

Annexure-A of SH&SFD Circular No. 05 dated October 11, 2024



State Bank of Pakistan

**Challenge Fund for Technology Adoption &
Digitalization of SME Banking**

**Expression of Interest
Document**

October 11, 2024

CHALLENGE FUND FOR SME BANKING

Background

Small and Medium Enterprise (SME) sector plays a significant role in the economic development of country. This sector is considered as the backbone of any economy. As per the estimates of Small & Medium Enterprise Development Authority (SMEDA), there are more than 5.2 million SMEs in Pakistan. SMEs contribute 40% in GDP of Pakistan and 25% in overall exports¹. After Agriculture sector, SME sector provides employment to highest percentage of working population in the country. SME sector contributes to 78% of non-agriculture sector employment.

State Bank of Pakistan (SBP) has taken various initiatives to promote SME finance by offering enabling regulatory framework, dedicated Risk Coverage Scheme for SME financing and creating awareness and building capacity of bankers. Further, SBP aims to enable and promote innovative product design by leveraging technology to build an inclusive financial ecosystem.

As per data reported as on Dec 31, 2023, SME financing stood at Rs 543 Billion to 175,000 borrowers. SBP has aimed to double the SME outstanding portfolio to Rs 1,100 billion by 2029. In this regard, SBP is encouraging banks to use technology to enhance SME finance.

Challenge Funds for SMEs (CFS) – General Guidelines

Providing innovative and digital financial solution for SMEs is one of the priority of SBP. Therefore, SBP is launching a Challenge Fund for SMEs (CFS) to fund and support innovative solutions for SME banking in the country. The objective is to use innovation to make markets inclusive so that SMEs in Pakistan have access to electronic/online business solutions in hassle free manner.

a. Objective

The challenge fund is aimed to spur innovations for SME banking by leveraging the use of technology (including FinTech). Digital SME banking includes a broad range of financial services accessed and delivered at affordable cost through digital channels. It can be helpful to provide affordable financing option to encourage entrepreneurship. It is estimated that the market potential of Digital Finance Services (DFS) in Pakistan will cross US\$ 36 Billion by 2025, providing a 7% boost to the GDP, creating 4 million new jobs and resulting in US\$263 Billion new deposits.² This potential can only be achieved through a robust and efficient DFS ecosystem. Currently, Pakistan possesses a nascent DFS ecosystem which needs to be nurtured at both government and industry level.

The CFS aims to support banks and financial technology providers (Fintechs) with a digital solution to develop new or amend existing financial products & services and delivery platforms that will enhance access to finance to SME sector.

The purpose of this challenge fund is to help:

¹ National SME Policy 2021

² Mc Kinsey Global Report, "Digital Finance for All: Powering Inclusive Growth in Emerging Economies" Sep 16

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- develop and implement innovative ideas to increase financial inclusion of SMEs by creating easy digital access to formal financial services including savings products, lending services, pensions, insurance tools, remittances, etc.
- develop user friendly and cost effective innovative banking solutions for business entrepreneurs

b. Potential areas for grant under CFS

The CFS provides an opportunity for banks/SBP regulated entities to implement innovative digital banking products & services to improve access to finance to SMEs either individually or in partnership with Fintech/EMI. The scope of CFS will focus, but not be limited to the following areas:

- Loan Origination and Processing System for SMEs.
- Developing digital products (digital score card, digital supply chain products, digital on-boarding of SMEs for account opening, etc.).
- Creation or enhancing digital platforms that offer financial education, helping customers make informed decisions about their banking and financial management.
- Upgradation or development of digital banking platforms, including mobile banking apps, online banking system and customer portals.
- Any other unique idea relating to technological innovations that address the issues faced by SMEs to avail financing.

The above mentioned areas will focus to enhance financing to SMEs sector with more focus on marginalized segments such as starts-ups, women led SMEs and underserved areas.

c. Operational Mechanism

i. Fund Management

A cross-functional Evaluation Committee having senior level representation from SBP's relevant departments will evaluate the proposals. After having initial evaluation by SME, Housing & Sustainable Finance Department (SH&SFD) SBP, the shortlisted proposals will be presented to Evaluation Committee to be chaired by Deputy Governor (FI&I). SH&SFD will serve as CFS-Secretariat.

ii. Submission/ approval of proposals

Applicant banks may submit their complete proposals to CFS-Secretariat (SH&SFD will serve as CFS-Secretariat). After having initial evaluation by SH&SFD, the shortlisted proposals will be presented to Evaluation Committee to be chaired by Deputy Governor (FI&I). The Committee after analyzing the proposals including its deliverables and impact on SME financing will accord approval along with financial assistance to implement/pilot test the innovation.

iii. Duration and Size & Cost Participation

Grant size will be determined according to the financing requirements of the proposal under consideration. However, each grantee will contribute 15% of the total cost. Depending upon the quality & innovations of proposal, the grant size can vary from project to project basis. However, one bank will get one grant only. The duration of the projects should be ideally not more than 8 months.

iv. Monitoring

The CFS-Secretariat will monitor the progress through monthly/quarterly progress reports submitted by grantees. The monthly/quarterly reviews will present three key aspects of projects, including progress on work plan, outcomes and grant utilization. The project's progress will be seen monthly and in case of signs of failure or dissatisfaction; the project funding may be ceased.

v. Knowledge exchange

The grantees are expected to share project experiences in the form of regular reporting, contribution to newsletters, presentations and conferences.

d. Eligibility and Proposal Evaluation Criteria

Commercial Banks (conventional & Islamic) and other SBP regulated entities are eligible to apply for CFS. Banks can also apply in partnership Fintechs/EMIs. However, lead responsibility will rest with applicant bank. The banks will be required to fulfil the eligibility criteria as defined below:

Broadly, the CFS Evaluation Committee will analyze the proposal based on feasibility, relevance and impact on SME financing. However, the final selection will be made on how the solution has transformational potential impact on increase in

- i) number of borrowers
- ii) SME financing portfolio (outstanding)

e. Terms & Conditions

- Interested banks/SBP regulated entity shall submit only one expression of interest (EOI), either individually or in collaboration with other entity (Fintech/EMI).
- The interested banks shall bear all costs associated with the preparation and submission of their EOI.
- The EOI prepared by the banks, as well as all correspondence and documents relating to the EOI exchanged by the banks and the SBP shall be in English.
- At any time prior to the deadline for submission of proposal, the SBP may, for any reason, whether at its own initiative or in response to a clarification requested by a prospective bank, amend the CFS proposal. Amendments will replace/supersede earlier CFS proposal.

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- SBP reserves the right to make final decision.

f. Format and Submission of Proposal

Proposal should be submitted as per format appended at annexure-B of SH&SFD Circular No 05 dated October 11, 2024 and should reach to CFS Secretariat within two week of issuance of this Circular.

g. Reporting & Coordination

The main point of contact from SBP during execution of CFS project will be:

Ms. Fatima Javaid
Senior Joint Director
SME, Housing & Sustainable Finance Department
State Bank of Pakistan, Karachi
Ph: +92-21-99221151
Email. Fatima.Javaid@sbp.org.pk

h. Ownership of Confidential Information

The grantee(s) bank would ensure that all the data/ information collected under CFS grant is kept confidential and will be the sole and exclusive property of SBP. The grantee will not, acquire any right, title or interest in or to any of the confidential information collected for this project.
