BSM - FINANZWESEN

MINUTES OF THE SAVINGS & CREDIT FORUM 19TH OF JUNE 2006

Small & Medium Enterprise (SME) Lending

For the participants of the Savings & Credit Forum
and other interested persons

Dear colleagues

The Savings & Credit Forum on 19.6.2006 discussed the rationale for, and good practises of SME lending. It highlighted the particular technical assistance (TA) experience of ShoreBank International in introducing SME lending in down-scaling programmes. The discussion was enriched very much by the case study of Microfin, the leading micro-credit organisation in Bosnia-Herzogovina.

Mr. Hansruedi Pfeiffer (SDC) first welcomed the participants and then introduced the speakers: Messrs. Steve McConnel, Vice Chairman of ShoreBank Corporation, Ed Siegel, Vice President of ShoreBank International Ltd., and Alexandar Kremenovic, CEO of Mikrofin.

Mr. McConnel gave an introduction to SME lending. He first pointed out the overwhelming significance of SMEs in terms of job creation, innovations, export performance and support for the local economy. He then stressed the interest margin required for the sustainable operation of the lending institution and the development impact that is expected, too. Both together are referred to as the double bottom line of SME lending. He explained that the uniform lending technology is cash-flow based and that, with new technologies, the lending institutions tend more and more towards statistical credit scoring.

Mr. McConnel distinguished SME lending from micro credit in that it constitutes much higher risks and that collateral is therefore much more important. He also pointed out the importance of regular monitoring, the rating of all loans by the lending staff and independent loan reviewers as well as a clear set of written lending procedures. He indicated that banks and microfinance institutions (MFIs) meet 'in the middle' and that MFIs must take deposits in order to enter into SME lending due to the increasing refinancing requirements.

Mr. McConnel introduced the organisational set up of ShoreBank Corporation before Mr. Siegel reported on down-scaling field lessons of ShoreBank International Ltd. Mr. Siegel stressed the following overall principles for successful down-scaling: (1) support the lending institution in developing profitable loan products, (2) create sustainable capacity through proper on-the-job training of loan officers and managers, and (3) apply a collaborative approach in technical assistance provision by adapting the advisory methods to the structure and strategic plans of the lending institution. He also outlined the strategic importance of training in selling skills and customer service, a good marketing strategy and performance incentive schemes.

Mr. Siegel explained the evolution of the TA approach that starts with proper lending policies and procedures and the training in classroom and on-the-job. Once the skills are in place, focus is given to optimise the loan management through streamlining and automatisation processes. The strengthening of internal control and audit plays an important role as well as the graduation from judgmental to statistical credit scoring. Full success will be achieved when there is a close collaboration between the loan- and sales departments of the lending institution.

Mr. Siegel referred to his personal experience with the same Romanian bank during 19996-98 and 2000-2003 with two different donors. The first assignment was not successful as the bank management was not committed to SME lending, as competition was limited and state treasuries offered a lucrative non-risk investment. Moreover, the donor did not set the right incentives for a good performance. The second assignment was very successful, as he could apply a long-term 'embedded' TA approach that corresponded to the market, aligned the incentive systems and moved towards statistical credit scoring.

After a common lunch Mr. Kremenovic presented the impressive raise of Mikrofin as the leading micro credit MFI in Bosnia (it reached financial self-sufficiency already after 2 years). Mikrofin has now a Euro 37 million loan portfolio with more than 25.000 clients and around 172 staff. Mr. Kremenovic described Microfin's development phases as follows:

(1) 10/1997 – 6/1999: project of Care International
The project started with a group lending approach without analysing properly the market conditions in Bosnia. As no competition and ample credit demand existed after the post-war rehabilitation time, clients had no choice but to accept group loans despite the cumbersome requirements to attend promotional and organisational meetings as a group loan pre-condition. A gradual shift to individual lending started in early 1999 on a pilot basis.

(2) 7/1999 – 12/2000: local NGO
The project was "localised" by creating a local NGO. It received a "lending permission" with the help of an agency agreement with the IBRD. More focus was given on individual lending.

(3) 1/2001 – present: micro credit organisation (according to the law on MCO of 2001).
Group lending was fully replaced by cash-flow based individual lending by 2002. The new regulation of MCO facilitated the access to new funding sources, including a Sfr. 0,1 million credit line of SDC under the KfW managed European Fund for Bosnia & Herzogoniva. Mikrofin focuses on SME lending since 2002 where it sees the greatest market potential. Since then it persued an active market segmentation and also entered into agro lending (loans between Euro 500 to 15.000) and quick loans (loan between Euro 250 to 2.500) and started recently house improvement loans.

Mr. Kremenovic explained his convincing business strategy to seek a strategic alliance with a major commercial bank that would become the main shareholder of Mikrofin (EBRD has already been mobilised as first strategic investor). This would secure financial leverage through the growth of the equity base and allow Mikrofin to concentrate on lending through its extensive branch network as its comparative advantage compared to the commercial bank. Mr. Kremenovic also plans to create separate companies that would offer agro leasing and micro insurances so as to offer a broader range of financial services to Mikrofin's clients.

When asked about the need to mobilise savings as the most secure refinancing strategy, Mr. Kremenovic stressed that the strategic alliance with a commercial bank would permit Mikrofin to continue concentrating on lending (what it knows best) and leave savings mobilisation to the bank as strategic investor. He would therefore not need to invest into new management systems and corresponding staff training (that are required for taking deposists from the public) and, most importantly, Mikrofin would not need to acquire a banking licence.

Mr. Hans Ramm (Intercooperation) shortly summarised the key findings and conclusions of the workshop. He pointed out the rapid increase of competition in Southeast European financial markets (compared to many financial markets in the South) that will not leave much time for financial NGOs to transform into financial institutions and to seek rapid growth in order to survive in the market. He praised the innovative approach of Mikrofin in seeking strategic alliances with commercial banks that would allow Mikrofin not only a solid equity base, but also offer diverse financial services to its clients, including leasing and insurance services. Mr. Pfeifer then thanked the speakers and the participants for their valuable contributions. He pointed out that all powerpoint presentations can be downloaded from the website http://www.intercooperation.ch/finance/download/#pvsc.

On behalf of the Financial Sector Backstopping Team of SDC
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