



## **Terms of Reference**

### **Hiring of Consultancy for Comprehensive analysis of supply and demand-side constraints in financing to SMEs**

**State Bank of Pakistan**

## Background

Pakistan accounts for more than 3 million economic establishments SMEs play a crucial role in the development of countries with major challenges of employment and income distribution. SME sector is playing an important role in the economic development of Pakistan as SMEs are contributing 30 percent towards the country's GDP, employing more than 80 percent of non-agricultural workforce and generating 25 percent in export earnings. Hence, the development of SME sector is top priority of governments of developing countries and Pakistan is one of them.

However, despite its immense significance, the sector remains largely financially excluded, as reflected from the current level of financing facilities to the sector that stands at Rs 513 billion (as on December 31, 2018) and banks' SME financing share in private sector financing has also shrunk to 9 (in 2018) from 17% (in 2006 which is considered to be the highest point for SME financing in term of percentage share in private sector credit). As compared to other developing/ neighboring countries like India, Sri Lanka and Bangladesh, the quantum of SME finance is fairly low in Pakistan.

In Pakistan, formal financing to SMEs is constrained due to limited access and understanding of financial products besides the lack of collateral which can be offered. Most of the SMEs don't possess necessary documentation to access credit from formal channel. Moreover, banks are shy of taking exposure on SMEs since a large number of SMEs lack credit history based on which it becomes difficult for banks to assess their creditworthiness.

In order to develop the SME sector, Government of Pakistan has taken some measures including establishment of SME Bank and Small & Medium Enterprise Development Authority (SMEDA). However, these were not sufficiently specified and prioritized to be able to speak of any coherent SME policy or approach.

In this context, State Bank of Pakistan has been actively pursuing the objective and playing its role since 2014. SBP's major emphasis was on facilitating banks & DFIs to understand the opportunities prevailing in the SME sector as well as address the challenges faced by financial institutions in providing financial services to the SME sector. SBP's initiatives include conducive regulatory framework, credit guarantee scheme, advisory services facility for banks, capacity building and awareness creation programs.

State Bank of Pakistan introduced the Credit Guarantee Scheme for Small and Rural Enterprises (CGS) in 2010. The scheme was launched in collaboration with UK's Department for International Development (DFID) under which risk coverage of up to 60% is provided to participating financial institutions (PFIs) against their lending to small, rural and micro enterprises. Further, SBP is working with DFID for setting up an independent Credit Guarantee Company, for which the consultant has been hired to prepare a business plan.

Apart from other developmental measures, State Bank of Pakistan in collaboration with the World Bank, DFID and Government of Pakistan is facilitating the establishment of an Electronic Secured Transactions Collateral Registry. The electronic registry will enable the registration of charges on movable assets of un-incorporated entities. The electronic registry will draw its authority from the Secured Transactions Law which was passed in July 2016. Allied areas of preparation of rules & regulations, procurement of hardware & software applications and the appointment of registrar are under process at the government's level. It is expected that the secured transactions collateral registry will be functional by the end of December 2019.

In order to provide concessional financing to the underserved sector, SBP introduced various refinance schemes for modernization of and investment in SMEs; for women entrepreneurs in the underserved areas; and a refinance scheme to meet the working capital requirements of SMEs.

The Prime Minister of Pakistan launched the Policy for Promotion of SME Finance on December 22, 2017. The policy document was prepared by SBP which consists of 9 essential components for development of the SME sector with respect to financing.

### **Financial Inclusion & Infrastructure Project (FIIP)**

To support the implementation of Pakistan’s NFIS, the World Bank Group (WBG) has approved the Financial Inclusion and Infrastructure Project (FIIP). Under the project a loan has been provided to Government of Pakistan for improving access to financial services for microenterprises and SMEs (MSMEs). In this regard, the State Bank of Pakistan seeks to hire a consultancy firm to undertake a detailed analysis of financial constraints in the SME sector. The analysis should have a “Future outlook” with a view to identifying new approaches and new innovative solutions that can be used by policymakers and financial institutions engaged in SME finance to foster a rapid development of the sector.

### **Definition of Small Enterprise**

A Small Enterprise (SE) is a business entity, which meets the following parameters:

<b>Number of Employees</b>	<b>Annual Sales Turnover</b>
*Up to 50	Up to Rs. 150 million

*\*including contract employees.*

Further, an entity has to fulfill both the criteria of number of employees and sales turnover for categorization as small enterprise. However, in cases where an entity fulfills one parameter of SE and its second parameter falls within the range prescribed for medium enterprise (ME) or above the upper limit prescribed for ME, then the subject entity shall be classified as ME or commercial/ corporate entity as the case may be.

### **Definition of Medium Enterprise**

A Medium Enterprise (ME) is a business entity, ideally not a public limited company which meets the following parameters:

<b>*Number of Employees</b>	<b>Annual Sales Turn-Over</b>
51-250 (Manufacturing & Service MEs) 51-100 (Trading MEs)	Above Rs 150 million and up to Rs 800 million (All types of Medium Enterprises)

*\*including contract employees.*

Further, an entity has to fulfill both the criteria of number of employees and sales turnover for categorization as medium enterprise. However, when an entity’s one parameter is as per ME criteria and its second parameter is as per SE criteria, than subject entity would be categorized as ME. Similarly, when an entity’s one parameter is as per ME and its second parameter is above the upper limit prescribed for ME, then the subject entity shall be categorized as commercial/ corporate entity.

### **Objective**

The objective of this survey is to conduct an assessment of the state of SME finance in Pakistan, identify the size and nature of the SME financing gap and formulate a set of policy, regulatory and institutional recommendations to enhance SMEs’ access to finance, including:

1. A comprehensive analysis of supply and demand-side constraints against SME financing

2. A review of the robustness, coverage and efficiency of the existing financial infrastructure (credit information systems, insolvency and credit rights, payment systems)
3. Assess available financial products for various SME sectors
4. Provide as fair estimate regarding financing gap in terms of amount and population separately for SEs and MEs and in the underserved areas
5. Review and assess the efficiency of existing delivery channels for the SME segment
6. Possible Fintech solutions to finance SMEs
7. Provide a fair estimate on potential financing needs of SMEs operating in formal and informal sectors
8. Recommendations

Proposed recommendations by the consultant should help in addressing the demand and supply side factors and should support innovation, institutional capacity and market infrastructure development to sustainably develop SME financing in Pakistan.

### **Scope of Work/ Tasks**

The consultant/ firm will deliver the following analysis for the SME sector assessment using latest data and performance indicators:

Comprehensive analysis of supply and demand-side constraints against SME financing

The consultant will review existing literature and data on SMEs in Pakistan bifurcated in to small enterprises and medium enterprises, by sector, geography, and size. This will require coordination with organizations such as SMEDA, MOI, SME Bank Ltd., provincial investment boards/ departments, Special Economic Zones, and other institutions which interface with SMEs.

The consultant will quantify and qualify the state of SME finance and gaps using available primary and secondary data, to assess the factors mentioned in the objective above. The analysis will include the following (but not limit to):

- a) SME importance and role for economic growth: Outline the specific case of Pakistan and assess the impact of a lack of financing for SMEs on economic growth;
- b) Review of Pakistan's strategies, policies and specific action plans for SME sector development; It will also include an assessment of the effectiveness/impact of existing programs and policies, drawing lessons learned, and with a view to better targeting future support and rationalizing existing programs
- c) Demand analysis: Conduct a survey/ study of a sample of at least 5,000 SMEs operating in various economic sectors. The survey will be conducted to assess the financing needs of SMEs in Pakistan using questionnaire, data collection tools, to quantify the existing gap in financing, and conduct focus group meetings with SMEs with business chambers/ associations;
- d) Supply analysis: including (i) All financial institutions and as many as possible non-financial institutions with their mandate, (ii) type of funding instruments, (iii) characteristics of funding recipients, (iii) institutional and regulatory issues, (iv) funding of intermediaries, (v) key constraints in the supply side, and (vi) supply estimate. This should include an analysis of past experience with SMEs, and how quality of SME loan portfolios (perhaps divided by SEs and MEs and possibly by sector) compares with quality of corporate or consumer loans what lessons have FIs learned from their experience with SME loans. The main reasons due to which SMEs request for credit are turned down by banks should also be narrated.
- e) Gaps in SME sector financing: including (i) gaps by products, (ii) gaps by type of SME Business (manufacturing, trading or service concern), (iii) gaps in liquidity of intermediaries, (iv) potential and capability of FIs to fill gaps.

A review of the robustness of the existing Financial Infrastructure (credit information systems, insolvency and credit rights, payment systems)

Weak financial infrastructure is a key impediment to the development of the SME financing ecosystem in Pakistan. In the World Bank's Ease of Doing Business 2017's ranking for 'Getting Credit', Pakistan is ranked at 147, behind India (at 44), Sri Lanka (at 118) and Bhutan (at 82).

The State Bank of Pakistan has introduced various concessional short term and long term refinance schemes for the development of the underserved sectors. Refinance schemes have been introduced for various needs including working capital requirements, balancing, modernization and replacement of plant and machinery of SMEs, women entrepreneurs, operating in the various sectors of the country including export oriented sectors.

The consultant will conduct an assessment of the financial infrastructure in Pakistan to identify specific bottlenecks among different groups of stakeholders and describe actionable recommendations that can be undertaken to address the deficiencies. The assessment will address:

- a) Legal & regulatory systems support: This area will seek recommendation on how can the legal and regulatory support be enhanced towards improving the access to finance component for SMEs.
- b) Credit information systems: How access to high quality credit information can be expanded, and the private sector can play a role in the credit information market?
- c) Insolvency and credit rights regimes: This includes recommendations on speedy out of court resolution, smooth bankruptcy procedures, contingency allowances in the event of a temporary set-back etc.;
- d) Innovative digital financial solutions: How to enable increasingly digitalized and efficient payment solutions to address information asymmetry issues and help new business development.

Assess available financial products/ services for various SME sectors

This component of the assessment will focus on providing an assessment of the landscape of products and services that are currently available for various sectors SMEs are operating in and determining any gaps that can be filled by financial institutions. This component would specifically address:

- a) Existing SME-specific products available through the formal financial sector (including information on pricing, collateral requirements, documentation requirements, turnaround time etc. for key products)
- b) Other financial products (not SME-specific) that are used by this sector
- c) SME-specific value added services provided by the formal financial sector (e.g. business planning advisory, financial advisory)
- d) Products and services available through informal channels and their competitive advantage
- e) Successful marketing efforts undertaken by formal financial institutions, specifically targeting the SME segment

Assess the financing gap in terms of amount and population separately for SEs and MEs in the underserved areas.

This component of the assessment will focus on fairly estimating the financing gap in absolute amount separately for SEs and MEs, through primary and secondary data collection using recognized analytical tools. The consultant will provide a detailed review separately for SEs & MEs in underserved areas of the country including the provinces of Khyber-Pakhtunkhwa, Balochistan, South Punjab, Rural Sindh, Gilgit Baltistan and Azad Jammu & Kashmir.

Review and assess the efficiency of existing delivery channels for the SME segment

This component of the assessment will directly address the current delivery channels for the SME segment and provide a perspective on which channels are more effective than others in addressing the needs of this segment. The issues addressed in this component will include:

- a) Core channels currently used by financial institutions to reach out to the SME segment (e.g. branches, automated channels such as ATMs/ internet, mobile banking etc)
- b) SME perceptions on the effectiveness of the key channels used for delivery of financial products and services
- c) Gaps in the use of innovative channels to reach out to SMEs
- d) Possible incentives to increase the use of one channel over another

#### Possible Fintech solutions to finance SMEs

Pakistan has seen a remarkable degree of mobile account outreach in recent years through mobile service providers. The government has expanded the coverage of unique Computerized National Identity Cards (CNIC) and Smart Cards which have been biometrically augmented. While mobile account usage to date has been largely limited to money transfers, there is considerable scope for innovative Fintech business ideas/ solutions that can help grow the SME sector.

Drawing on international experiences in East Africa (mainly Kenya and Tanzania), India, China and elsewhere, the consultant will assess various Fintech enabled SME financing business models, and appraise their scope in the context of the Pakistan market. The consultancy will map and analyze Global/Local FinTech products/models which have a focus on financing & sourcing of MSMEs including start-ups/early stage including detailed information on various schemes, pricing, collateral requirements, documentation requirements, and turnaround time etc. for these offerings. It will also map and analyze existing partnerships (Global/Local) between traditional financial institutions and FinTech companies. Additionally, the consultant will examine the policy and regulatory actions that are necessary to allow these business models to flourish while mitigating risks to financial integrity, stability and investor protection.

#### Estimate potential demand in the informal sector

It has been observed that the employment structure and other macroeconomic factors such as taxation, regulatory burden, social security and income levels influence SMEs to avail financing from the informal sector. The consultant will be required to assess and project the fair estimate about the potential credit needs of SME in both the formal and informal sectors through questionnaires and interviews. Further, the consultant will identify the key constraints for obtaining finance through formal sources compared to finance obtained through informal source. The informal potential demand for SME finance as a percentage of the formal potential demand for SME finance in other developing countries may also be used for a cross country analysis.

#### **Recommendations**

To diversify and expand SME finance, the consultant will provide recommendations and potential policy interventions needed in the areas such as legal, regulatory framework and any incentivization required from the government or central bank etc.

#### **Proposed Activities**

The consultant, in response to these TORs, is expected to provide a proposed methodology for achieving the objectives detailed above. However, in an effort to provide some direction and guidance for project design, a set of possible activities has been outlined below. With the exception of the SME survey, which is a core activity for the project, this list is indicative. Consultants should use their past experience with similar projects to develop a more specific project plan.

The consultant will be required to carry out a detailed assessment that will include an overview of existing studies and data, general research, analysis, case studies, and provide concrete recommendations and suggestions on possible next steps.

### **1. SME Workshops/ Seminars with key players**

It is expected that the consultant will conduct, at a minimum, two workshops/ seminars as part of the project.

In order to understand the supply side constraints to SME finance, the consultant will need to organize and facilitate a workshop/ focus group within the first few weeks of the project, with key players in the SME finance market, including a representative sample of public sector banks, private sector banks and DFIs. The purpose of this workshop would be to:

- Understand from the key players their perceptions on the constraints to expanding the level of SME finance availability, including regulatory constraints
- Brainstorm on possible solutions to the identified constraints to providing SME finance
- Facilitate knowledge sharing on successful service models for the segment and how these can be leveraged

Upon completion of the assessment and report, the consultant will need to organize and conduct a closing workshop/ seminar to share the findings and results of the assessment with the key players in SME finance and relevant policy makers.

### **2. Interviews/ Surveys**

The consultant would be required to collect data and information directly from allied stakeholders. This could include, but is not restricted to, the following:

- Banks and DFIs to collect information on their SME portfolio, their approach in targeting the SME segment, products and services offered and constraints to SME finance.
- A sample of at least 5,000 SMEs (separately covering SEs and MEs) or sector organizations to understand issues with accessing finance, gaps in products and services and perceptions of the formal financial sector to meet financial needs. Understanding the size and scope of the SME segment in Pakistan, all attempts should be made to provide a representative sample.
- Policy makers (e.g. Ministry of Industries, State Bank of Pakistan) to understand their view on perceived constraints to SME finance, actual size of SME finance gap and what can be done to address this.

Any sample groups and surveys/ questionnaires for the above or other identified stakeholder groups must be agreed with the SBP.

### **Deliverables**

The first draft study will be presented to SBP after 15 months of project initiation for feedback and review. The findings of the draft report will be disseminated through a series of seminars and workshops in close consultation with the SBP team.

The following deliverables are expected from the project:

#### **a) Proposed Methodology and Desk Research Results**

The Consultant will document in the first three weeks of the project, the final methodology, including a time line for delivery of the assessment, survey questionnaires, and results of desk research as a basis for rest of the assessment.

b) Workshop/ Focus Group Outcomes Report

The Consultant will provide a detailed account of the proceedings of the pre-survey with a focus on key agreed outcomes and proposed next steps.

c) Final Report-SME Finance Assessment Report (including an Executive Summary)

The Consultant will provide a comprehensive report on the findings of the assessment (responding to all the questions from objectives section as well as additional information found by the Consultant), overall conclusions on the size and nature of the SME finance gap and specific recommendations to increase outreach to this segment. The report should annex all interviews and survey results in support of the findings and recommendations.

d) Closing Workshop Report

The Consultant will provide a detailed account of the proceedings of the Closing workshop and will integrate relevant feedback from the workshop in the final report prior to publication.

e) Publication and Dissemination of Final report

The consultant will conduct interactive sessions on finding, publish and disseminate the final report to key stakeholders as advised by SBP.

### **Required Skills/ Experience**

- a) Significant and demonstrated experience in mapping the SME sector and conducting financing needs assessments for SMEs
- b) Demonstrated understanding of SME risk capital needs
- c) Demonstrated experience in consultative research and producing high quality analyses
- d) Demonstrated knowledge of the SME space and its financing needs in Pakistan and South Asia Region will be an advantage
- e) Excellent writing and communication skills in English

The Consulting Firm will be assessed and evaluated to deliver on the tasks and outputs outlined in the scope of work above and on any other related task.

### **Duration of Services Compensation and Reporting**

- a) The assignment period would be 19 months (July, 2019 – March, 2021).

### **Compensation and Reporting**

- a) Compensation will be according to skills and experience in line with agreed contract provisions finalized in line with Bank Procurement Regulations.
- b) All fees will be paid after SBP acknowledges satisfactory delivery of the output attached to that payment milestone. Fees and time schedule for the deliverables will be based on agreed contract provisions finalized in line with Bank Procurement Regulations.

### **Payment Terms**

Following are the payment terms:

- a. 10% payment will be released on satisfactory submission of Inception Report – highlighting the plan of action for the duration of the project (after 2 months of project initiation)
- b. 10% payment will be released on submission of progress report of interviews/surveys –after 6 months of project initiation
- c. 20% payment will be released on submission of Mid Review Report – highlighting the progress of project (after 12 months of project initiation)

- d. 20% payment will be released on submission of First Draft of SME Finance Assessment Report – after 15 months of project initiation
- e. 20% payment will be released on submission of Final Draft of SME Finance Assessment Report – after 18 months of project initiation
- f. 10% on satisfactory Presentation to SBP – within two weeks of submission of final draft
- g. 10% for conducting interactive sessions on findings of report, publication and dissemination of report (after finalization of report by SBP)

### **Reporting & Coordination**

The main point of contact for this exercise during execution of contract from SBP will be:

Mr. Shahid Ali Khan  
Additional Director  
Infrastructure, Housing & SME Finance Department  
State Bank of Pakistan  
Karachi  
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### **Confidentiality Statement**

All intellectual property rights arising from the execution of these terms of reference are assigned to State Bank of Pakistan. The contents of written materials obtained and used in this assignment may not be disclosed to any third parties without the expressed advance written authorization of the State Bank of Pakistan.