
Targeted Sector	All Sectors	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns	All Business Concerns
Amount	Min:0.5M-Max: 75M	Min:0.5M-Max: 75M	Min:0.5M-Max: 75M
Tenure of Loan	1 year-5 year	Max 1 year (on renewal basis)	3 to 5 years
Product Specification	Cash flow based, collateral based, program based	Cash flow based, collateral based, program based	Cash flow based, collateral based
Repayment Mode	-	Varies	Equal installments, monthly, quarterly, half yearly
Time of Loan Approval	Max 37 Days	Max 37 Days	Max 37 Days
Collateral Requirements	Land, building, inventory, PGs, CA etc		

Table 3 BANK AL-FALAH LIMITED

Product	Karobar Finance	Milkiat Finance
Type of Product	SME specific	SME specific
Targeted Sector	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns
Amount	Min: 0.5M-Max: 75M	Min: 0.5M-Max: 75M
Tenure of Loan	1 Year	2 Years -12 years
Product Specification	Cash flow based, collateral based	Cash flow based, collateral based
Repayment Mode	Quarterly, flexible mode	Equal monthly installments
Time of Loan Approval	30 Days	45 Days

[11] All the data in these tables have been taken from SBP's report on SME Financing Product by SME Dept.

Table 4 ASKARI BANK LIMITED

Product	Running Finance	Term Finance	Cash Finance
Type of Product	General	General	General
Targeted Sector	All Sectors	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns	All Business Concerns
Amount	Max: 75M	Max: 75M	Max: 75M
Tenure of Loan	1 Year (max)	5 Years (max)	1 Year (max)
Product Specification	Cash flow based, collateral based	Cash flow based, collateral based	Cash flow based, collateral based
Repayment Mode	Monthly, quarterly, flexible, bullet repayment	Monthly, quarterly, flexible, bullet repayment	Monthly, quarterly, flexible
Time of Loan Approval	21 Days	9 Days	21 Days

Table 5 STANDARD CHARTERED BANK LIMITED

Product	Tana Bana	Rang Hi Rang	Agri Deal	Kissan Card	Business Power	Business Installment Loan
Type of Product	SME specific	SME specific	SME specific	SME specific	General	General
Targeted Sector	Textile weavers	Textile dyers & printers	Dealers of agri inputs,fertilizers, pesticides	Agriculture	All sectors	All sectors
Type of SMES	Manufacturing Concerns	Manufacturing Concerns	Traders	Farmers	All business concerns	All business concerns
Amount	Min: 0.5M-Max: 75M	Min: 1M-Max: 20M	Min: 0.5M-Max: 30M	Min: Rs.32000-Max: Rs.125000	Min: 1M-Max: 20M	Min: 0.5M-Max: 2M
Tenure of Loan	Evergreen facility renewed annually	Evergreen facility renewed annually	Evergreen facility renewed annually	Evergreen facility renewed annually	Evergreen facility renewed annually	1-3 years
Product Specification	Secured program, collateral based	Secured program, collateral based	Secured program, collateral based	Un-secured program	Secured program, collateral based	Un-secured program
Repayment Mode	Monthly mark-up payment	Monthly mark-up payment	Monthly mark-up payment	Bi-annual mark-up payment	Monthly mark-up payment	Equal monthly installments
Time of Loan Approval	16 Days	16 Days	16 Days	16 Days	16 Days	14 Days

Table 6 BANK OF KHYBER

Product	Running Finance	Demand Finance
Type of Product	General	General
Targeted Sector	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns
Amount	Min:5M-Max:100M	Min:5M-Max:100M
Tenure of Loan	One Year (renewable)	One Year (renewable)
Product Specification	Cash flow based, collateral based	Cash flow based, collateral based
Repayment Mode	Monthly, quarterly	Monthly, quarterly

Time of Loan Approval	14 Days	14 Days

Table 7 CITI BANK

Product	Running Finance	Term Loan
Type of Product	SME specific	SME specific
Targeted Sector	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns
Amount	Min:3.75M-Max:52.5M	Min:6M-Max:105M
Tenure of Loan	1 Year (max)	5 Years (max)
Product Specification	Cash flow based, program based.	Cash flow based, program based.
Repayment Mode	Bullet payment	Quarterly
Time of Loan Approval	45 Days	35 Days

Table 8 NIB BANK LIMITED

Product	Small Business Loan	Salaam Business Loan	General
Type of Product	SME specific	SME specific	SME specific
Targeted Sector	All Sectors	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns	All Business Concerns
Amount	Min:Rs.30,000-Max:Rs. 750,000	Min:Rs.10,000-Max:Rs. 3M	Up-to 75M
Tenure of Loan	1-5 Years	3 months-10 Years	As negotiated with the customer
Product Specification	Cash flow based, program based, collateral based.	Cash flow based, program based, collateral based.	Program based
Repayment Mode	Equal installments monthly	Equal installments monthly	Bullet repayment
Time of Loan Approval	30 Days	30 Days	-

Table 9 SME BANK LIMITED

Product	Smart Loan	Assets Finance	Running Finance
Type of Product	SME specific	SME specific	SME specific
Targeted Sector	All Sectors	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns	All Business Concerns
Amount	Min:Rs.50,000-Max:Rs. 0.5M	Min:Rs.50,000-Max:Rs. 75M	Min:Rs.250,000-Max:Rs. 75M
Tenure of Loan	3 months-5 Years	1-4 Years	3 months-1Year
Product Specification	Cash flow based	Cash flow based, collateral based.	Program based
Repayment Mode	Monthly installments	Monthly, quarterly installments	Flexible mode
Time of Loan Approval	10 Days	30 Days	30 Days

Table 10 FAYSAL BANK LIMITED

Product	Long-Term Finance	Running Finance
Type of Product	General	General
Targeted Sector	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns
Amount	Min:5M-Max: 75M	Min:2.5M-Max:75M
Tenure of Loan	3-7 Years	1Year
Product Specification	Cash flow based, collateral based.	Cash flow based, collateral based.
Repayment Mode	Monthly, quarterly installments	Flexible mode
Time of Loan Approval	20 Days	20 Days

Table 11 DUBAI ISLAMIC BANK

Product	Shirkut-ul-Milke	Ijarah	Istisna	Wakala Istithmar
Type of Product	General	General	General	General
Targeted Sector	All Sectors	All Sectors	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns	All Business Concerns	All Business Concerns
Amount	Up-to 75M	Up-to 75M	Up-to 75M	Up-to 75M
Tenure of Loan	6 months-5 Years	1-4 Years	6 months-5 Years	30 days-180 days
Product Specification	Cash flow based, collateral based.	Cash flow based, collateral based.	Cash flow based, collateral based.	Cash flow based, collateral based.
Repayment Mode	Flexible mode	Flexible mode, monthly, quarterly	Flexible mode, monthly, quarterly, bullet	Flexible mode, monthly, quarterly, bullet
Time of Loan Approval	15-30 Days	15-30 Days	15-30 Days	15-30 Days

Table 12 AL-BARAKA ISLAMIC BANK

Product	Murabaha	Ijarah	Musharaka
Type of Product	General	General	General
Targeted Sector	All Sectors	All Sectors	All Sectors
Type of SMES	All Business Concerns	All Business Concerns	All Business Concerns
Amount	Up-to 75M	Up-to 75M	Up-to 75M
Tenure of Loan	90 days- 1 year	3-5 Years	3-7 Years
Product Specification	Cash flow based, collateral based.	Cash flow based, collateral based.	Cash flow based, collateral based, program based.
Repayment Mode	Flexible mode	Monthly, quarterly	Monthly, quarterly
Time of Loan Approval	15 Days	15 Days	15 Days

Table 13 UNITED BANK LIMITED

Product	Rice/Paddy Advances	Cotton Ginners Advances	Credit against liquid securities	Running Finance
Type of Product	SME specific	SME specific	SME specific	SME specific
Targeted Sector	Rice growing sectors	Cotton growing sectors	All Sectors	All Sectors
Type of SMES	Manufacturing	Manufacturing, trading	All Business Concerns	All Business Concerns
Amount	Min:1M-Max:20M	Min:1M-Max:75M	Min:1M-Max:75M	Up to 75M
Tenure of Loan	3-7 years	9 months	1-3 Years	1 Year
Product Specification	Program based, collateral based.	Cash flow based, collateral based.	Collateral based, program based.	Collateral based
Repayment Mode	Quarterly	Quarterly	Quarterly	Quarterly
Time of Loan Approval	14 Days	14 Days	14 Days	40 Days