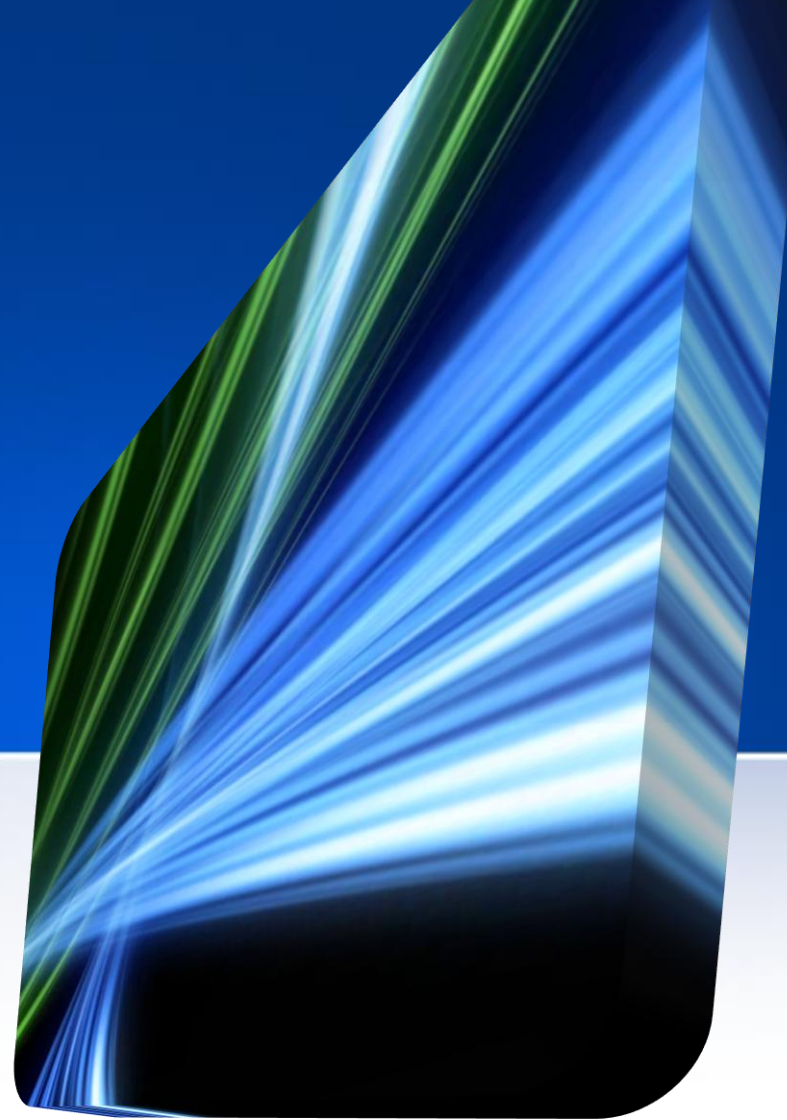


ISSUE & CHALLENGES FOR ISLAMIC BANKING IN 'SME'

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Meezan Bank Limited



Snap Shot of Presentation



- SME Definition
- Economic Contribution by SME
- Financing Behavior of SME
- ISSUES & Challenges for Islamic Banking to SMEs
- ISSUES & Challenges for Islamic Banking by Banks
- Perception and Scope Of Islamic Banking
- Importance Of SME
- Conclusion

SME Definition



- Ideally not a public limited company

	Trading	Manufacturing	Services
No. of Employees up to	50	250	250
Total Assets (exc: Land & Building) at cost up to	Rs. 50 Mn	Rs. 100 Mn	Rs. 50 Mn
Total Sales Turnover up to	Rs. 300 Mn	Rs. 300 Mn	Rs. 300 Mn

- An individual, if he or she meets the above criteria, can also be categorized as an SME.”

Economic Contribution by SME

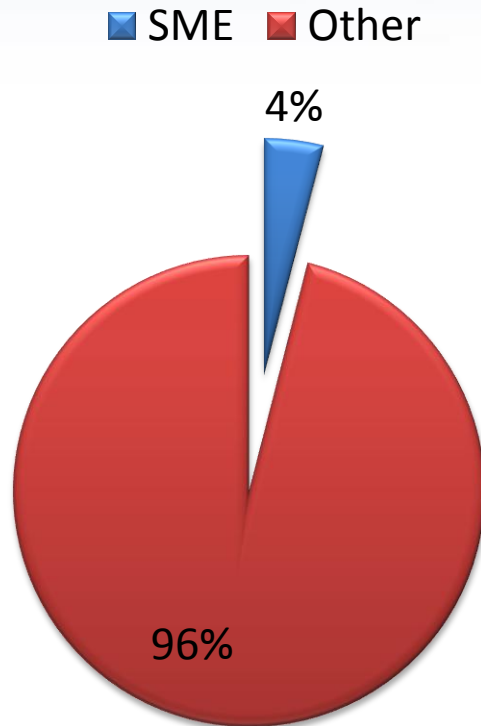


- SME constitutes 90% of all Private Enterprises
- Employees over 75% of Non Agri labor force
- It contributes 30% of National GDP
- 25% exports of manufacturing goods & 35% of value added goods
- And more...

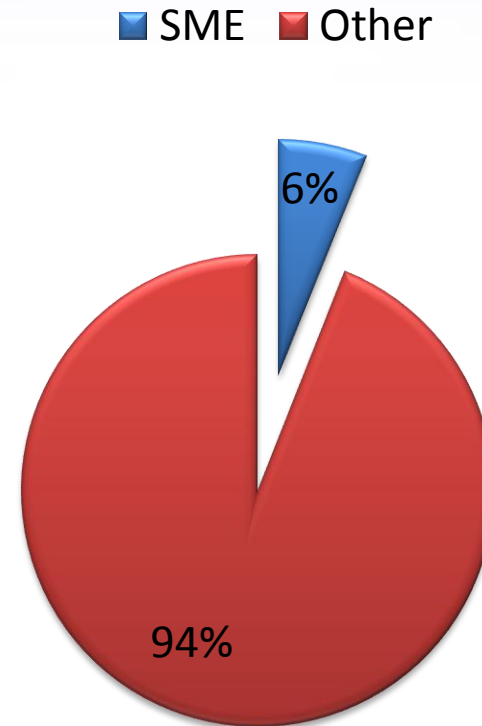
Financing Behavior of SME



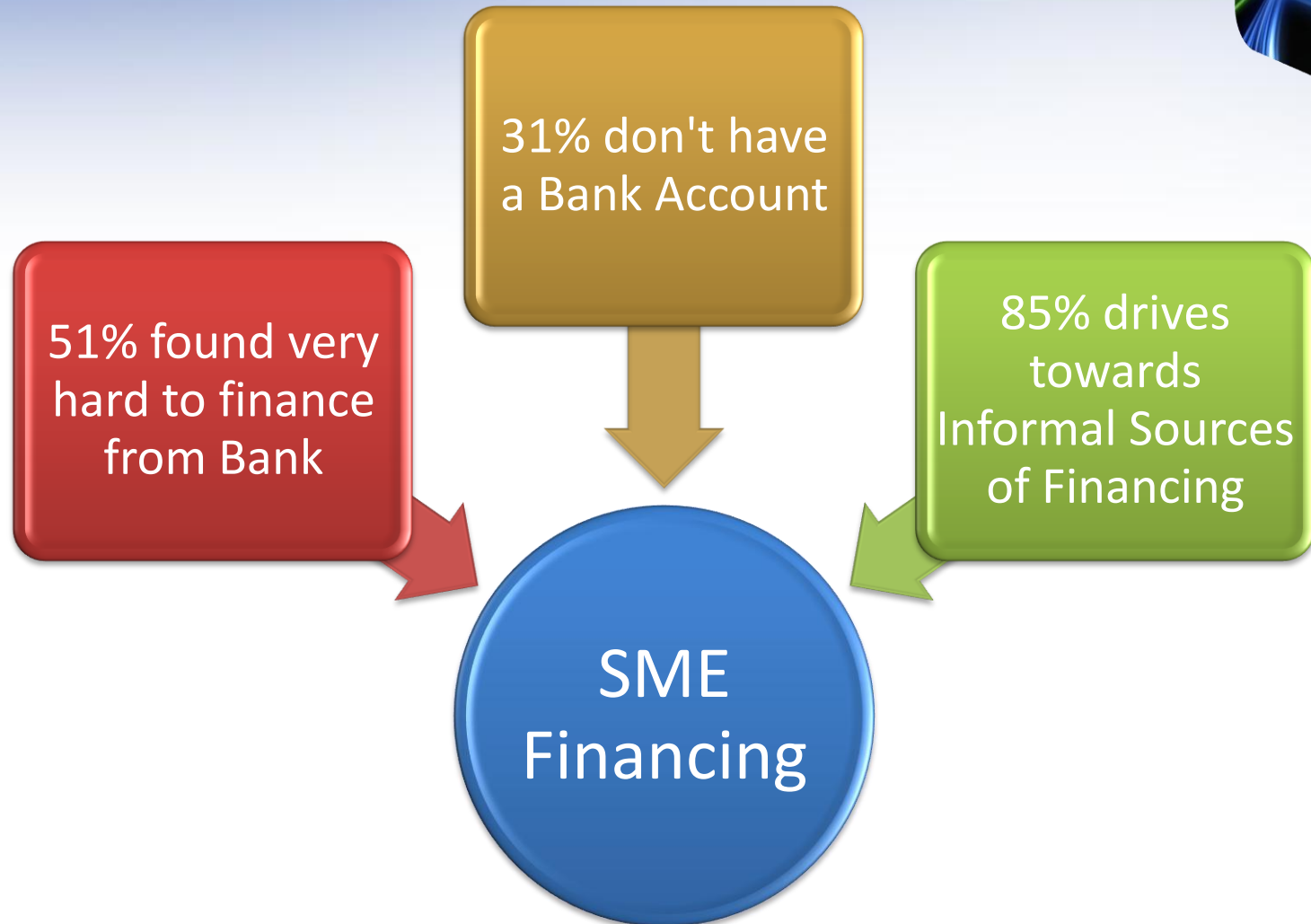
SMEs Financing % from Banks



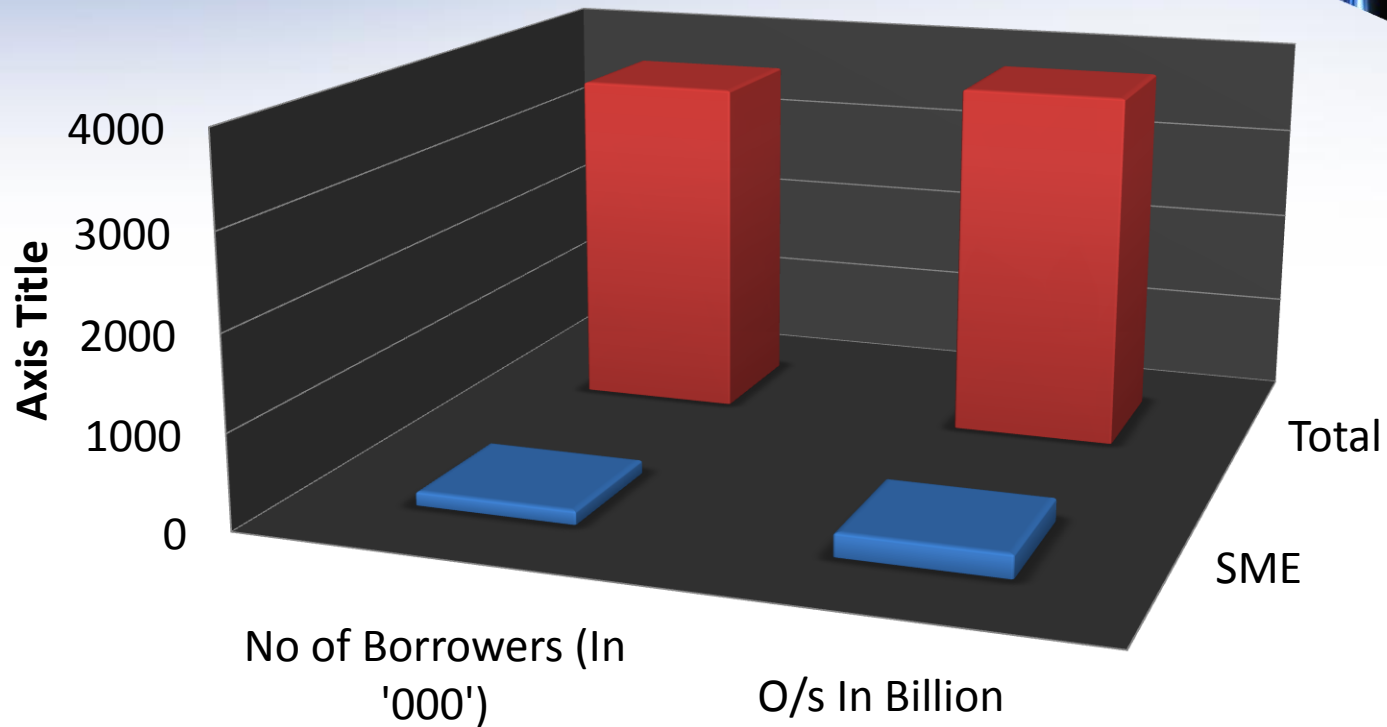
Banks Financing % for SMEs





Financing Behavior of SME



Financing Behavior of SME



	No of Borrowers (In '000')	O/s In Billion
 SME	148	247.86
 Total	3618	3785.87

Issues & Challenges for Islamic Banking to SMEs



- **Public awareness**

To convey the message of Islamic Banking to the masses at all levels and to create awareness about the prohibition of Riba.

- **Migration from Riba-Based to Riba-Free Banking**

SMEs at times vulnerable to migrate from conventional to Islamic as they have already settled processes/needs with the Riba Based Banking. IBs always face challenge to cater the processes/needs with Riba Free Banking Products

- **Shariah Information asymmetry (Lack of Shariah Knowledge, Process, & Procedure)**

SMEs do not have proper awareness of different financing options offered by Islamic financial institutions. They are also unable to understand the process, procedures of Shariah and its implications.

Issues & Challenges for Islamic Banking to SMEs



- **Perception of IB to SMEs**

Doing the one & the same thing is the most common perception in masses for IBs. It is difficult to make them understand that, end result is same but process make it shariah compliant.

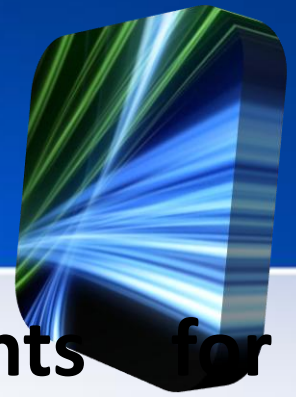
- **Need Based Financing**

IBs are generally focused towards assessing the basic business need of the customer and then provide financing to them. However SMEs lack the capability to present their project proposals and borrowing requirements and are not prone to such extensive exercise and customary of misusing funds from IBs.

- **Informal Account and Management System**

IBs are also attuned to evaluating repayment capacity of their borrowers through proper financial statements. Due to low levels of literacy and high costs associated with preparation and maintenance of accounting records, SMEs generally keep track of their performance through cash based single entry journal/ register, hand-written vouchers/receipts and utility bills etc. Which makes them more vulnerable towards shariah Risk.

Issues & Challenges for Islamic Banking to SMEs



- **Excessive Documentation requirements for Shariah Compliance**

SMEs shows high reluctance while accessing the Islamic Banking options due to many factors such as Inadequate and delayed credit processes, Cumbersome/lengthy financing & documentation procedures and Insistence on collaterals and guarantees.

Issues & Challenges for Islamic Banking by Banks/FIs



Training of Banking Professionals in the Use of Islamic Financial Products

Lack of qualified manpower is one of the biggest hurdles in the advancement of Islamic banking products to SME. Shariah knowledge expert staff is scarce in Pakistani Market and thus make them train is costly and time taking process. This scarcity leads less offering of Islamic products to SMEs.

- **Risk Management of SMEs is high**

IBs are unable to charge profit over and above the due date in most of the products, they have to made charity of that amounts which shrinks IBs profit and increase the Risk margin. Other factors may be as:

- Vulnerability to market changes
- Inadequate management capability
- Short business/industry track record
- Misuse of loan proceeds
- No adequate leverage for financing porrtfolio

- **Wider use of Islamic products**

85% of Islamic financing is off Musharakah, Murabaha & Ijarah. It is a challenge for IBs to offer different Islamic products to cater all SME needs such as; Working capital, Running Finance, Short term, long term and project finance requirements

Issues & Challenges for Islamic Banking by Banks/FIs



- **Focus of IBs towards Corporate Financing**

IBs are inclined towards Corporate Financing because they are unable to assess cash flows from informal records, financial health from family lifestyles of SME sponsors and other non-financial aspects etc. resulting in lack of appropriate financing products and procedures for SMEs.

- **Unable to launch User friendly & Standardized documentation and policies**

IBs are facing problems in customization of products to small ticket customers and due to volatility in nature of SME business a standardized financing policies and manual are difficult to catch.

- **Shortage of Marketing Skills/efforts on part of bank**

Though some financial institutions market their products, most IBs do not aggressively target their low-end borrowers.

Issues & Challenges for Islamic Banking by Banks/FIs



- **Lack of Infrastructure for SME Business**

There are many IBs/IFIs which have not developed necessary infrastructure in terms of IT and human resource to handle large number of small loans, such as Credit Scoring, Cash flow based Lending, Program Based Lending etc. Credit scoring techniques provides sophisticated statistical tools for identification of variables that are powerful predictors of risks of default and enable banks to devise product programs for different segments of SMEs.

- **Absence of SME R&D Centers in Banks**

Tapping of new ventures, cluster based financing and commodity based financing are the areas which are under umbrella of SMEs and IBs are not able to significantly touch the same. Thus becoming a basic challenge for today & for future competitiveness.

Thanks & JAZAKALLAH



IF IT DOES NOT CHALLENGE YOU, IT DOES
NOT CHANGE YOU!

AGENDA



- **PERCEPTION AND SCOPE OF ISLAMIC BANKING**
- **IMPORTANCE OF SME**



ISLAMIC BANKING IN SME FINANCING

PERCEPTION OF ISLAMIC BANKING



Islamic Banking

Parties: Bank & Client
Limit: Rs 10.00 Mn
Rate: K+2
Tenor: 1 year
Purpose : To buy Cotton

Conventional Banking

Parties: Bank & Client
Limit : Rs 10.00 Mn
Rate: K+2
Tenor : 1 year
Purpose : To buy Cotton



PERCEPTION OF ISLAMIC BANKING



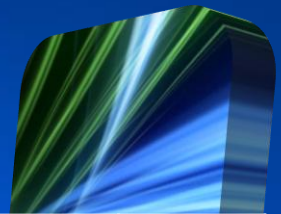
Islamic Banking

Parties: Bank & Client
Limit: Rs 10.00 Mn
Rate: K+2
Tenor: 1 year
Purpose : To buy Cotton

= **OWNERSHIP**

Conventional Banking

Parties: Bank & Client
Limit : Rs 10.00 Mn
Rate: K+2
Tenor : 1 year
Purpose : To buy Cotton

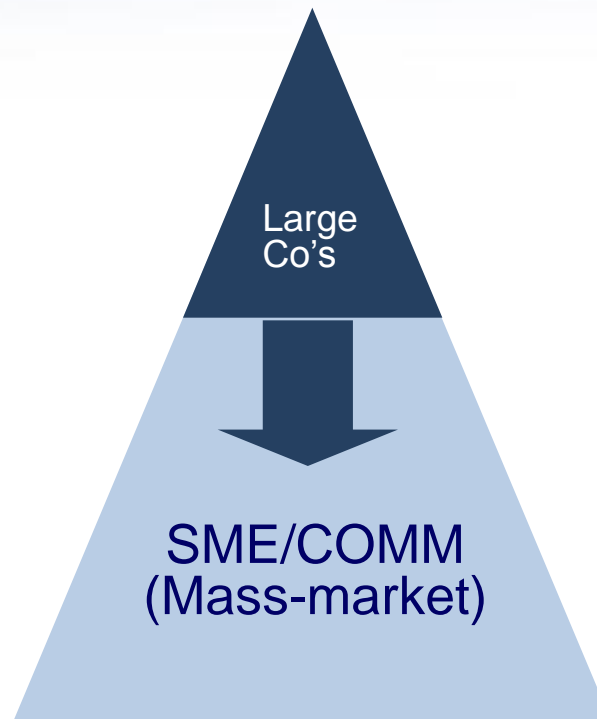


EQUITY	2011	2012	ASSETS	2011	2012
Ordinary Share Capital	605	750	FIXED ASSETS		
Retained Earnings	1,705	1,815	Plant, Property and equipment	655	860
Total Equity & Reserves	2,310	2,565	Other non current assets	25	25
			Total fixed assets	680	885
NON CURRENT LIABILITIES					
Long term debt	750	650	CURRENT ASSETS		
Deferred tax	465	560	Stocks	2,140	3,225
Total non current liabilities	1,215	1,210	Debtors	2,255	2,980
			Prepaid expenses	105	130
CURRENT LIABILITIES			Other current assets	10	20
Creditors	1,045	2,280	Cash	370	60
Accrued expenses	165	185	Total current assets	4,880	6,415
Taxes payable	130	180			
Interest payable	35	50			
Other current liabilities	60	30			
Current portion of LTD	150	100			
Bank overdraft	450	700			
Total current liabilities	2,035	3,525			
TOTAL EQUITY & LIABILITIES	5,560	7,300	TOTAL ASSETS	5,560	7,300



	2011	2012
Sales	19,368	24,210
Cost of goods sold	14,912	18,640
Gross profit	4,456	5,570
Selling, General & Admin Expenses		
Selling & delivery expenses	1,756	2,195
Salary	664	830
General & Admin expenses	1,588	1,985
Depreciation	56	70
Total SG & A expenses	4,064	5,080
Operating Profit	392	490
Other income	36	45
Financial charges	160	200
Profit before tax	268	335
Tax	136	170
Profit after tax	132	165
Dividends	0	55
Net profit after tax & dividends	132	110

IMPORTANCE OF SME (An untapped & misunderstood sector)



IMPORTANCE OF SME (An untapped & misunderstood sector)



- Do not look at the size of entity
- Do not weigh based on the number of employees
- It is a way of conducting business activities
- Clubbing of all unique business & personal attributes which make any entity truly SME
- A small shopkeeper to a manufacturing unit fall in SME because of being into business

ATTRIBUTES OF SME CUSTOMERS



- No Documentation- Free Style working behavior
- No Recording of transactions-Verbal commitments
- Owners are managers of business
- No succession planning
- Less educated
- Street smart & know the business very well
- Not prone to tax payments
- No sharing of information
- Highly reliant on informal financing sources
- Informal financing cost is high but willing to bear to avoid documentation

ATTRIBUTES OF SME CUSTOMERS



- Not able to address their own process hindrances
- Limited exposure of broader spectrum of business
- Cursing External factors as the cause of their stagnant situation
- Non availability of problem solving skills
- No awareness of growth prospects (Local & International)
- Only interested in money, “Show Me Money, do not need anything else” thinking
- No knowledge of SME products & services as it is a new concept