

Utilising a Cluster Based Approach to SME Financing

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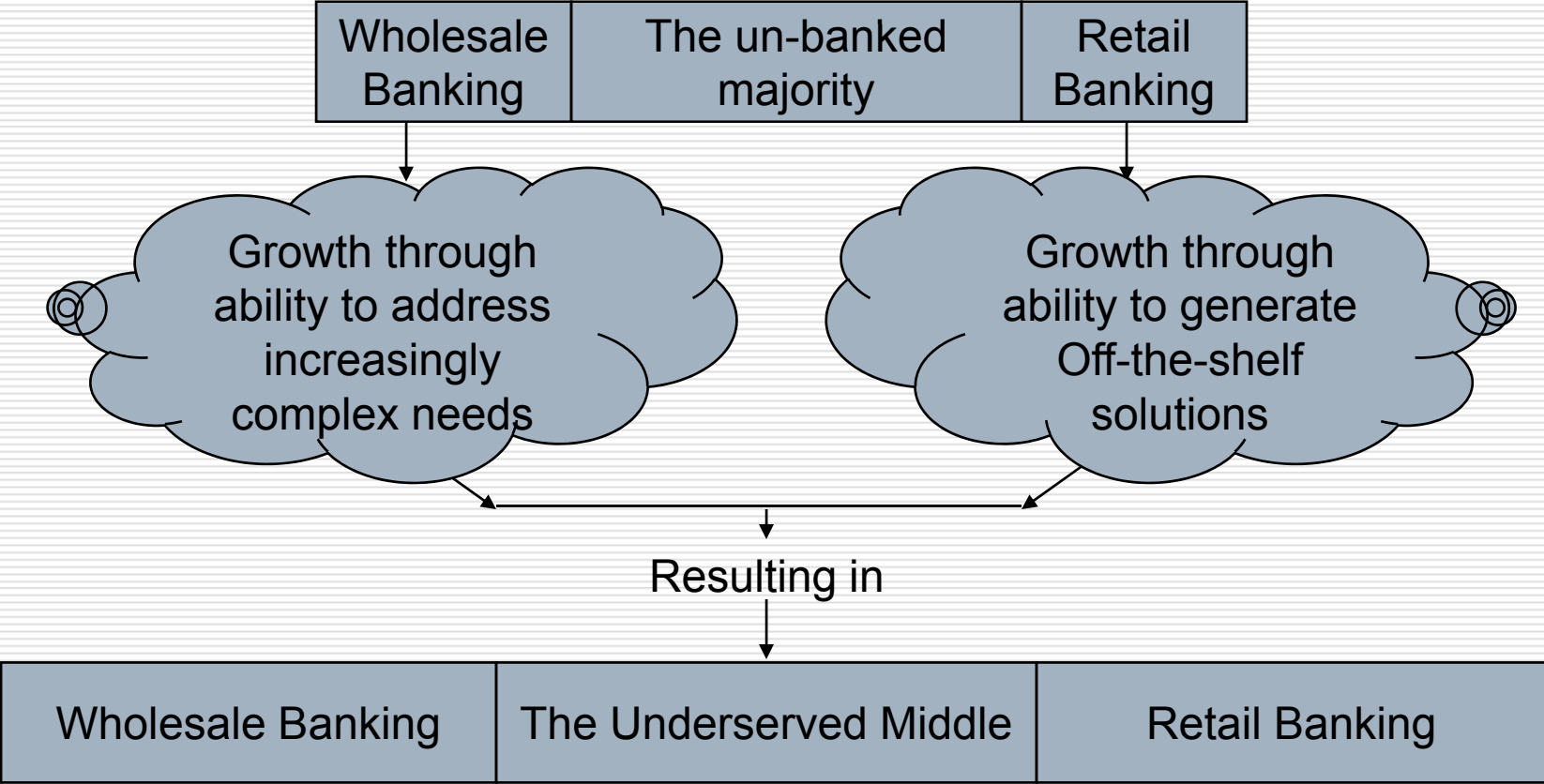
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Bangladesh Economy : At a glance

	GDP	Inflation	Per Capita Income	Real GDP Growth	Contribution to GDP			Annual Budget	Exchange Rate	Foreign Remittance
					Agriculture	Industry	Service			
	USD Billion	%	USD	%	%	%	%	USD Billion	BDT/USD	USD Billion
FY 05	61.00	6.49	463.00	6.00	22.30	28.30	49.40	7.80	61.40	3.85
FY 06	65.00	7.16	476.00	6.60	21.80	29.00	49.20	8.40	67.10	4.80
FY 07	74.00	7.20	523.00	6.40		28.70			69.92	5.98
FY 08	84.00	9.94	599.00	6.20				11.50	68.52	7.91
FY 09	92.00	6.66		5.90	19.10	28.60	52.30	14.50	69.00	9.69
FY 10 proj								16.50		

	DSE Mkt Capitalization	DSE Mkt Cap/GDP	Deposit in Banking Industry	Deposit / GDP	Import	FX Reserve in Central Bank	FX Reserve / Import	Export	RMG Export	(Exp + Remit) / IMP
	USD Billion	%	USD Billion	%	USD Billion	USD Billion	Months	USD Billion	USD Billion	Times
FY 05	3.30	5.40	21.00	34.00		3.00		8.70		
FY 06	4.70	7.20	25.00	38.00		3.50		10.50		
FY 07	10.92	14.80				5.10		12.20		
FY 08	15.34	18.30	36.00	43.00	21.63	6.20	3.40	14.10	10.70	1.02
FY 09	19.00	20.90	43.00	47.00	22.50	7.50	4.00	15.50	12.36	1.12
FY 10 proj						12.50				

Market Evolution



The Underserved Middle



- ❑ Came to be branded as the SME market.
 - ❑ In reality,
 - Is actually a spectrum of small enterprise markets
 - Ranges from the very small to the fairly large
 - Each range having its own unique requirements
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Opportunity Recognition

- ❑ The bank opened a branch in a district famous for textiles weaving.
 - ❑ The weavers were provided with power looms through lease finance.
 - ❑ The regular repayment lead to greater involvement and inclusion of working capital loans
 - ❑ The learning from this cluster finance was adopted as a business model
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Clusters worked with

- ❑ Belkuchi – textile weaving
 - ❑ Madhabdi – Grey Cloth
 - ❑ Bogra – foundries, agricultural equipment
 - ❑ Joypara (Dohar) Inland water transport building
 - ❑ Rongpur – agroprocessing & preservation
 - ❑ Konabari Cluster intervention – tech upgrade
 - ❑ Keranigonj - RMG retailing
 - ❑ Cox's Bazaar – tourism, lobster hatchery, contractors
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SMEs Require

□ Wholesale products

- Working capital
- Capital machinery finance
- Business expansion finance
- Short term & festival working capital loans

□ Delivered retail style

- Simple, standardized terms & conditions
 - Quick delivery
 - Flexible repayment structure - matched to cash flow
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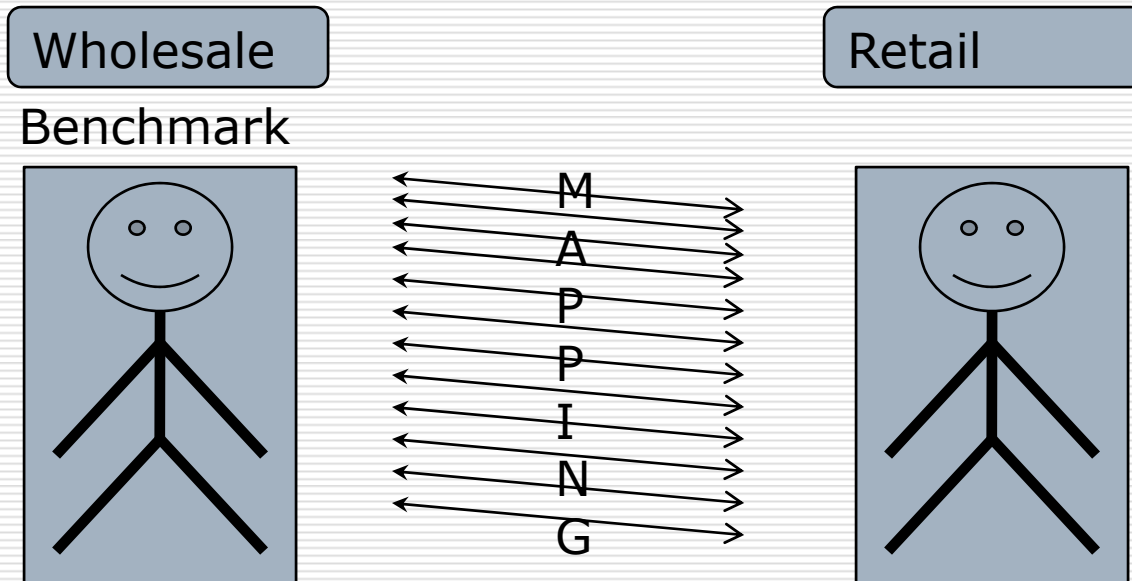
SMEs are Unique

- This causes strategies aimed at this segment to become complicated and raises a rather difficult question:
 - How do you blend the relationship banking characteristic of wholesale and the portfolio management structure of Retail, to cater to SME niches?
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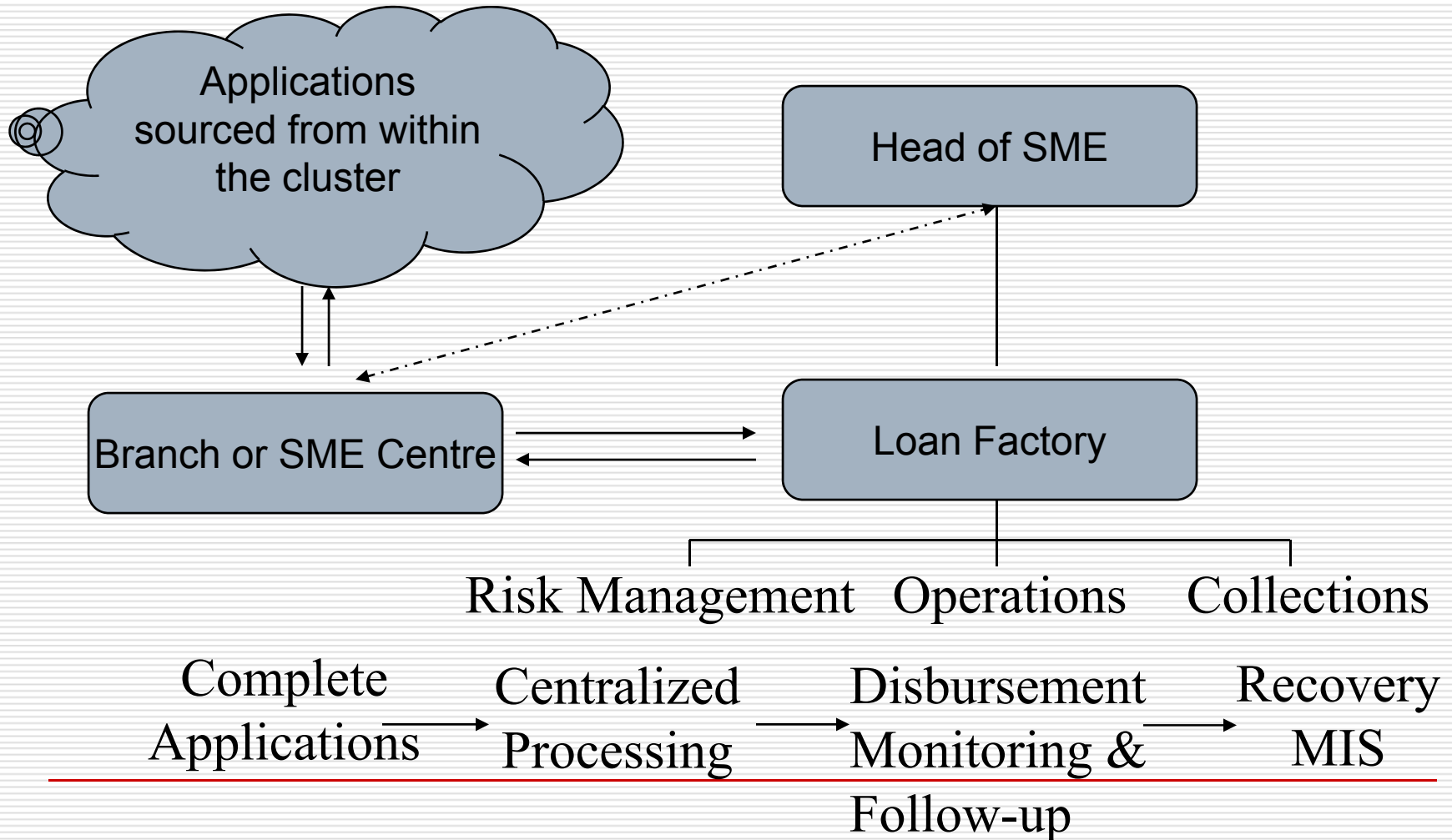
The Challenge

- To develop a non-transactional relationship-based approach that
 - can be applied across a large enough segment of the market.
 - generates enough volume to be sustainable
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One possible solution is the Cluster Based Approach



The Business Model



What is a Cluster?

- A cluster is a group of enterprises that are similar in terms of their
 - Nature of business
 - Stage of production
 - Technology and
 - Business volumes
 - And are located within geographic confines such that in many respects, they are like a single enterprise.
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A Cluster is Characterized by:

- ❑ A large number of similar enterprises
 - ❑ Substitutable goods/services
 - ❑ Selling to the same markets
 - ❑ Almost identical susceptibility to changes in economic variables
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The Cluster Based Approach

- The cluster based approach requires:
 - A Cluster, preferably offering a mix of Primary, Secondary & Tertiary clients
 - Products that address all three targets
 - Systems that are able to support and drive these product portfolios
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Primary Targets

- ❑ The main business line within a cluster
 - ❑ Contributing to about 60% of total output in the cluster
 - ❑ Typically, engaged in the production of something that the area is known for.
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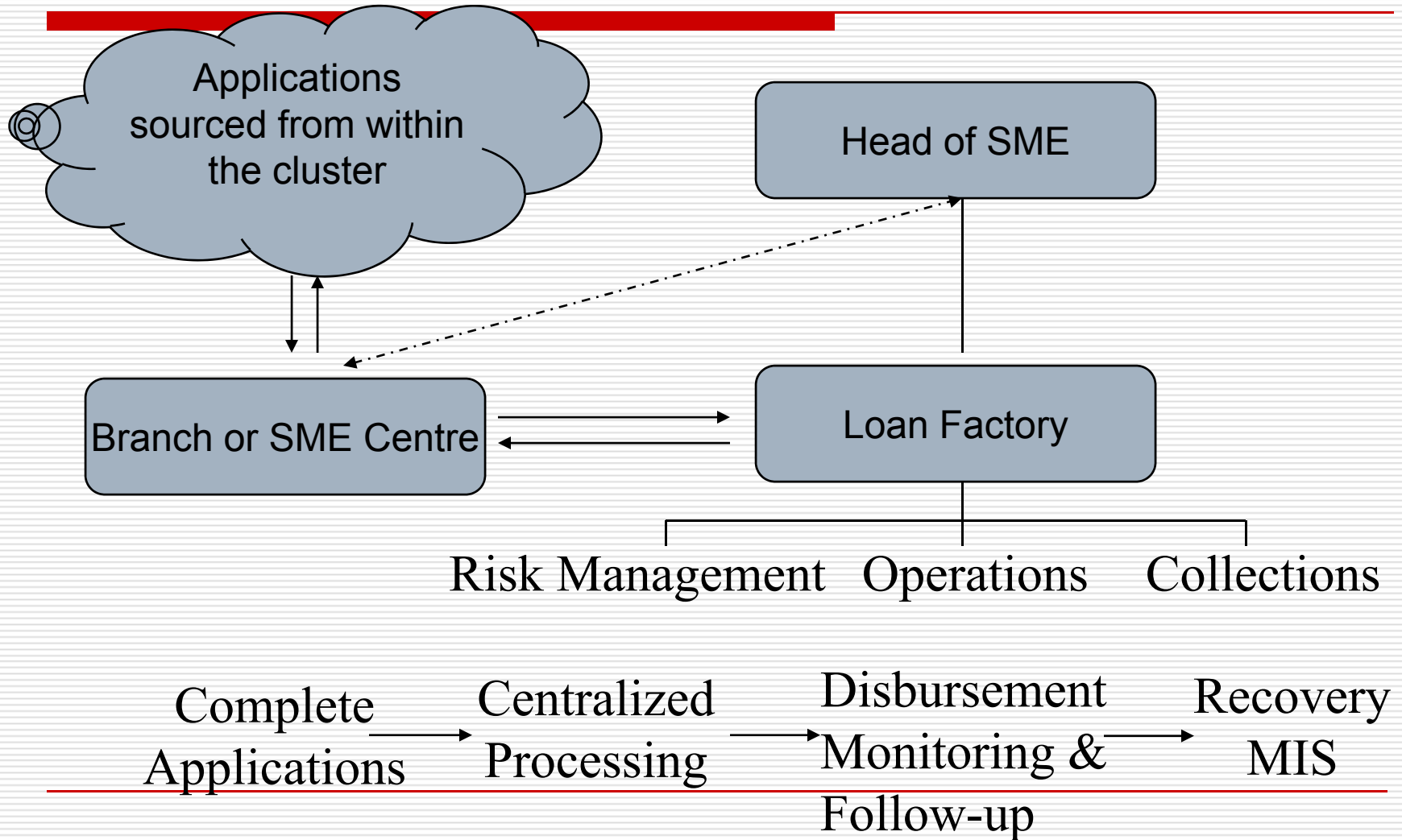
Secondary Targets

- Related businesses typically engaged in
 - The provision of support services
 - The supply of inputs.
 - The production of components
 - Generate about 80% of the trading volume within the cluster and about 40% of the production.
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Tertiary Targets

- Businesses unrelated to the main business line of the cluster, but providing related services to the community in general.
 - Typically a small percentage of the total production/ traded volumes
 - Includes departmental stores, restaurants, bakery & food shops, clothing outlets etc.
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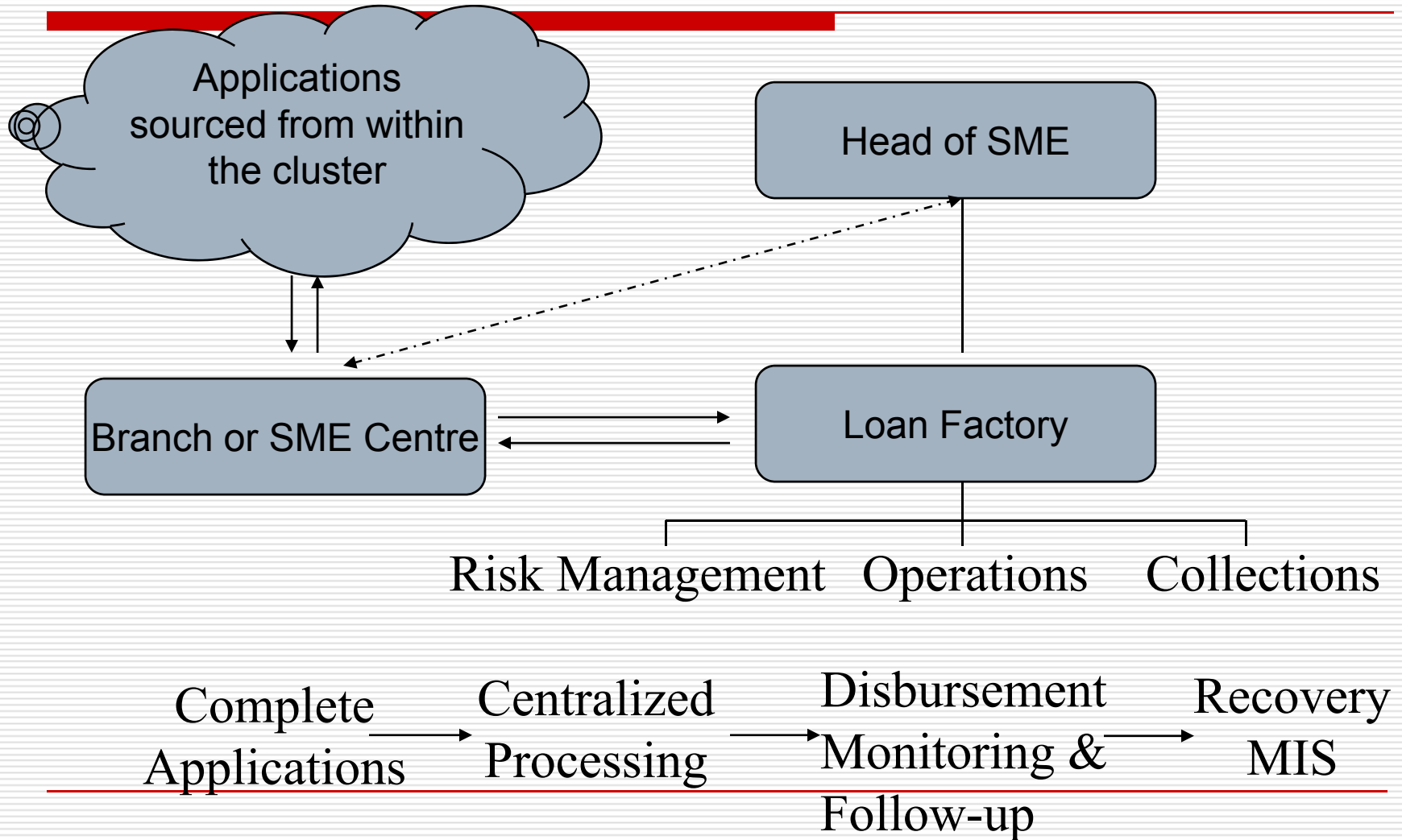
The Business Model



Role of Branch / SME Centre

- A branch or an SME Service Center located within the geographic location of the cluster works closely with it to:
 - Keep tabs on the vital signs of the cluster
 - Periodic reporting of client specific & overall market data
 - source applications from potential clients
 - Evaluate the standing of the individual client and recommend for facilities with supporting information
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The Business Model



The Loan Factory

- Risk is handled at the loan factory which works towards
 - Maintaining parameters based on the intelligence gathered
 - Providing guidelines and checklists on what constitutes a complete application
 - Providing approvals and documenting the credit facility
 - Collaborating with the Branch/Centre in facilitating collections.
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The Loan Factory

- The loan factory has the required capabilities to process large numbers of applications while addressing the specific requirements of each cluster.
 - It does so through combining wholesale and retail components.
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Head of SME

- Mainly responsible for strategy:
 - Choosing a cluster
 - Evaluating the cluster to document its potential
 - Benchmarking the “typical” client in the cluster
 - Determining product appropriateness and making necessary changes to credit policies in order to accommodate any special requirements.
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Product Requisites

- Products aimed at clusters
 - Must apply across multiple clusters through changing parameters only, within accepted ranges.
 - Have to support all three segments within clusters
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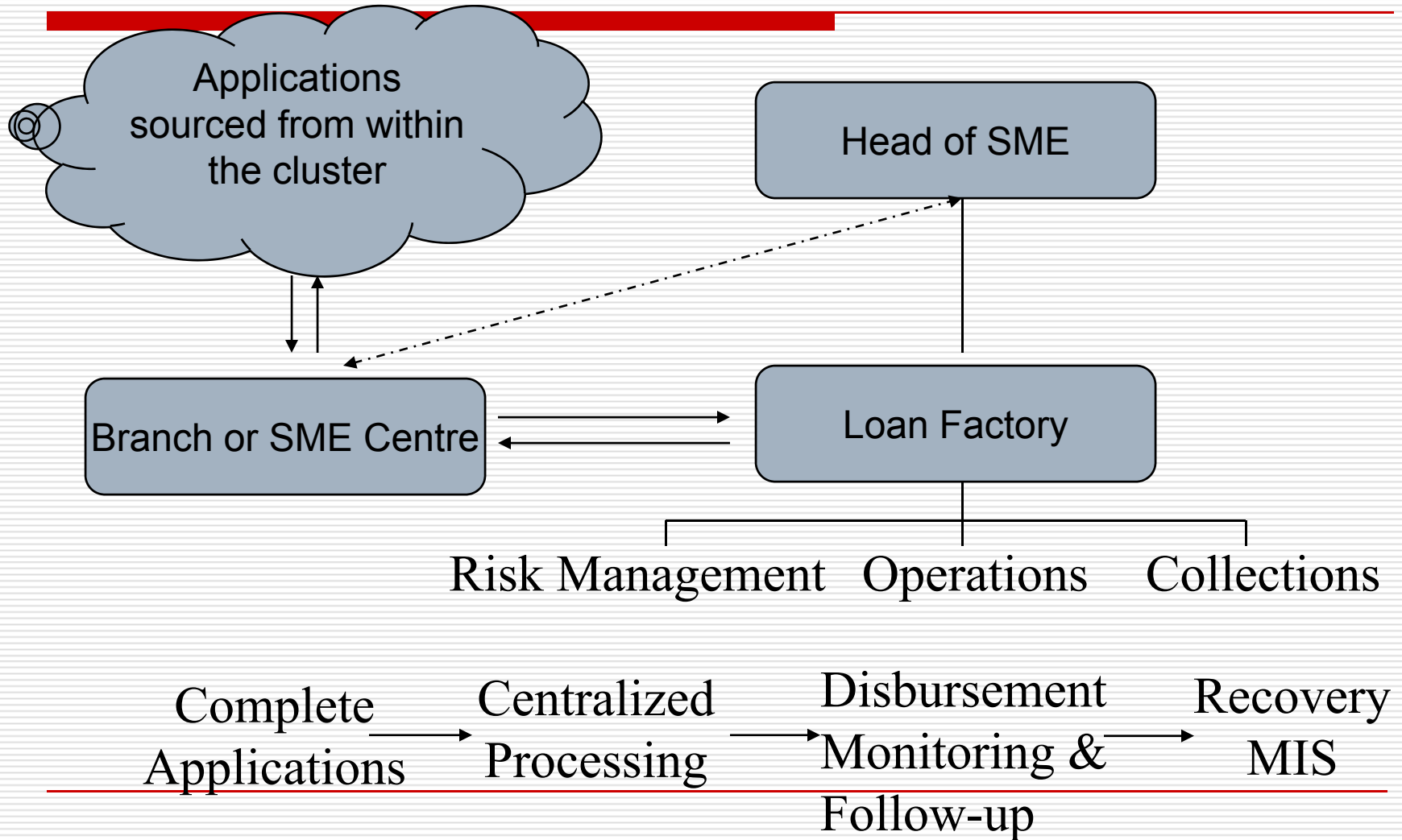
Products

- The product mix should allow for different repayment structures and should typically support:
 - Periodic interest repayments with principal repaid at maturity
 - Monthly Instalments
 - Moratoriums
 - Partial / Bullet / Balloon repayments
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Pricing

- Risk based pricing
 - ROI increased through collection of
 - Upfront fees
 - Charges
 - Margins
 - Advance payments
 - deposits
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The Business Model



Assessing loans from a cluster

- Collectively, the cluster behaves much like a single large entity.
 - Assessment therefore requires:
 - The cluster's future viability
 - Benchmarking of the 'typical' individual within the cluster
 - Ranking the applicant, from within the cluster, by comparing with the Benchmark
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The cluster's future viability

- Trends in supplies of inputs
 - Sources of inputs
 - Additional sensitivities relating to procuring inputs – transportation cost, timing of purchase, seasonality of availability or transport
 - Means of inbound transport and alternatives (water, road and/or air)
 - Inventory and management of inputs
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The cluster's future viability

- Manufacturing details:
 - The details of the manufacturing process
 - Manufacturing and inventorying costs
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The cluster's future viability

- Operational issues:
 - The level of technology and its future viability
 - Storage and handling issues
 - Availability and cost of labour
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The cluster's future viability

- Trends in buyer's behaviour
 - Reliance on the cluster's products/services
 - The Perception that the cluster is the best choice
 - Substitutability
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Creating Benchmarks

- Simple verifiable parameters
 - Identification
 - Value setting
 - And testing
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Present standing of the 'typical' individual within the cluster

- Provides inputs into the
 - Operating cash cycle – (instalments come out of cash flow, not accruals)
 - ROI, ROE, debt structure
 - Profitability, liquidity and Solvency to conclude on overall financial viability of individuals within the cluster
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Benefits / Advantages of the Model

- Delivers the “wholesale banking, Retail style” proposition at viable costs
 - Strong relationship based approach increases loyalty and “share of wallet”
 - Incorporates means for client readiness through
 - early anticipation
 - preparation
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Weaknesses / Disadvantages of the model

- ❑ High reliance on the skill level available at Branch
 - ❑ The relationship element narrows down to one or two Relationship Managers – easily affected by staff turnover
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