SME Finance Annual Review 2016

Infrastructure Housing & SME Finance Department

State Bank of Pakistan

Team Leader:

Syed Basit Aly basit.aly@sbp.org.pk

Members:

Prepared by:

Mr. Adil Jamshaid adil.jamshaid@sbp.org.pk

Reviewed by:

Mr. Imran Ahmad imran.ahmad@sbp.org.pk
Mr. Akhtiar Ahmed akhtiarahmed@sbp.org.pk

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

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1. Executive Summary

Small and Medium enterprises play a vital role in economic growth in both developed and developing countries due to their significant contribution in terms of output, exports and employment. Taking into account the enormous economic potential of the SME sector, State Bank of Pakistan (SBP) has undertaken several initiatives for promotion of SME Finance. Some of these include issuance of separate Prudential Regulations (PRs) for Small Enterprises (SEs) and Medium Enterprises (MEs), efforts for putting in place an Electronic Secured Transactions Collateral Registry in the country to facilitate SME's access to finance by using movable assets as collateral, implementation of SME specific subsidized and affordable financing schemes like credit guarantee scheme and refinance schemes for modernization of SMEs, mark up subsidy cum guarantee facility for Rice Mills in Sindh, monitoring and supervision of banks financing under PM Youth Business Loans Scheme, SME cluster surveys and capacity development measures for banks and Development Finance Institutions (DFIs).

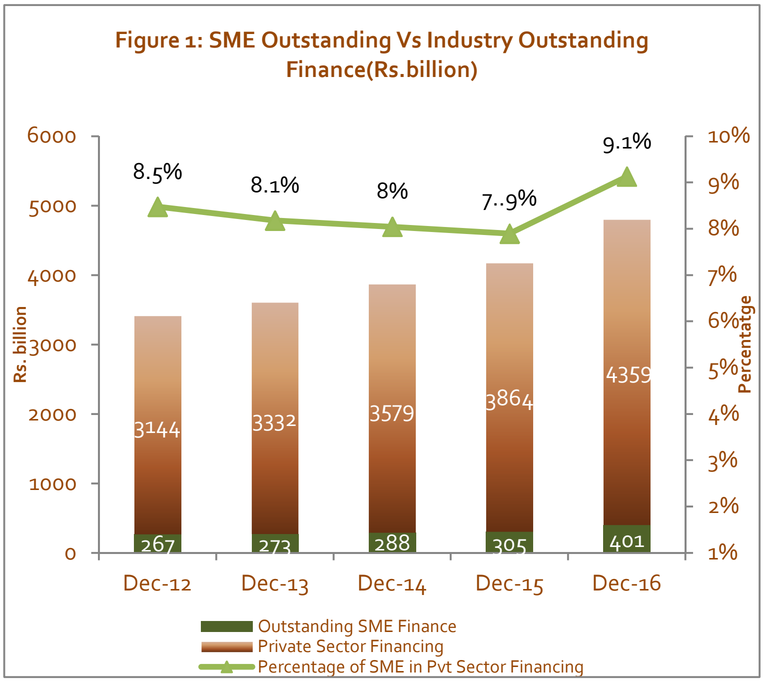
SME financing of banks and DFIs stood at Rs. 401 billion as on 31st December, 2016 showing an increase of Rs 96 billion or around 32 percent when compared with SME financing portfolio of Rs 305 billion as on 31st December, 2015. The number of SME borrowers reached 177,595 recording an increase of 12 percent on Y-o-Y basis. Facility wise break up shows that working capital facility constituted 67 percent of outstanding SME financing followed by fixed investment and trade finance with shares of 22 percent and 11 percent respectively.

Domestic private banks held 67 percent share while public sector banks held 25 percent share in total SME financing. The remaining share in total SME financing was held by Islamic banks and Islamic divisions of conventional banks, foreign banks and DFIs.

2. SME Financing Analysis

2.1 SME Finance:

SME finance outstanding portfolio recorded a growth of 50.5 percent over 5 year period (2012-16). Figure 1 shows that the percentage share of outstanding SME finance in total private sector financing stood at 9.1 percent at the end of December 2016 in comparison to 7.9 percent as of December 2015.



SME financing of banks and Development Financial Institutions (DFIs) reached to Rs 401 billion as of 31st December 2016 from Rs 305 billion in December 2015, registering a growth of 31.5 percent on Y-o-Y basis. A part of the improvement in SME financing in the year 2016 may be attributed to the introduction of SME finance targets for the bank/DFIs and issuance of revised Prudential Regulations for SME financing in May, 2016. Table 1 shows the trend of SME financing over the 5 years period.

Table 1: SME Financing Trend (Rs. billion)

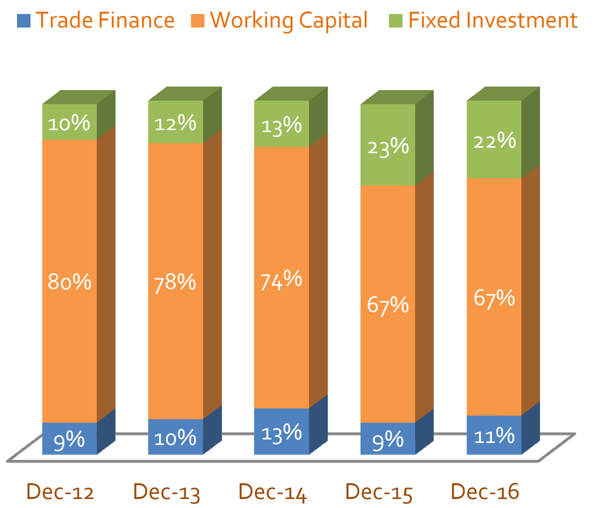
Category	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16
Outstanding SME Finance	266.51	272.53	287.88	305.09	401.28
Private Sector Financing	3,144.23	3,331.54	3,579.18	3,864.49	4,359.18
% of SME Share in Total Private Sector Financing	8.5%	8.1%	8.0%	7.9%	9.1%
SME NPLs as percentage of Outstanding SME Finance	35.8%	31.8%	30.2%	25.3%	20.3%
SME Borrowers	132,167	136,940	134,521	157,887	177,595

SME NPLs ratio which was 35.8 percent in December 2012, declined significantly and reduced to 20.3 percent at the end of December, 2016. Increase in the overall financing to SME sector and improved recovery efforts by financial institutions were the main contributing factors in decline of SME NPLs ratio.

2.2 Facility-wise SME Finance:

The available facilities of finance to SMEs are broadly categorised as working capital, fixed investment and trade finance. Among these three categories, working capital facility constituted 67 percent of total outstanding SME financing at the end of December, 2016.Fixed investment and trade finance had share of 22 percent and 11 percent respectively. Figure 2 shows the share of working capital has followed a declining trend over five years since it decreased from 80 percent in December 2012 to 67 percent in December 2016. The share of fixed investment finance and trade finance witnessed increase during the same period. As far as facility-wise distribution of borrowers is concerned, 53 percent of total SME borrowers availed fixed investment finance facility, while 44 percent of total SME borrowers availed working capital facility.

Figure 2 : Facility wise composition of SME Financing(Percentage)



2.3 Sector-wise composition of SME Finance:

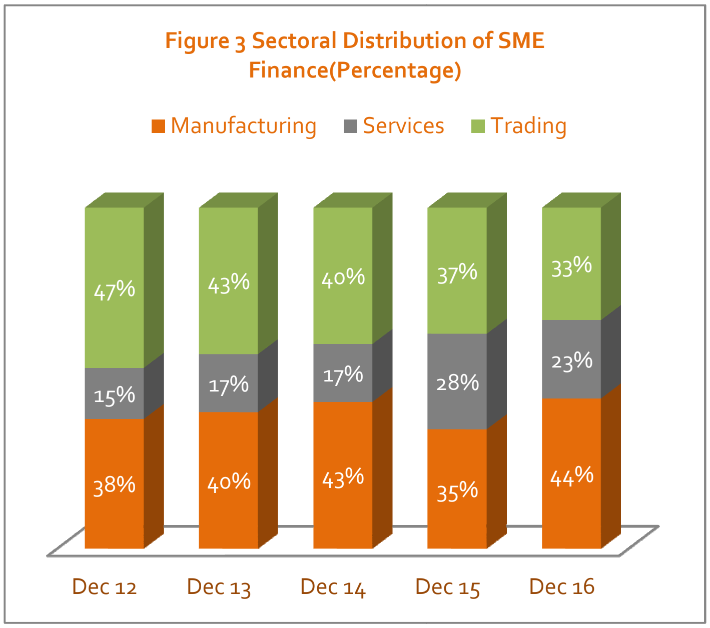


Figure 3 Sectoral Distribution of SME Finance(Percentage)

SMEs are generally classified in three sectors viz. trading, manufacturing and services SMEs. At the end of December, 2016, manufacturing SMEs availed 44 percent share of financing, followed by trading SMEs at 33 percent and services SMEs at 23 percent respectively (Figure 3). Averaging out sector-wise composition of SME finance over the five years time span reflects that an average of 40 percent of the total SME finance was availed by each of the manufacturing and trading SMEs while during this period the average share of the service centered SMEs in the total outstanding SME financing was 20 percent. Figure 3 also shows that between 2012 and 2016, there is a shift in sectoral distribution of SME financing from trading sector to manufacturing and service sectors respectively since the share of loans to trading SMEs decreased from 47 percent in 2012 to 33 percent at the end of December 2016; while the share of loans to services sector SMEs and manufacturing sector SMEs increased during the same period.

As regards SME borrowers' sector-wise distribution is concerned, the data shows that 47 percent SME borrowers were from services sector, 43 percent were from trading sector and 10 percent were from manufacturing sector.

2.4 Banking Groups-wise distribution of SME Finance:

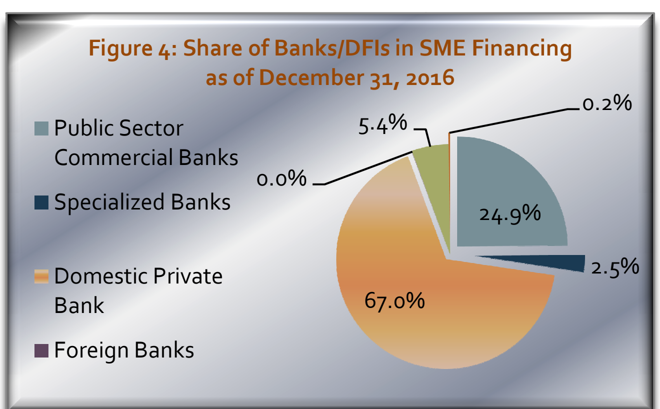


Figure 4: Share of Banks/DFIs in SME Financing as of December 31, 2016

Figure 4 provides a snapshot of banking groups-wise share in total outstanding SME financing as of December 31, 2016, which has generally remained the same over the last 5 years. Domestic private banks had the largest share of 67 percent in total outstanding SME finance showing an increase of 3 percent on Y-o-Y basis. Public sector commercial banks' share in total SME finance was 25 percent recording a decline of 4 percent on Y-o-Y basis. The remaining share in total SME financing was distributed among Islamic banks and Islamic divisions of conventional banks, foreign banks and DFIs.

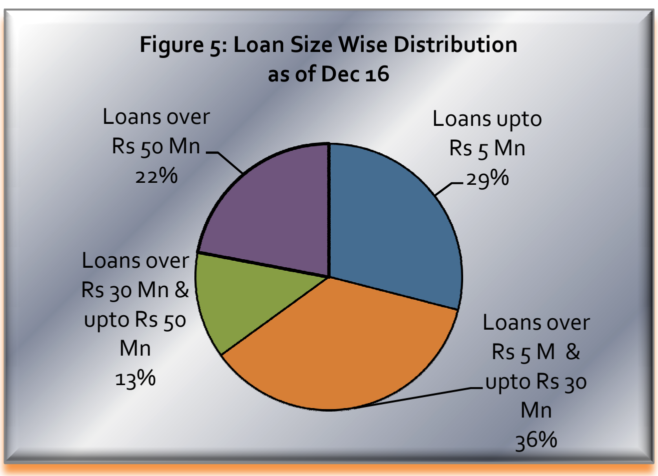
2.5 Average Loan Size:

As on December 31, 2016, under SME financing, average loan size was Rs 2.2 million. Table 2 shows banking sector-wise average loan size. The disbursements show that public sector banks' average SME loan size was Rs 1 million and these banks served 53 percent of total SME borrowers. This indicates that small enterprises are the major target sector of public sector banks. Average loan size of domestic private banks was Rs 6.7 million. The Development Finance Institutions (DFIs), which have the lowest number of borrowers, have the highest average loan size of Rs 62.9 million.

Table 2: Bank wise Average loan Size & percentage share of borrowers(December-2016)

Institutions	Average loan Size (Rs million)	Percentage of borrowers
Public Sector Banks	1	53%
Specialized Banks	0.3	21%
Domestic Private Banks	6.7	22%
Islamic Banks	4.1	3%
Foreign Banks	11.5	0.6%
DFIs	62.9	0.4%

2.6 Loan size-wise Review:



SME loans size-wise distribution as of December 31, 2016 reflects that loans up to Rs 5 million had 29 percent share in total SME financing (Figure 5) while loans over Rs 5 million and up to Rs 30 million had a share of 36 percent. SME loans of over Rs 30 million and up to Rs 50 million had a share of 13 percent while 22 percent share was held by loans over Rs 50 million. Loans up to Rs 30 million held the majority share of 65 percent in total SME outstanding finance.

2.7 Agri SME Outstanding Financing:

Out of the total SME outstanding finance, loans to Agri SMEs were recorded at Rs.27.68 billion as of December 31, 2016 registering growth of 20% on Y-o-Y basis (Table 3). Number of Agri SME borrowers also showed growth of 19% on Y-o-Y basis; whereas Agri SME financing NPLs declined by 30.5 percent on Y-o-Y basis.

Table 3: Agri SME Financing (Rs billion)

Category	Dec-15	Dec-16
Outstanding Finance to Agri SMEs	23.11	27.68
No. of borrowers	6,575	7,851
Non Performing loans-Agri SME	3.02	2.1

2.8 Outstanding Financing under SBP Refinance Facilities for SMEs:

In order to encourage SMEs to modernize their units for producing quality products and to meet their power shortages, State Bank of Pakistan introduced Refinance Facility for modernization of SMEs in 2009. Under this scheme, the outstanding financing stood at Rs.65 million as of December 31, 2016 as shown in Table 4. Financing Facility for Storage of Agriculture Produce, another refinance scheme, was also introduced by SBP to encourage private sector to establish silos, warehouses and cold storages in order to enhance their storage capacity. The outstanding finance under FFSAP stood at Rs.1,757 million in December 16 as compared to Rs.1,766 million in December 15.

Table 4 :Outstanding Financing under SBP Refinance Facilities for SMEs (Rs million)

Category	Dec-15	Dec-16
Refinance facility for modernization of SMEs	81	65
Financing facility for Storage of Agriculture Produce	1,766	1,757

2.9 SME Financing by Islamic Banking Institutions and Divisions:

The contribution of Islamic Banking Institutions towards SME sector followed an upward trend from 2012 to 2016 as evident from Table 5. Islamic SME finance increased from Rs 20.83 billion in December 2015 to Rs 29.03 billion in December 2016 showing a significant growth of 39 percent on Y-o-Y basis.

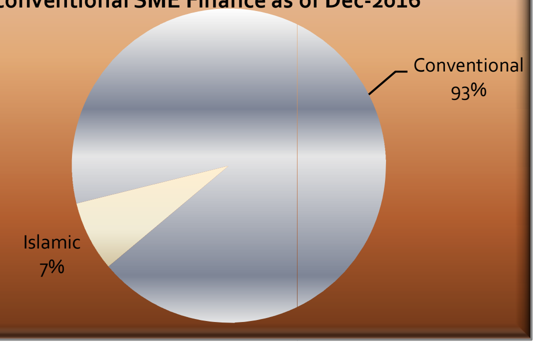
The reason for this significant increase in Islamic SME finance was the achievement of targets set-forth for the banks by SBP in January 2016. As of December 31, 2016, among Islamic Banks, Meezan Bank Limited had the highest share of 36 percent in total outstanding Islamic SME finance

Table 5: Islamic Banks &IBDs SME Outstanding (Rs billion)

Category	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16
IBDs	4.25	11.35	9.05	9.84	7.76
Islamic Banks	5.99	5.42	6.09	10.99	21.27
Total	10.24	16.77	15.14	20.83	29.03

followed by Albaraka Bank and Dubai Islamic Bank Pakistan Limited with shares of 29 percent and 18 percent respectively. In Islamic SME financing, Islamic Banks and Islamic Banking Divisions of conventional banks had a share of 73 percent and 27 percent respectively.

Figure 6: Islamic SME Finance viz-a-viz conventional SME Finance as of Dec-2016



From Figure 6, it is evident that conventional banks had a share of 93 percent and Islamic banking institutions held share of 7 percent in total SME financing portfolio by the end of December 2016. With substantial contribution of Islamic banking divisions of big conventional banks, the share of Islamic SME finance is likely to improve in the coming years.

2.10 Performance of Banks & DFIs against SME Finance Targets:

SBP introduced targets for SME finance for banks/DFIs with effect from January 1, 2016. The targets were based on size of the banks/DFIs in terms of their assets, branch network, existing SME finance portfolio and their capacity to achieve the required targets. Further, banks were advised to take following minimum measures which will facilitate them in achieving the assigned target smoothly:

1. SME financing set up should be separated from commercial financing departments/divisions.
2. There should be at least one dedicated SME finance specialist placed in each of the Credit Administration Department and Risk Management Department.

It can be seen from Table 6 that public sector banks achieved 117 percent of the assigned targets and Islamic Banks achieved 112 percent of the assigned targets.

Table 6: Performance of Banks/ DFIs and Targets (Rs billion)

Category	SME Finance Target Dec, 2016	SME Finance O/S (Dec-16)	% Achieve ment
Islamic Banks	21.40	23.91	112%
Pub. Sector Banks	87	101.36	117%
Pvt. Sector Banks	277.20	265.12	96%
DFI	1.20	0.88	73%
Other inst. w/o targets	11.06	10.01	
Totals	397.86	401.28	

The growth in public sector banks was primarily led by National Bank of Pakistan and the Bank of Punjab. It is pertinent to note that SME financing targets were assigned to 32 banks and DFIs to reach at Rs. 398 billion by

December 31, 2016. The assigned targets for 2016 were fully achieved.

2.11 Prime Minister's Youth Business Loans Scheme:

The Government of Pakistan, being cognizant of the important role played by youth and small businesses in the economic development, introduced Prime Minister's Youth Business Loans Scheme in 2013. The main objective of this scheme is to provide unemployed youth opportunities of financial independence through self-employment. Under the scheme, small businesses are extended loans up to Rs 2,000,000 at a service charge of 6 percent. Number of PMYBL applications received by the banks working as executing agencies under the scheme reached 74,461 at the end of December 2016 showing growth of 17 percent on Y-o-Y basis. Of the total applications received under the Scheme, 86 percent were from male applicants while the share of female applicants was at 14 percent. Of 74,461 applications received since 2013, number of sanctioned applications was 21,137 as on December 31, 2016 showing an increase of 34 percent on Y-o-Y basis. Since the launch of the Scheme, loans worth Rs 17,706 million had been disbursed to 17,691 borrowers' upto December 31, 2016 showing an increase of 176 percent on Y-o-Y basis (Table 7).

Table 7: Prime Minister Youth Business Loans (Rs million)

Category	Dec-15	Dec-16	Y-o-Y Change
Total Applications Received	63,691	74,461	17%
No. of Loans Sanctioned	15,788	21,137	34%
No. of Loans Disbursed	6,921	17,691	156%
Amount of Loans Disbursed	6,409	17,706	176%

3. SBP initiatives for the promotion of SME Finance during 2016

State Bank of Pakistan has taken following key measures during 2016 for promotion of SME finance in the country.

3.1 Prudential Regulations-Revised:

Provision of enabling regulatory environment for SME financing is a core activity of SBP. IH&SMEFD issued amendments in SME PRs in May 2016 to align them further with changing market dynamics.

3.2 Credit Guarantee Scheme for Small and Rural Enterprises:

SBP launched Credit Guarantee Scheme (CGS) for Small and Rural Enterprises in March 2010 in collaboration with UK's Department for International Development (DFID). Government of Pakistan has also contributed Rs 300 million. Total funds available under the Scheme are Rs 3.7 billion. The Scheme aims to encourage financing towards fresh and collateral deficient borrowers. Under the Scheme, risk coverage of up to 60 percent is provided for credit losses of financing banks on their financing to small, micro and rural enterprises. The extent of risk coverage is linked with the level of loan collateralization. The lower the loan collateralization, the higher the risk coverage extended under the Scheme Moreover 60 percent risk coverage is provided against financing to borrowers ,in particular women, start-up businesses and small, rural and micro enterprises operating in the under-served areas of the country with respect to SME financing.. More than 20 banks and microfinance banks are participating in the Scheme. To date, loans of Rs 18,387 million have been sanctioned under the Scheme and around 25,860 borrowers have been facilitated through it.

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

State Bank in collaboration with Sindh Enterprise Development Fund (SEDF), Government of Sindh launched Mark up Subsidy and Guarantee Facility for the Rice Husking Mills in Sindh for promoting, modernization and up-gradation of rice mills in Sindh in 2013. The end-user mark up rate for borrowers is 2.75%. In addition to 2.75%, the financing bank receives an additional 1.5% paid by SEDF.SBP's refinance rate of 3.25% is also borne by SEDF. Other than mark-up subsidy, SEDF also provides risk coverage of 30% against the loans extended under the Scheme.

3.4 SME Cluster Surveys:

Availability of reliable and credible data on SMEs is a pre-requisite for banks to align their financing strategies and design SME specific financing products and services. In view of the importance of reliable sectoral data, DFID UK under FIP provided funding and SBP arranged research studies on key SME sub-sectors in collaboration with renowned institutions like IFC and LUMS. So far 21 SME sub-sectors have been completed out of which 10 research reports were finalized in 2016 and widely disseminated through training sessions. These reports have also been placed on SBP website for benefit and use by the stakeholders.

3.5 Secured Transaction Reform Framework – Legal Framework:

Financial Institutions (Secured Transactions) Act 2016 has been passed by the Parliament. This law will help create charge on movable assets of small and unincorporated entities thereby providing a window of access to finance for SMEs. SBP is facilitating GOP in establishment of electronic secured transactions registry. World Bank is providing consulting services for setting up Electronic Registry.

3.6 SME Dissemination Workshops/Melas and Capacity Building Sessions:

SBP has collaborated with IBP & NIBAF in designing and delivery of different training programs for various layers of SME banking functions. Further, SBP in collaboration with SMEDA organized seven interactive sessions for banks and SMEs in major regional hubs across the country. Workshop on SME Supply Chain with IFC was organized in Karachi in November 2016. Moreover, SBP in collaboration with SMEDA, banks and

DFIs organized an Expo/Seminar for Promotion of SME financing on December 19, 2016. The Seminar/expo was well attended by regulators, bankers, trade associations, entrepreneurs, academia and representatives of IFC, USAID & chambers, etc.

3.7 Islamic SME Financing:

Realizing the role that Islamic Banking Institutions can play in fulfilling the SMEs financing needs, SBP advised IBIs to increase their penetration in SME market. In this respect, during 2016, SBP held meetings with individual banks. Besides, IBIs were also advised to formulate and submit to SBP their Islamic SME financing strategies which they previously lacked. State Bank further assisted the banks by devising a 'Strategy Format' for all the banks. Close coordination is being maintained with IBIs with the objective of attracting greater focus of the IBIs towards SME financing.

4. ANNEXURE

Useful links for SME Finance related areas

1. SME Cluster profiling http://www.sbp.org.pk/departments/ihfd-ifc.htm

2. SME Finance Prudential Regulations http://www.sbp.org.pk/publications/prudential/PRs-SMEs.pdf

3. Credit Guarantee Scheme for Small and Rural Enterprises http://www.sbp.org.pk/smefd/circulars/2010/C1.htm

4. Credit Guarantee and Risk Sharing Scheme for Rice Husking Mills in Sindh www.sbp.org.pk/smefd/circulars/2013/C6.htm

5. Refinance Facility for Modernization of SMEs http://www.sbp.org.pk/incentives/ltf-eop/ConsolidatedScheme.pdf

6. Scheme for Financing Power Plants using Renewable Energy http://www.sbp.org.pk/smefd/circulars/2009/C19.htm

7. Extension in renewable energy Circular: http://www.sbp.org.pk/smefd/circulars/2014/CL7.htm

8. Prime Minister Youth Business Loans Scheme http://www.sbp.org.pk/smefd/circulars/2013/C10.htm

9. Development Finance Review http://www.sbp.org.pk/SME/DFG.htm

10. Incentives for Exporters http://www.sbp.org.pk/incentives/index.asp

11. Quarterly SME Finance Reports http://www.sbp.org.pk/departments/ihfd-qdr.htm

12. SME Finance Related Training Programs http://www.sbp.org.pk/departments/ihfd-smefp.htm