Training Program on "Scaling Up SME Banking Business": January 7-9, 2013,
<u>Pearl Continental Hotel (PC), Karachi – Inaugural Speech by Deputy Governor</u>

Ladies and gentlemen, it's my pleasure to be here in the inaugural session of this Training Program, arranged by State Bank of Pakistan in collaboration with IFC on **"Scaling Up SME Banking Business".**

I welcome you all for this event. I also welcome the experts from IFC who are conducting this important session for the banking community of Pakistan.

The training program provides a valuable opportunity to the participants to improve their insight in successful SME Banking models and strategies used globally, and thus will resultantly enhance their skill set enabling them to serve the sector more effectively.

SME development boosts employment more than large firm growth due to the fact that SMEs are normally more labour intensive. In Pakistan, the SME sector contributes 30 percent towards GDP, employ more than 70 percent of the non-agricultural workforce and generates 25 percent in the export earnings.

However, despite its significance, the growth of SME sector in Pakistan remains constrained by a number of factors on both demand and supply side. Most SMEs are sole proprietorships or family businesses that are managed rather informally, and therefore, face issues such as lack of formal business management skill, poor maintenance of accounts, lack of business planning, etc. They often do not have adequate collateral to meet banks' requirements, and have little awareness about available financing options. On the supply side, lack of appropriate skills to evaluate SMEs' credibility on non-traditional parameters is a major issue. This is reflected in the lack of innovation in product design and marketing of financial products for SMEs.

A sustainable solution requires that we take a more holistic view of this problem, where, a large number of players have to be involved in contributing to the success of SMEs. Among these players, State Bank of Pakistan and Commercial Banks have key role to play in improving access to finance for SMEs.

As far SBP's role is concerned, it has been taking various important measures for improving the business environment for the sector. These measures include provision of Prudential Regulations (PRs) for SMEs, Refinance Schemes for SMEs, Credit Guarantee Scheme for Small and Rural Enterprises and cluster development surveys. Further, SBP, in collaboration with IFC, has been assisting banks in their capacity building efforts with focus on the areas of Strategy Formulation, Product Development, Risk Management and HR Development etc. These efforts will revitalize the SME lending in participating institutions and will be a prototype for other institutions which could see SME Financing as profitable business venture.

I would, now, emphasize the role of banks which is crucial for the development of SMEs, given their critical positioning and greater capacity in terms of their outreach and availability of funds. The lending figures of SMEs are not encouraging in recent years. Bank credit to SMEs has declined over the last 4 years from Rs 437 billion in 2007 to Rs 248 billion on June, 2012. With this decline, the SMEs' loan proportion to the total advances of banks has also decreased from 16 percent in 2007 to less than 8% percent in 2012.

Although, this decline can partly be attributed to adverse economic conditions during the period and growing NPLs, however, a more risk-averse posture of banks remains a major factor responsible for their low exposure to SMEs. In the recent years, banks have increasingly invested in safer havens - opting for government paper and increased financing for commodity operations, rather than supporting the private sector which is the main driver of economic activity.

I would urge the financial industry to move from this tendency and take steps for promoting SMEs through prudent and more innovative banking solutions. The banks should formulate strategies to overcome the challenges presented by the market as well as by the cyclicality in economic conditions. Banks need to shift from traditional banking approach towards SMEs to the provision of more customized and differentiated financial products and services to suit different SME segments. They also need to develop and implement appropriate credit evaluation techniques used globally such as credit scoring, cash flow based lending, and program based lending.

Let me re-iterate the objective of this program that is to assist bankers to develop better understanding of SME Banking and its important Building Blocks, and thus equip them with required skills. I hope the trainers of this program with their vast exposure in the subject area will help the participants in shaping their ideas and enhancing their skill set further. The program, as such, will result in better banking solutions by the respective institutions for the benefit of SMEs.

With this I inaugurate the Program and wish you all a happy and fruitful learning experience.

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