

Conference on SME Financing –  
Issues and Strategies

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Closing Remarks at the “Conference on SME Financing – Issues and Strategies” on May 11, 2005

Bismillahi-arehaman-nirahim

Distinguished Ladies and gentlemen

First of all let me thank all of you for your perseverance, for your patience, for your dedication by staying up for last two days and participating, listening and interacting during this conference. The attendance has been quite impressive and I want to appreciate your keen sense of dedication and interest in this conference. I also want to thank the speakers, both, particularly from outside the country who have joined us during these two days and shared their knowledge and wisdom with this group and also our domestic speakers who enriched the discussion by providing the insights they have gained in practicing in this country. This admixture of the international best practices and the local experience is the key to doing anything which is new and innovative. You learn from what has gone elsewhere but at the same time you try to be aware of the slippages, which can take place within the particular working environment of a country.

I would not try to summarize, although I have been given the findings of every single session and I also took notes on the group discussions. What I like to do is provide you a road map because we all are very good at talking and making speeches, but then we think that this is the end of our business. To me this is the beginning of our work and therefore we have to be very clear of what we are going to do in the next few years.

First of all, what is the vision for the SME sector? Unless we know what the vision is and what the direction is, some of you may be going towards Multan, the others towards Jehlum and we will never be able to sort that out that who's right and who's wrong. So let's start with the vision. The vision is to bring the informal enterprises into the formal enterprises. Second is to bring the sole owners & proprietors or partnerships in the SMEs into private limited liabilities companies. The third is to bring SMEs to integrate with the large corporate sector through the sub contracting relationships. The fourth is to bring SMEs and not all of them to become large companies.

If this is the vision then we have to ask the question; how do we go about this? The financing again, to repeat ourselves, is only one component, very critical, but one component which can lead to the materialization of this vision. The technical and institutional support mechanism to the SMEs through SMEDA, through the provincial governments, through the local organization, local governments, those are elements which can compliment and supplement financing. Otherwise, putting financing in a

situation where there is lack of technical know-how, where there is a lack of infrastructure facilities, where there is a lack of technological absorption would be putting money down the drain. And that I think is that the banks have to connect themselves, and the word 'connect' is a very important, with the other elements of this value chain. You have to have a proactive approach you don't sit in your offices and say that the SMEs will come and you know try to apply for a loan. That's a kind of banking, which will not work in these circumstances. So you have to have, and I am glad that the groups came up with, the relationship managers. And the relationship managers should be to be people who have knowledge of the industrial activities, which are taking place in that particular area.

Just to give an illustrative example of what I have in mind, if you are located in Gujrat your relationship managers should be well versed in the furniture and fans. If you are in Gujranwala, you should be well versed in consumer electronics - drying machines, washing machines, cooking ranges, microwave ovens all those plus sanitary ware. If you are in Daska you should be able to understand the small agriculture implements in the machinery. If you are in Sialkot you should understand the leather garments and gloves industry and the surgical and the sports good industry. If you are in Wazirabad, your relationship managers should know what cutlery is all about if you are in Khairpur you should know what the dates industry and what the ajrak industry is all about. If you are in Gawadar and Karachi coast you must know what the fisheries is all about. If you are in Peshawar and the Valley you must know what the marble and the granite industry looks like. If you are in Quetta and that area you should know what the fruits and vegetables can be done. If you are in Sargodha you should know what the citrus processing industry can do. If you are in Lodhran and Khanewal you should know what the dairy industry would look like. So the expertise of your relationship managers would help you, both, in understanding the industry parameters but also in the marketing and monitoring as to what is happening. So this is a very critical element of this equation.

The third thing the banks should do is to develop one or two products in consultation with SMEDA, in consultation with local chambers and industries, in consultation with the EPB. Now question had arisen as to we should do research and development. I disagree with it. We have done so much research and development, but we haven't exploited the results of that research and development that we keep on talking about the research and development. Let me tell you the Export Promotion Bureau has already announced that there are some products which are called as developmental exports and we want those exports to expand. What are those? These are the marble and granite, gems and jewelry

fisheries, pharmaceutical products, livestock & dairy products, horticulture, cutlery and engineering goods. We have a category where it says we should try to develop these exports. How do we develop these exports if we do not have the production facilities? If we don't have the production facilities for them than we cannot export. So its linked up. How can you develop the production by providing them the financing? So the lineage between financing and production and export is very straightforward. So we don't need more market research. There's been so much research this room would be filled with studies, which have been carried out since 1947 on SMEs and agriculture and large-scale manufacturing. The tragedy is that we don't make any use of those studies and we go for another study. So that's my request.

The fourth thing and this also came up in the group discussions, was that please recruit young men and women who are quite fresh from the local areas, train and equip them with the tools like the cash flow lending and don't mix them up with the bankers. Now that to me is extremely important. We have successfully implemented this model in the micro finance. In the micro finance banks we have young men and women who are from the local areas. If it is Jacobabad the boys and girls are recruited from the local Jacobabadian area. They know the area they know the people and they are very dedicated and they have not been contaminated by the traditional banking which says *tell me what security you have than we'll lend to you* don't get them into that rut because you are going to destroy the SME banking services. You are never going to be able to launch the SME products. Train them teach them and let them be your relationship managers your marketing people your credit appraisal managers, what ever you want to do keep them separate.

The fifth element is that there are a large number of SMEs who do not want anything to do with the conventional banking because they consider this as based on *riba* and this is against their faith but they are quite willing to do Islamic banking. Now we have provided you the opportunities by allowing you to open the branches for Islamic banking. Some of you have been telling me that your deposits from the Islamic banking are expanding but you don't have much on the assets side. I can assure you that if you develop the products, Islamic banking products for the SMEs you will have a time when your loan book will build up so fast that you won't know what to do. So Islamic banking particularly in Peshawar in DI Khan, Swabi, Charsada in Quetta so Loralai, those are the areas. If you don't want to get out of Karachi, Lahore and Islamabad then I don't think you will be able to do very much because the demand for these assets will come form those areas because those people believe that they don't want to do the conventional

banking, and here it's a virgin land for you. People who are able to get into those markets sooner than later will make a lot of money. So it is in business interest that you go there. And you don't have to worry about people going from Lahore to those areas. You can recruit and train the people from those particular localities. There is an unemployment problem already in these areas. By making recruitments from those areas you are also helping in solving the unemployment problem. But that should be based on pure merit should not be based on considerations other than merit. Because if you don't recruit them on merit than you will have a lot of problem. You will have lot of non performing loans and this whole experiment will be a failure. So while I insist that you recruit the young men & women, engineers, MBAs, Masters in Commerce Masters in Economic who know how to do quantitative skills b/c in credit appraisal for the SMEs the quantitative skills, cash flow lending is extremely important. *We are fluent in conversing, we know how to write good English* but I think we have to change this. We have to go to understand the risk and how can we do the sensitivity analysis around the mean or around the average out come and then make a decision that this is within the tolerable limits and we can afford to provide the credit. That is the new area which your bankers do not know because it's been lazy man's bank – give the money to the T-bills to the government to the public sector corporations and the big corporate houses, because that is all the banking you know. Or if you want to give it to someone else you say *how much is your property worth* that's not the banking so when you go to the SME banking you have to have an different mindset altogether and I'm extremely happy to know that all the groups came up with the same proposition that you have to change the mindset. Mind set can be set because you're still in infancy stage by recruiting and training and equipping young men and women who will be of a different vintage then the normal bankers.

One other point and this is again in how to go about it is that the bank should publish and print the all their documents in Urdu and regional languages. If you expect an illiterate person to fill in all your forms and provide all your documents first you should simplify and standardize them. Second you should translate them in Urdu or Pushto or Sindhi or Punjabi or Barohi or whatever the language they know, because that is you're opening doors by conversing to them in their own language and providing them documents in their own languages. If you do think that with a necktie and with a suit you want to communicate with those people there is a cultural barrier. They don't understand you and you don't understand them and the transaction will never take place. So the cultural barrier which exists starts with the language and if you pretend that anybody who doesn't know how to fill in a form and provide a document in English is not eligible for financing by you as bankers, then I'm sorry you are missing a very large segment of population and

businesses and you are perpetuating inequities in the distribution of credit. This is something I feel the banks have to reconsider.

The other element, which I find is that, like Mr. Mohsin Syeds example, we should document more success stories of the SMEs; case studies, teach them at the universities at the business schools in your own curriculum of the banking institutes so that people know as to what are the critical success factors. It is not just connections, but here is a person who persevered for three years and did every thing under most adverse circumstance but he succeeded eventually. I think the younger men and women will be inspired by these kind of stories. So we should try to document these kind of stories. And all of you bankers should know, like Mr. Lakhani pointed out the bakri walas stories and you should teach them in schools and in the banking institutes both to understand as well as to inspire people about this.

Finally in today's world of IT enabled environment please try to use a decentralized IT enabled IT based, mobile phone based banking SME lending. Every body should have in their PCs and sooner or later you will have the PDAs in which all the information of your clients in an area will be held by the relationship managers and during a visit he comes across a client and tries to find out what is happening. These days the interest rates are going up when he made his calculations that he will make X amount as monthly repayment his calculations were based on a different interest rate scenario. The traditional response of the bankers is that this is a contractual obligation. What does it do? It turns that loan into an NPL; it puts that industry at a risk because once it becomes NPL that industry is shut off from future credit from anywhere else. What does it do to you? Your balance sheet becomes weak. Is it helping anyone? No. You know exactly that this is something, which is beyond the control of the borrower. It is not that he doesn't want to pay you but the entire assumptions on which that contractual relationship was designed has changed. Now if you have your PC or your PDA, you plug in and say in order to continue to receive that X amount we have to stretch the maturity from original 5 years to 6 yrs or 7yrs or give some grace period or whatever. You completely restructure that credit into a new credit in order to allow the borrower to remain current on his obligations borrower while you have turned a potential loss to a performing loan. This is the attitude of good sensible relationship managers who are able to keep track of the assumptions on which the loan was approved and carry out in a dynamic sense the restructuring without waiting for 90 days till the clock hits and then the whole hell gets lose on everybody else. Unless you do that this SME, or agriculture or micro finance or consumer loans will just not fly. Because the dynamic situation and the repayment capacity constraints of

individuals of small scale entrepreneurs are totally different from that of a corporate. For a corporate you will do anything because that's a big borrower and makes a big difference to your balance sheet. So you would try to do anything in order to restructure or help a big borrower. But your attitude towards a small borrower is that of apathy and indifference. If you don't change that attitude than this segment will become totally uneconomical.

My request is that those of you who feel uncomfortable with this way of doing things should not work on the SME, agriculture, micro finance or consumer lending. They are better off doing the LC, government borrowing or the traditional way of doing things. I would like the presidents here who are representing the banks, and some of you are really interested since you have stayed here for two days and didn't disappear after the inaugural ceremony, you should have your own sessions with your regional managers where the concentration of the SMEs is and try to think what your strategy is going to be. Unless you have your own strategy both in terms of products, in terms of the services, in terms of the manpower, in terms of the technology and how do you position yourself and in which markets you want to position yourselves I don't think you would be able to do very much. We would organize the Local Advisory Committees in 16 places where the State Bank Branches are, you encourage your local managers to make use of these advisory committees where we bring in the SME representatives, we bring in the banks and our Chief Manager chairs the meetings and we try to resolve the problems at the ground. Everything doesn't have to come to Karachi. We have a mechanism, which exists and has worked very well for the agriculture and I want to use the same mechanism for the SMEs also. Please make use of that. We have formed an SME dept. I am not going to make any commitments so far, because we have not had our internal strategizing on the SME department so far but once we do at least from your perspective you have a point of contact if you have any problems in terms of the SME lending as far as the SBP is concerned and even beyond SBP if you have problems with any governmental agency we would be happy to work with you. We offer you our services. But most importantly the banks will have to put their own houses in order on the lines which I have outlined for your consideration. Some of you may be doing all this which I have outlined but the main thing is that you have to make serious efforts to prepare the grounds for this new type of lending.

Somebody asked a question about the mandatory credit limits. Ladies and gentlemen those were the practices of the 1950s. You cannot use the arms and ammunition of the 1950s to fight the battles of 2010. Unless this makes sense to you and your bottom line

any mandatory credit from the central bank or the government is most likely to be violated, if it is not violated than its going to be circumvented, if not then you will pay the penalties which was the case before which is what the central bank can do. When I came to this office and I reviewed the agriculture credit all the big 5 banks were never able to meet their mandatory credit targets. What were they doing they were paying the penalties to the State Bank and also recovering the losses from the SBP. It was a very comfortable situation for them. After we revamped the scheme, even the Private Commercial banks, who never were given the credits, have increased their lending by 110% in just last one year because they are making 300 –350 basis points on their cost of funds, in this segment the recovery rate is 95%. Won't you do the business? That's the only motivation; it's a win- win situation. The farmers are getting the credit they are using it to buy fertilizers, seeds and agricultural implements; their productivity goes up they get higher incomes and the income of Pakistan in form of higher GDP goes up. The same situation; you provide funds to the SMEs they will employ more people, you have higher employment that means there is less poverty, and also at the same time GDP goes up and the exports go up because most of the SMEs are also export oriented. So that's the linkage. It's a win-win situation. The banks make money and the country has achieved its macro economic objectives of higher growth, lower poverty and lower unemployment.

Unless we can think in terms of win-win situation for every one, the old ways of doing thing, where you give directives, the thanaydari culture in banking is over gentlemen. Let me tell you we will never be able to build banking on the basis of thanaydari. It will be based on incentives and those who are found in violating the regulation will be taken to task. But we will not tell you how to do business because you are the best judge of doing the business yourselves.

Once again I want to thank you and I want to assure you that the State Bank will be able and willing to help every one of you who is keen in extending their business in the SME.