



Benchmarking SME Banking Practices

Emerging Lessons and Best Practice

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 **IFC**
International
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Corporation
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SME Banking and IFC's Role

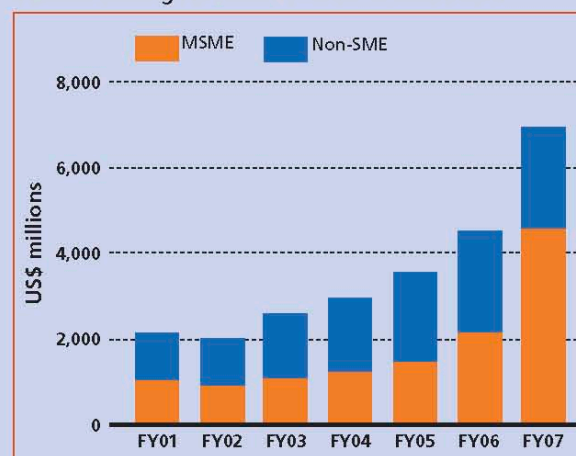
Small and medium enterprises (SMEs) are major contributors to GDP and employment in many parts of the world. However, their financial needs are often underserved and this continues to be a constraint to their growth. Banks, which have traditionally served the corporate and large business segments of the market, view SMEs as a challenge due to information asymmetry, lack of collateral and the higher cost of serving smaller transactions. However, as corporate banking margins continue to shrink and increasing fiscal restraint lowers yields on government borrowing, banks have begun to assess the opportunities that SMEs offer in terms of growth and portfolio diversification.

In recent years, IFC, a member of the World Bank Group, has shifted its involvement with SMEs from direct investment in enterprises to mainly channeling funds through financial intermediaries.

IFC's micro, small and medium enterprise (MSME) portfolio represents 24 percent of its total portfolio and 56 percent of its financial markets portfolio. Commitments to financial institutions for the MSME sector reached \$1.9 billion in fiscal year 2007. As of December 2006,

IFC's financial institutions clients accounted for about five million MSME loans for a total value of \$57.1 billion. In addition to its investments, IFC's financial markets technical assistance activities in SME banking include creating SME operations, bank downscaling, scaling up microfinance institutions, and creating leasing operations and products.

IFC Outstanding Portfolio in Financial Institutions



Benchmarking SME Banking Practices

Benchmarking SME Banking Practices is an IFC initiative which aims to identify key success factors and highlight links between performance and business models,

Banks view the SME segment as a strategic opportunity that, despite its challenges, can be profitable.

processes and tools adopted by participating banks. In its current phase, which began in 2005, the project has focused on qualitative and quantitative

benchmarking studies at five banks in OECD countries and six emerging market banks located in the US, EU, Latin America, Asia, and Australia.

The results of the Benchmarking SME Banking Practices initiative point to a number of emerging lessons learned by banks offering SME banking. They have also enabled IFC to establish a core set of benchmarks and best practices, which are set out. In a second phase, the core set of benchmarks built will be used with additional emerging markets financial institutions interested in participating in the exercise.

SME Segment Offers Growth & Profit

The banks surveyed during the benchmarking exercise highlight fierce competition in the corporate and retail segments as a key factor in entering the SME market. The SME market is viewed as an untapped segment with margins for growth given shrinking margins in the corporate sector and increased competition in retail banking. In addition, SME banking is seen as a high margin business with a strong potential for profitability and important cross-selling and portfolio diversification opportunities. The banks surveyed reveal that SME banking is a profitable business despite challenges such as the need for buy-in at both management and operational staff levels and the need to adapt products and develop IT tools. As highlighted in *ROA SME Versus Total Bank*, page 4, SME portfolios generate higher return on assets (ROA) than total bank portfolios. Four out of five banks noted higher portfolio and income growth for the SME segment than the total bank.

Definitions of SMEs Vary

The participating banks' definitions of SMEs and the criteria used to categorize them vary considerably. Most banks note that loan size is not

an adequate criteria and indicate that they have evolved more sophisticated criteria based on thorough analysis of their SME clients. Nine of the 11 surveyed banks use client intrinsic characteristics

The challenges in SME banking are similar for all players but the solutions vary significantly. Banks are still refining their business models.

as their primary criteria. The banks suggested that they define SMEs using data easily collectable by front office staff and based on: (1) whether they are asset customers or liability only customers; and (2) risk/return profiles which enables the bank to determine potential revenue, adjust cost to serve, and maximize profit.

Higher Unsecured Lending in OECD

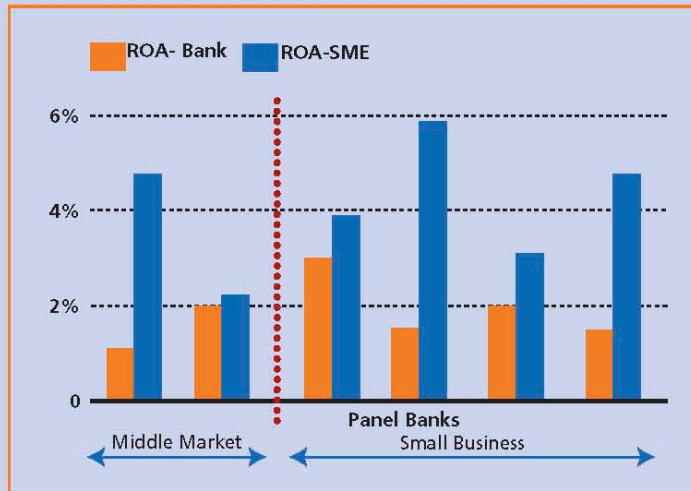
Unsecured lending in the small business segment is higher overall in the banks in OECD countries compared to emerging market banks. Unsecured lending is 64 percent for the OECD banks analyzed compared to 36 percent on average for their emerging market counterparts. This is likely due to the availability of better information on clients and credit scoring tools in OECD countries. The banks analyzed in emerging markets view the ability to

Focus on IFC's Core A2F Products

Core/traditional A2F products are shaded in dark orange.

Financial Intermediaries	Financial Infrastructure	Strategic Goals
<div>SME Banking</div> <div>Microfinance</div> <div>Housing Finance</div> <div>Leasing</div> <div>Sustainability Finance</div> <div>Trade Finance</div> <div>Insurance</div>	<div>Credit Bureaus</div> <div>Collateral Registries</div> <div>Securities Markets</div> <div>Payment Systems & Remittances</div>	
Expand Access to Finance		<ul style="list-style-type: none"> • Maximize IFC's development impact • Differentiate IFC's product offerings • Add value to IFC's clients • Brand IFC's name

ROA SME Versus Total Bank



provide unsecured loans as the next opportunity to expand into this market. Banks recognize that the market belongs to players able to decrease information asymmetry through strong internal databases and credit bureaus.

Focused SME Banking Strategy

All the banks surveyed had recently redesigned their organizational structure to support a strategy that focuses on addressing the SME segment. About half the banks have organizational set-ups which are less than two years old, while the SME models for 10 of the 11 banks are less than five years old and only one surveyed bank sees its model as fully mature. Most of the banks separate small businesses from middle market clients and have shifted their organizational set-up from a geographic or functional focus to a business line focus. Four main business models have been identified and are highlighted in *SME Banking - Four Business Models*, right. The chart reveals that five of the 11 surveyed banks use a model in which SME clients are part of the retail business line. Although the business models vary, the analy-

sis did not reveal a correlation between the model used and performance.

Specialized Service for SMEs

The analysis of the banks reveals a strong emphasis on specialization as all the banks have dedicated mid-market staff and 90 percent have dedicated small business staff, from sales to back-office to management. Banks note that in the absence of distinct units, staff tend to remain focused on retail and corporate clients which are easier and, some feel, are more rewarding to serve. Commitment at the highest level of the bank and focus at the operational level have been crucial to the success of these banks in the SME market.

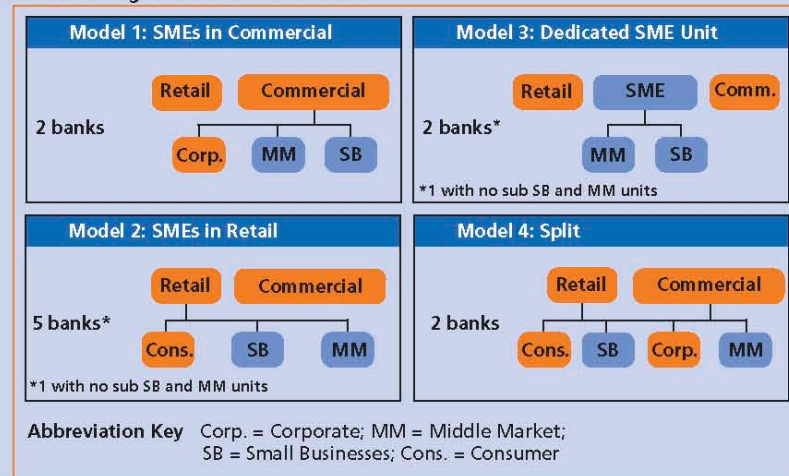
From Lending to Banking

The banks have shifted their focus to SME banking from a narrower SME lending approach. Banks use credit to attract and retain clients but rely on

The segregation of business acquisition and risk management/ credit decision is the rule

substantial revenue generation from value-added products. Cross-selling is a major profit driver. The banks in the sample reveal that less than 40 percent of revenues are generated by credit products as not all SMEs need to borrow but they generally need core banking products such as deposit and account

SME Banking - Four Business Models



management in order to run their operations. A standardized product offering for small businesses is seen across the participating banks, with a more tailored offering for middle market clients. As banks gain experience, they develop more sophisticated standardized products for smaller businesses.

Credit Risk Management

Independent credit underwriting is the rule for the surveyed banks. Rather than using a standardized model, institutions aim to quantify risks and align processes with their risk appetite. The model is largely determined by the bank's history, target market, and incentives for branch-based officers. The majority of the banks segregate sales and risk whereby relationship managers do not play a role in credit approval. The three common models noted are: (1) a centralized credit underwriting unit reporting directly to a global credit department with no links to business lines; (2) a decentralized credit underwriting team reporting to a global credit department with a secondary reporting line to the branch manager; and (3) use of automated scoring tools which are developed and validated with the independent or centralized credit team. Centralized credit risk management does not prevent local underwriting as six out of 10 surveyed banks have the ability to provide decentralized decisions through the use of scoring tools for the small business segment. The use of credit scoring is quite developed even in emerging market banks.

Proactive Sales & Customer Service

The banks aim for a proactive but cost-efficient sales and customer services strategy. A proactive sales strategy relies on a prospects database for leads and on dedicated sales staff. Ten of the 11 banks analyzed have a central leads origination team that manages a prospects database and allocates leads to business developers. The prospects database is generally purchased or built from multiple external sources, including credit bureaus, when the information is available and affordable.

Banks often employ the "hunters and farmers" approach to optimize client acquisition and activation. This approach consists of separating the sales

Chart 4. Uses of Scoring vs. Rating - OECD Banks

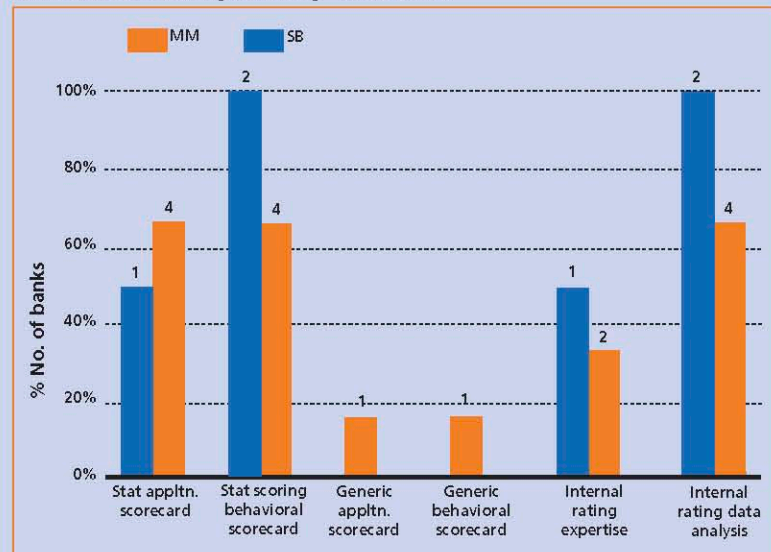
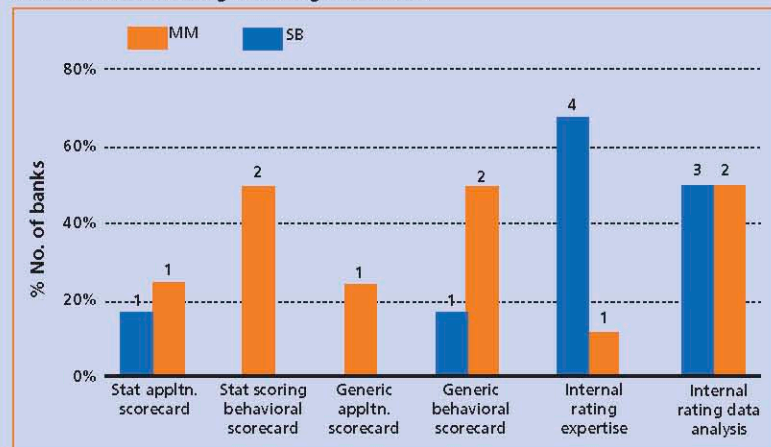


Chart 5. Uses of Scoring vs. Rating - EM Banks



and relationship management functions, whereby the "hunters" perform sales and bring in new business and "farmers" focus solely on cross-selling and client support. As relationship management for small businesses can be costly, banks have had to innovate

A proactive sales strategy and a multi-channel acquisition and servicing model are critical

low cost delivery channels such as the use of call centers. The banks recognize that a multi-channel approach consisting of a wide branch network and low cost delivery channels is key to SME banking. For example, eight of the 11 banks have inbound and outbound call-centers for SMEs and three banks

perform more than 90 percent of their small business transactions through such low-cost delivery channels such as the internet.

Measuring P&L

The banks recognize the need for robust data and performance measurement as profitability analysis is essential for cost containment. To analyze data, banks need strong analytic teams dedicated to the

The ability to measure profitability is essential for cost containment but Management Information Systems (MIS) remain a challenge

SME segments. Nine of the 11 surveyed banks have the capability to calculate profit and loss (P&L) at the business unit level in the small business segment and five in the medium market segment. However, only one bank out of seven in the medium market segment can provide breakdowns of P&L at the branch and product levels. Risk analytics continues to be a challenge.

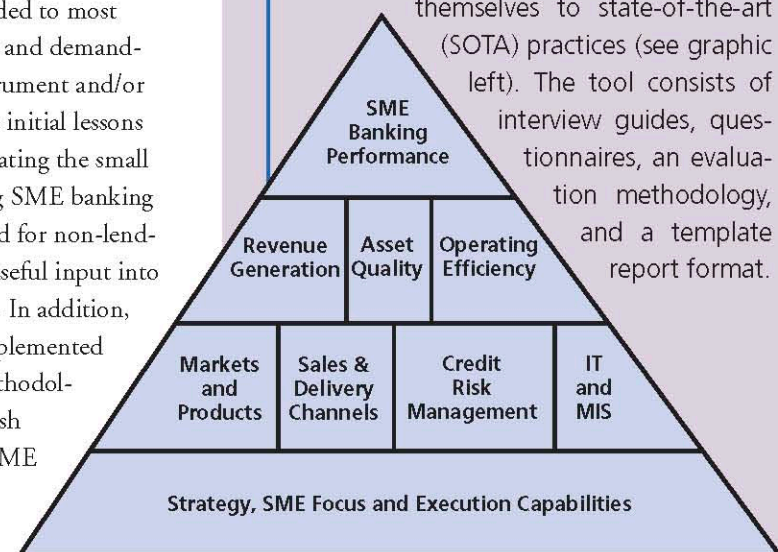
Next Steps

This initiative designed to benchmark SME banking practices is the first step towards the roll out of a more comprehensive set of benchmarks for SME banking practices in emerging market banks. In an effort to continue establishing best practice and promoting SME banking in emerging markets, the core set of benchmarks will be extended to most of IFC's client banks, on a voluntary and demand-driven basis, through an off-site instrument and/or IFC technical advisory facilities. The initial lessons that have emerged, such as differentiating the small and medium banking business, using SME banking business models, and the clients' need for non-lending products, are already providing useful input into IFC's technical assistance operations. In addition, the benchmarking work will be complemented by IFC's SME banking CHECK methodology. These two tools will help establish IFC's leadership role in promoting SME banking in emerging markets.

IFC SME Banking CHECK: a tool for technical assistance appraisal of SME banking operations

To conduct the Benchmarking SME Banking Practices initiative, IFC used as a conceptual framework its recently developed IFC SME Banking CHECK methodology (CHECK). CHECK consists of a diagnostic toolkit which is used to assess the SME banking operations of IFC's clients before designing a tailored action plan and technical assistance program to strengthen those operations.

CHECK offers a method for assessing the different business areas specific to SME banking: strategy and SME focus, products, sales approach, risk management, technology, and financial management. This formalized approach guides analysts through an organized and exhaustive framework, which can also be used by bank staff to perform their own self-evaluation. Based on SME best practices, the methodology helps banks quickly compare themselves to state-of-the-art (SOTA) practices (see graphic left). The tool consists of interview guides, questionnaires, an evaluation methodology, and a template report format.



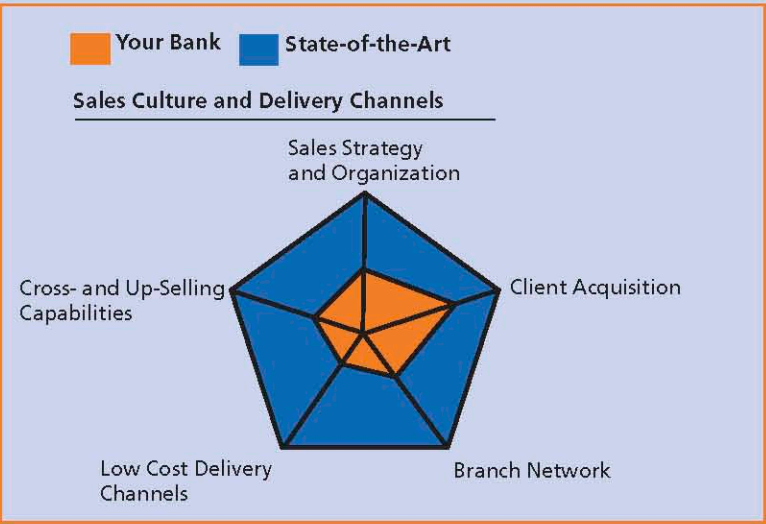
Summarizing the IFC SME Banking CHECK

Banks are assessed in five different areas, each of which is divided into several sub-areas. These sub-areas are scored from 0 (most formative practice) to 8 (most developed practice, or "State-Of-The-Art (SOTA)").

Stellar graphs, such as the one opposite for the "sales culture and delivery channels" area, summarize the bank's performance and compare it to a SOTA bank.

The notes attributed are qualitative, yet not subjective as they are based on pre-established benchmarking tables, as illustrated by the example below.

Stellar Graph Showing Bank's Performance vs. State-of-the-Art Bank



Sample Benchmarking Table

The evaluation methodology is based on qualitative benchmarking tables (see samples opposite). These tables draw on IFC's long track-record of providing financial and technical support to emerging markets financial institutions to set out descriptions of banking practices at the different stages of banking sector development.

1.1 Sales Strategy and Organization				
Sales Culture and Delivery Channels / Sales Strategy and Organization				
	Formative	Emerging	Developed	State Of The Art
Formative	There is no sales culture, as possible for risk is low and/or because the environment is not competitive enough.	Sales culture is limited, but competitive. It ensures business and/or management to improve growth performance.	Growth and market share are closely monitored by board and senior management.	There is a strong focus on sales performance and on sales capabilities.
1.2 Client Acquisition				
Sales Culture and Delivery Channels / Client Acquisition				
	Formative	Emerging	Developed	State Of The Art
Formative	The bank has a historic name and logo, but they typically do not convey any specific value.	The bank has a logo and a tagline, which conveys a specific value and helps differentiate the bank from competitors.	The branding strategy is fully consistent with the bank's history, market position, mission and conveyed.	The bank's image and brand are supported by specific communications support targeting shareholders, clients, and other stakeholders.
1.3 Branch Network				
Sales Culture and Delivery Channels / Branch Network				
	Formative	Emerging	Developed	State Of The Art
Formative	Each branch is a bank inside the bank. It includes operational front office and back office functions, including credit processing and local credit committees.	The branch set up is being simplified, with centralization of some functions at the regional level.	Back office functions have been centralized outside branches, and branch staff focus mainly on client interaction. More than 50% of the relationship managers' (RM) time is spent on visiting clients, prospects, and meeting bulk in.	The branch network is considered as a bank's sales and marketing channel. Branches are small and staffed mainly with sales and customer service staff. Branch staff used the majority of
1.4 Low Cost Delivery Channels				
Sales Culture and Organization / Low Cost Delivery Channels				
	Formative	Emerging	Developed	State Of The Art
Formative	Branches are the only delivery channel. Some of them have an ATM, mainly used by international card holders.	The branch network is complemented by an internet or ATM.	A large number of ATMs allow performance of basic cash and account checking transactions.	The bank uses branches, call centers, ATMs, and internet banking as a set of distribution channels whose cost is optimized by creating innovative digital to use lowest cost channels.
1.5 Cross-Selling and Up-Selling Capabilities				
Sales Culture and Organization / Cross Selling and Up-Selling Capabilities				
	Formative	Emerging	Developed	State Of The Art
Formative	Cross selling is not identified as a necessity. Products are viewed primarily as a funding source, not as a vehicle for selling other products.	The bank understands the necessity to cross sell. However, there is no clear strategy to increase the cross sell ratio.	The bank develops strategies to increase the cross sell ratio and monitors product penetration. Products provided by subsidiaries are also sold through the bank network.	Cross selling is considered as a major profit driver, at the group level. Sales staff focus on understanding customer experience and needs rather than on placing a product.
Emerging	Cross selling is essential and mainly concerns bank clients, on subjective basis. Limited marketing campaigns can be performed centrally or at the branch level, on occasional and non structured basis.	Cross selling is essential and mainly concerns bank clients, on subjective basis. Limited marketing campaigns can be performed centrally or at the branch level, on occasional and non structured basis.	Cross and/or selling are supported by a CRM system to predict the probability for a client to buy an additional product.	The client system generates leads not only for cross selling but also to maximize client.
Developed	Direct marketing via call centers, mail and monthly account listing is used to promote and cross sell products. Branch staff, including tellers, are given training and incentives to sell additional products each time they have a client contact.	Direct marketing via call centers, mail and monthly account listing is used to promote and cross sell products. Branch staff, including tellers, are given training and incentives to sell additional products each time they have a client contact.	This system shows client demographic and account data, along with history of contacts, and generates cross sell leads that are sent to call centers, RM, or BOCs.	Outbound call centers are key in the cross selling strategy, especially to ensure that all clients are contacted at least once a year.
State Of The Art	The bank cannot easily measure the number of accounts and facilities utilized by one client.	The bank estimates the average number of products/facilities used by one client, typically between 1 and 3.	The bank monitors monthly the cross selling ratio.	Marketing campaigns are conducted continuously. They are driven by relationship scoring and geo marketing analysis to optimize client response. The bank may acquire customers via non profitable product and then increase profit by cross selling products. The bank has developed innovative approaches to sell up the value chain (e.g. digital banking, commercial banking).
State Of The Art				The bank monitors detailed cross selling ratios, in terms of number of products and revenue generated. They are able to monitor client profitability.

Partnering with IFC

Examples of Assignments

- Conduct detailed diagnostic and gap analysis
- Organize strategic workshops for senior management
- Design and implement separate SME banking operations
- Design profitability analysis models
- Undertake customer segmentation
- Assist in new product design
- Re-engineer front-office/ back-office balance and branch organization
- Design and implement credit scoring for the retail and small business segments
- Implement internal rating systems
- Re-engineer workout processes
- Train credit and risk staff
- Assist in selection of new MIS
- Design appropriate MIS reports

Selected References

Central and Eastern Europe

- TBC, Georgia

East Asia

- ACLEDA Bank, Cambodia
- Sacombank, Vietnam

Latin America and the Caribbean

- FINDESA, Nicaragua
- COMPARTAMOS, Mexico

Middle East & North Africa

- CIB, EDBE, Egypt
- Attijariwafa Bank, Crédit Populaire du Maroc, Morocco
- Riyadh Bank, Saudi-Arabia

South Asia

- BRAC Bank, City Bank Ltd, Islami Bank, Bangladesh
- Bank Of Bhutan, Bhutan National Bank
- Hatton National Bank, Commercial Bank, Sri Lanka

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