Quarterly SME Finance Review-June, 2014

Infrastructure, Housing & SME Finance Department

Team Leader

Syed Samar Hasnain samar.husnain@sbp.org.pk

Members

Reviewed by:

Dr. Saeed Ahmed Dr.Ahmed@sbp.org.pk

Mr. Imran Ahmad imran.ahmad@sbp.org.pk

Prepared by:

Sabeen Raja sabeen.raja@sbp.org.pk

For feedback/queries: smefd@sbp.org.pk

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EXECUTIVE SUMMARY

Financing to the SMEs by the banking sector increased significantly in FY14. Disbursements increased by 8.2 percent to 252 billion, while Non performing loans (NPLs) declined by 4.56 percent (YoY end June 2014). Unfortunately the same could not be said about number of borrowers as they registered an 8 percent decline. This increase in SME financing portfolio of banks/DFIs can be associated with revised SME Prudential Regulations.

The decline in NPLs of SMEs indicates that either banks/DFIs are cleaning up their balance sheets (by write-off of loans with longer delinquency periods which have little chance of being recovered) or their recovery efforts have started to materialize. While another reason for lower NPLs ratio could be improved SME financing disbursements. With such improvements in overall SME Financing of the industry, the ratio of SME Finance NPLs to the total SME Financing decreased to almost 34% in June 2014 from 38% in June 2013. If this continues, it will enhance lending from banks/DFIs in this sector.

Facility-wise breakup shows that the working capital financing constitutes around 75% of total SME financing followed by fixed investment and trade finance with their respective shares of 13% and 12%. Banks'/DFIs' are inclined towards short-term financing to SMEs.

Bank wise distribution of SME lending shows the share of Private Sector Banks in total SME financing remained at 74.2% during period under review. Private sector banks are followed by public sector banks[1] whose share in total SME Finance was marginally up to around 19.6% in FY14 when compared to 18% in FY13. Five full fledged Islamic Banks provided 2.2% of SME Financing. The total SME financing by Islamic banking industry amounted to nearly 5% of total SME financing in FY-14 which was the same last year.

[1] NBP, FWBL, BOP, BOK, and Sindh Bank

Trends in SME Financing

The outstanding SME financing of the banks/DFIs posted higher growth in absolute terms when compared to previous quarter. SME financing is 252.73 billions as on June, 2014 which is 1% higher than 250.58 billions (March, 2014). The issuance of revised prudential regulations has given thrust to the SME financing and its gaining momentum upwards. As an indication of this, SME financing has shown a Y-o-Y increase of 8.21 percent when compared with June, 2013. Total financing and SME financing both are trending upwards in the quarter under review but not with same ratio which is why SME financing is 5.8% of total financing as compared to 6% (*ratio of SME financing with total financing*) of previous quarter. Moreover, decline in SME NPLs is also a factor which is shaping the ratios this way.

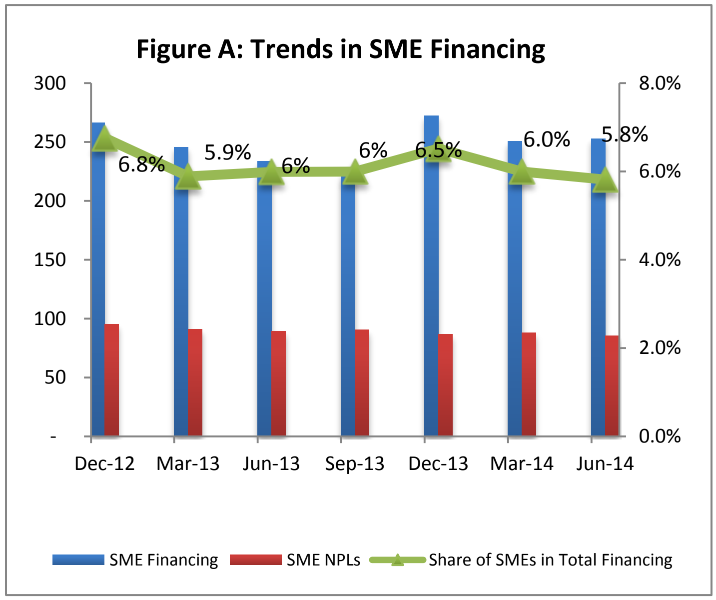
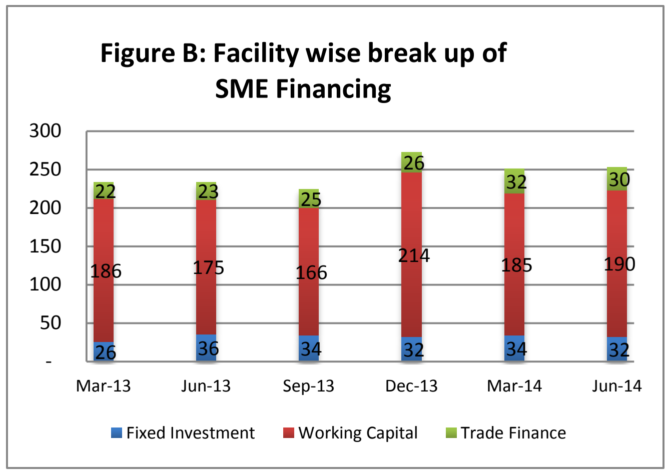


Table 1: SME Financing Profile of Banks/DFIs					
Category	**Periods ending**			**Change**	
(Amount in Billion Rs.)	**Jun-14**	**Mar-14**	**Jun-13**	**Quarter**	**YoY***
Total SME Exposure	252.73	250.58	233.55	1.00%	8.21%
Total Financing	4,339.23	4,176.50	3,896.30	3.90%	11.37%
SME Exposure as % of total financing	5.82%	6.00%	5.99%		
SME NPLs	85.49	88.23	89.47	-3.11%	-4.44%
NPLs as % of Total SME Exposure	33.83%	35.21%	38.31%		
No. of SME Borrowers	133,018	134,166	144,141	-1.00%	-7.72%
***. YoY: Year on Year**					

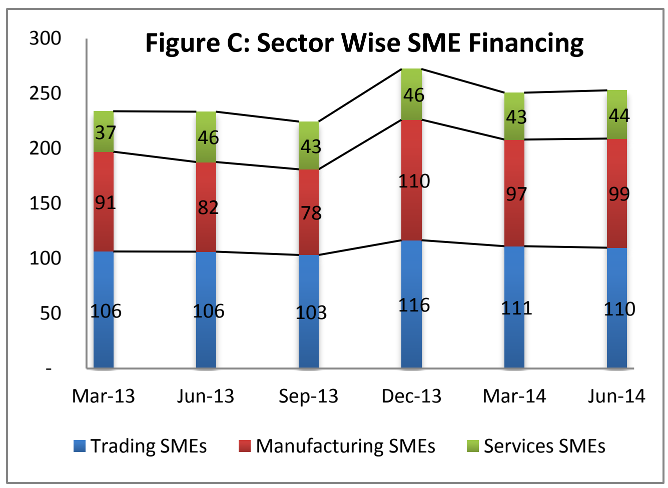
Although the number of SME borrowers declined by 1% during the quarter from 134,166 in March 2014 to 133,018 in June 2014, the Y-o-Y trend has witnessed a decline of more than 7% when compared with the June, 2013 position of SME borrowers (**Table 1**). A smaller decline in number of borrowers compared to the increase in SME financing amount can also be referred as the cyclical effects of small pickup of working capital financing by SME borrowers during the last quarter of the year. SME financing as compared to previous quarter is declined by 2%.

Non Performing Loans declined by 4% on Y-o-Y basis and similarly, when compared to previous quarter NPLs have shown a decline of 3% (**Table 1**). The decline in SME Finance NPLs indicates that either banks/DFIs are cleaning up their balance sheets by writing-off loans with longer delinquency periods and thus have little prospects of recovery or their recovery efforts have started to materialize. While another reason for lower NPLs ratio could be improved SME financing disbursements. If the long term trend of decrease in non-performing SME portfolios and growth in SME financing persist, the current excessively high NPL ratios of banks/ DFIs may normalize and even start to conform to overall delinquencies in private sector financings of banks/ DFIs to the corporate and commercial borrowers in coming quarters.

Facility-wise breakup shows that the working capital financing constitutes around 75% of total SME financing followed by fixed investment and trade finance with their respective shares of 13% and 12%. The facility-wise distribution of borrowers also depicts a similar scenario and further accentuates this view of tilt of banks towards working capital financing to SME borrowers.



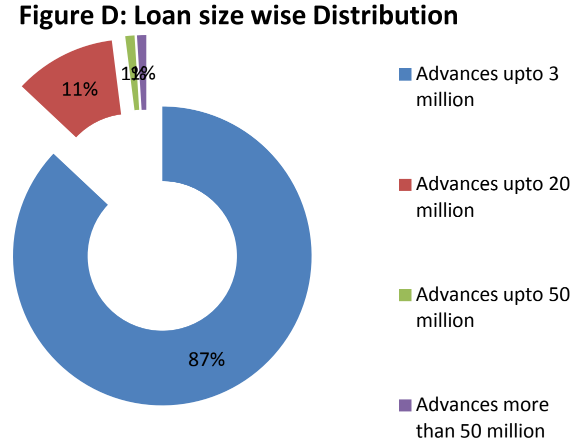
Sector Wise SME Financing shows the shares of trading, manufacturing and services sector in total SME financing remained stagnant without any significant change over the quarter, while on Y-on-Y basis manufacturing grabbed 21% more share as compared to same quarter of previous fiscal year. As a normal trend, the manufacturing and trading



SMEs together pick up around 80% of the SME financing with a fluctuation margin ±5% while the remaining is picked up by the services sector of SMEs.

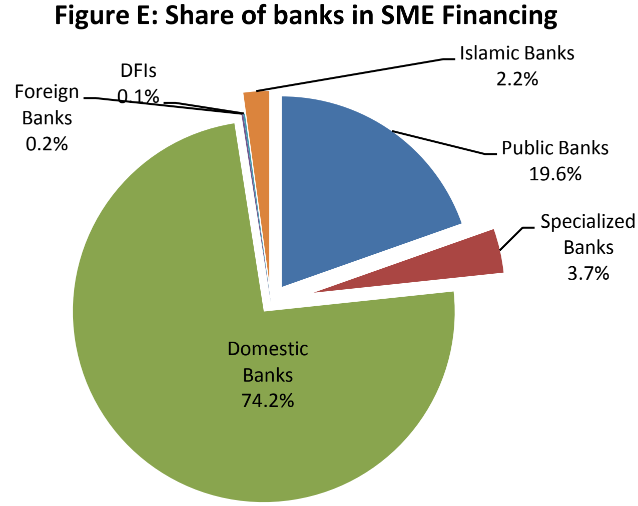
The SEs with up to 20 employees availed 59% of the total financing to the SMEs primarily because of the large number of lower end trading and services SMEs availing financing facilities from Banks & DFIs. On the contrary, manufacturing SEs with up to 20 employees availed 37% of financing to the SME manufacturers, which is 4% lower when compared to the previous quarter.

Figure D: Loan size wise Distribution



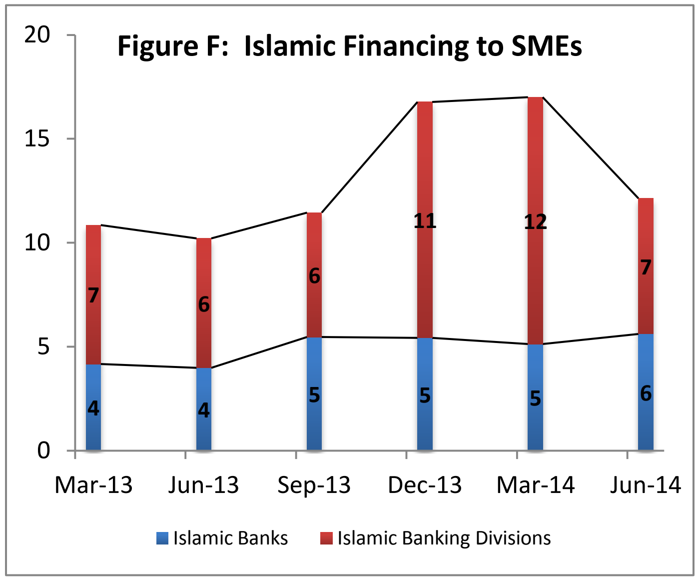
Loan size wise review shows that around 87% SME borrowers are using loans up to Rs. 3 million and their share in total SME financing is only 21%. Out of which, a major number of SME borrowers is availing loans of up to 0.5 million. In order to adequately capture even larger segment of these largely untapped small enterprises, the banks/DFIs have to develop capacities in terms of human resources, branch infrastructure and IT and deploy controls and procedures.

Figure E: Share of banks in SME Financing



Bank wise distribution of SME financing shows that the share of private sector banks (17 institutions) in total SME loans outstanding is highest as 74.2% (increased from 72.1% at the end of previous quarter). Private Sector banks are followed by Public Sector Banks (NBP, FWBL, BOP, BoK and Sindh Bank) which shared around 19.6% (decreased from 21.8% at the end of previous quarter) of total SME outstanding amount. Among private sector banks; Habib Bank Limited has grabbed the largest share of 15% SME financing followed by Bank Alfalah Limited with a share of 10%.

SME financing by Islamic banks and Islamic banking divisions (collectively called IBIs) is declined by 23% in quarter under review whereas share of Islamic Banking istitutions have increased by 30% when compared to same quarter of previous year which is a healthy emerging trend. The increase in overall SME financing with a decreasing trend in Islamic SME financing decreased the share of IBIs by 5% over the period under review is witnessed. It is worth mentioning that share of SME financing of Islamic Banking Divisions is more than the share of Islamic Banks in Pakistan.Total share of Islamic Banks in SME financing is 2% out of which 1% is financed from Albaraka Bank (Pakistan) Limited and 1% is financed by Meezan Bank Limited while IBDs are contributing 3%. There is a dire need to push Islamic Banks towards SME financing which will not only provide a variety of Islamic products to SMEs but will also help Islamic Banks in exploring SME markets.



Major Initiatives and their progress during the quarter

The major new initiative in SME financing during the period under review was formulation and launching of Prime Minister's Youth Business Loans. A brief on the initiatives and progress on earlier initiatives of the State Bank during the quarterly period under review are summarized below:

Prime Minister Youth Business Loans Programme

The Prime Minister Youth Business Loans Programme which was formally launched by the Prime Minister on December 7, 2013 is aimed to provide loans to unemployed youth for establishing or extending business enterprises in order to promote self-employment in the country. PMYBL Application Forms are available at all the branches of NBP, FWBL, SMEDA and website of these institutions.

As of June 30, 2014, over 57,000 applicants received approvals for financing under the Scheme. In the first balloting, 5,414 applications from 92 districts with aggregate loan amount of Rs 5.8 billion were declared successful on the basis of population of each province. Out of these 5,350 approved loans belonged to NBP while the rest 64 loans from FWBL. Province-wise position of successful applications in balloting transpired that 76.25% of successful applications were from Punjab, 12.47% from KPK, 6.43% from Sindh, 1.4% from Baluchistan, 1.39% from AJK, 1.94% from Islamabad and 0.13% from Gilgit-Baltistan. Prime Minister also chaired second balloting of PM Youth Business Loans held on June 4, 2014 at Islamabad. In 2nd balloting, 5,169 loans application with loan amount of around Rs 5 billion were declared successful.

Secured Transaction Reforms

Secured Transaction Framework calls for existence of a modern Secured Transaction Law that provides for establishment of Secured Transaction Registry in the country, which will register charge on assets especially moveable assets of the borrowers. Implementation of Secured Transaction Reform Framework shall generate the following benefits:

- Enable SMEs and Agri borrowers to use their assets especially moveable assets as collateral to obtain loans, thus enabling them to use a broader scope of assets as security for availing loans.
- Provide cheap & simple mechanism of online registration & search about encumbrance on assets.
- Provide clear rules on priority of creditors' claims on securities.
- Provision on effective enforcement of security will boost lenders' confidence in case of default

In view of the above, State Bank, with the financial support of DFID UK, is implementing Secured Transaction Reform (STR) Project. SBP has hired the services of legal consultants for drafting of Secured Transaction Law. During period under review, SBP organized Project Committee (PC) meeting and a Video Conference (VC) with World Bank to discuss and provide feedback on second draft of Secured Transaction Act. In the light of Project Committee members' feedback and VC discussions, the consultants submitted revised draft of the STR Act in June 2014, which was also shared with PC members for their feedback. After finalization of the Draft Secured Transaction Act by Project Committee, the same shall be forwarded to GOP for approval from the Parliament.

Credit Guarantee Scheme for Small and Rural Enterprises

SBP launched a Credit Guarantee Scheme (CGS) for Small and Rural Enterprises in March 2010, which allows banks to develop a portfolio of fresh borrowers who are creditworthy, but the banks are shy away from such customers due to perceived high risks, small ticket size, issues in documentation and collaterals, etc. The Scheme shares 40% of credit losses of lending banks on their loans to Small and Rural Enterprises. State Bank allocated Credit exposure limits of Rs. 6.56 billion (SBP Guarantee Coverage Limit of Rs. 2.62 billion) for the CY 2013 to 10 banks selected as Participating Financial Institutions (PFIs) under the Scheme. The Scheme has been well-picked. The net utilization of the guarantee limits by the banks as of end of the year was 64% with sanctioned loans of Rs. 4.19 billion to 6,268 borrowers. However, this figure does not include 3,555 guaranteed loans with sanctioned amount of Rs. 2.14 billion which have already been closed. State Bank is in final stages of allocating fresh limits to the banks under the Scheme for 2015-16.

Mark up Subsidy and Guarantee Facility for the Rice Husking Mills in Sindh

The objective of the Mark up Subsidy and Guarantee Facility for the Rice Husking Mills in Sindh is to help the sponsors of rice husking mills of Sindh to undertake projects of BMR for increasing effecinecy of their mills. Under this Scheme, SBP provides mark up subsidy of 6.25% and credit risk sharing facility of up-to 30% against the long term loans extended to rice husking mills of Sindh under the SBP Refinancing Scheme for modernization of SMEs. In view of the huge benefits of the structure of the Scheme, the Governor State Bank has invited other provinces to consider initiating similar mechanisms of lending to selected SME segments in their provinces from their budgetary resources and offered SBP's full support for such programs.