

Seminar Paper on 'Non-Financial Services (NFS) to SMEs for Sustainable SME Banking'

Introduction

There is a saying for banks that *'if clients do well, banks do well'*. This simple observation was a monumental shift in customer service in many industries over the past decades, when health insurers started investing in preventive health care, when utilities began investing in demand-side-management, or when Apple stores began offering free “geek glasses” to prospective and actual customers.

Banks have been for many years providing non-financial services to their clients to help them succeed. The services are mainly trainings on varied ranges of managerial and entrepreneurial topics along with information sharing, networking and even business consulting such as market or supply chain analyses and so on. In Bangladesh, the concept is yet to get institutionalized and popularized although some banks and FIs have already started practicing the same in limited scale.

As told, banks and financial Institutions (FIs) have long delivered non-financial services (NFS) to their business customers, especially the corporate clients, as part of helping the customers to succeed in business. But now a days, banks have been developing and delivering NFS targeted at their small and medium enterprise (SME) customers. Some commercial banks have been active in such initiatives, in both developed and emerging economies, but very much as part of their charitable or corporate social responsibility (CSR) activities.

IFC, perhaps the first time, carried out a study on the subject i.e. Why Banks in Emerging Markets Are Increasingly Providing Non-Financial Services to Small and Medium Enterprises. The study provides several key insights. First, banks are clearly using non-financial services to differentiate themselves. Second, they go beyond simple website-based outreach tools, they take it seriously and offer sophisticated services such as training and consultancy. Third, they are beginning to manage the benefits for themselves beyond the marketing impact, aiming at non-financial services that improve their clients' ability to repay loans or to grow their businesses.

Non-Financial Services (NFS): Means and Types

NFS come in many different forms with FIs developing an increasing range of such services for their business customers, often building on the increased delivery options and extended reach offered by new and mobile technology platforms.

A recent report found that women business owners rated their banks as much by the NFS services offered, especially opportunities to access knowledge and networks, as the financial products on offer. These NFS were seen as an important element of retaining business owners as customers. Some non-financial services are:

1. Training
2. Information
3. Advice and Consultancy
4. Linkage and Networking
5. Study and experience sharing visits
6. Business Diversification
7. Startup & New Business Creation
8. SME Toolkits
9. Website, E-marketing, Online business facilitation
10. Mentoring
11. SME hotline
12. Marketing
13. Facilitation (local and international)
14. Trade fair and exhibition
15. Advertisement and sales promotion
16. Regular meeting and conference
17. Award & recognition
18. Business plan and project profile
19. Management services
20. Bankable project
21. Financial literacy
22. Research & Development
 - Survey and study
 - Training need assessment
 - Market research
 - Innovation & product development
23. Business Incubation Centres
24. Training Academy/SME Academy
25. SME Clients Club

Financing is really the major operational and growth constraint for SMEs?

Questions have been raised whether financing is really the major operational and growth constraint for SMEs or whether other market frictions would actually make additional external financing ineffective. Some contributors have pointed out that not all SMEs are able to grow and that they would not necessarily get external financing even in a world without market frictions.

An interesting question that came up is whether "access to finance" is the most important obstacle SMEs face. After all, SMEs report many obstacles to their growth, such as regulations and taxes, corruption, infrastructure, anti-competitive policies, political instability, legal inefficiencies, inefficiencies, lack of capabilities and managerial skills with other macroeconomic factors and so on, in addition to financial obstacles. So how important is access to finance with respect to these other barriers? It is quite difficult to disentangle the impact of these different obstacles because they tend to be correlated.

Its true funding is very important for survival of SMEs. But more important is the issue of the inner desire and capability to operate the business in sustainable and growing mode. Access to funds without these corresponding issues leads to shallow thinking.

Case Study: Saminaka Local Council, Nigeria

Six farmers were selected for funding to support improved crop yields. They were given about \$3,500 dollars each. Only two were able to pay back. Remaining complained of other business variables as the basis for their failure like demand, storage and managerial skills. So it is apparent that financing alone is not the only mean to develop SMEs and more clearly sustainable SME banking.

Non-Financial Services: Demand & Supply Side Perspective

Bankers regard SMEs as high risk propositions, partly because they often cannot get the information they need from entrepreneurs to see what is going on in the business and why finance is needed. On the other side of the coin entrepreneurs get frustrated with their bankers because they feel that these bankers don't really understand what 'doing business' is all about. As business owners they are not able to articulate their dreams and what they need to achieve these dreams, in a language and form that is acceptable to the banks policies and procedures—so uneasy conversations and relationships ensure and mutually beneficial opportunities are missed.

On the demand side, growth oriented entrepreneurs are keen on NFS. A 2013 report on SME development in South Africa noted a strong unmet demand for NFS amongst SME owners and some recent FSD Kenya research with growth SMEs in Kenya found that several of entrepreneurs would benefit from receiving such help to plan and structure further business growth more effectively. Entrepreneurs want to network with the peers to help them find new business opportunities, know how to get the best deals for financing their business growth and how to manage the more complex mix of resources and activities that accompany growth.

One way of improving these relationships and unlocking these opportunities is through the use of targeted NFS. The provision of NFS to business clients is not new for the banking sector. However, poor communication between entrepreneurs and their bankers is often a stumbling block in the delivery of effective financing for enterprise growth throughout the world. The use of non-financial services (NFS) can help with this.

Non-Financial Services (NFS) to SMEs: Global Experiences

IFC, in 2010, commissioned a new market study on the practices of non-financial services, rationale, and patterns of 21 banks providing non-financial services to SMEs in developing countries. The study termed “*Why Banks in Emerging Markets Are Increasingly Providing Non-financial Services to SMEs*”. Later, in another study by Beck et al. surveyed 91 banks in 45 developed and developing countries and found that the majority of banks view the SME sector as a sizable market with good business prospects. All the findings suggest that banks are willing to make significant investments in developing SME business units and creating sophisticated products and services to meet the banking needs and preferences of SMEs.

Study Findings

1. First, 94% of banks indicated that their main objective in providing non-financial services to SMEs is to differentiate themselves from the competition. Other bank objectives include improving client retention (69%), portfolio growth (50%), and customer service (44%). In addition, several banks reported that they seek to encourage client sustainability and reduce the level of delinquency.
2. Second, banks supply a variety of non-financial service offerings. According to the results, 90% of the 21 banks provide direct support to their SME clientele through their account managers. Additionally, banks reported offering the other types of services like information dissemination (81%), training (76%), and consulting (19%).
3. A majority of the banks do not use their internal training centers for delivery of training services. Instead, they partner with a variety of service providers, both

international and domestic. According to the results, 79% of the 21 banks reported that they can identify sufficient service providers for current needs. Examples of partner service providers are training institutions, consulting firms, government training institutions, or nongovernmental organizations (NGOs).

4. The majority of the banks interviewed indicated that the major increase in their non-financial service activity came about in the past one to five years.

India

The main objective of **ICICI Bank, India** is to support SMEs to create a positive perception of the bank and establish an image of the bank as SMEs' main partner for growth. ICICI is the second-largest bank of India and largest SME bank in the world that have created SME Group five years ago as bank management recognized the SMEs' needs are different than the needs and preferences of their corporate clients. The bank tries to ensure that its offerings are responsive to SMEs' business challenges and meet their changing needs. Senior Managers often conduct customer meetings and focus groups with SME clients to discuss their requirements, and bank relationship managers try to monitor the relevancy of their products and services through their relationships with SMEs.

Colombia

The Banco BCSC in Colombia seeks to differentiate itself from its competitors and establish its reputation as an innovative financial institution that supports microbusinesses and SMEs. The majority of banks in Colombia offer financing under similar terms and interest rates, and many banks provide financial products to micro and SME businesses. Therefore, targeted non-financial service offerings for this client segment are something that clients cannot find at other banks in Colombia.

Macedonia

ProCredit Bank in Macedonia was established in 2003 specifically to provide financing to microbusinesses and SMEs. Most of its non-financial services are offered through its Business Center, which provides training on improved business practices through workshops and forums and hosts business-to-business (B2B) meetings in regional markets. Bank officials reported that ProCredit Bank's objective for both its financial and non-financial SME services is to gain competitive advantage over its bank competition. They also reported that a positive result of this approach is that it appears to decrease the level of loan delinquency. ProCredit's loan delinquency rate is 2%, as compared to the Macedonian market level of 10%.

Congo

Bank officials from **Advans Bank in the Congo** shared that the majority of applicants for microbusiness and SME financing do not understand the requirements of a financial organization. Many do not have a basic understanding of bookkeeping, marketing, or other important facets of business operations. Currently, only 37% of applicants for financing are approved. It can be speculated that training and mentoring services, among other types of non-financial bank services, help strengthen SME owners' business management and financial skills. They learn important business practices such as conducting cash-flow analysis, preparing financial statements, building information systems, and developing long-term business plans to grow their business. As SME owners and managers apply their new business skills and knowledge to their enterprises, their business operations should improve and generate more profit. This, in turn, should improve their ability to repay their bank loans, thereby mitigating SME credit risk.

Malawi

Officials from **NBS Bank in Malawi** reported that most of their SME clients who were trained in loan management proved to be loyal clients with good repayment records.

Kenya

In Kenya NFS provision for SMEs by the banks is not widespread but definitely emerging. KCB (a bank in Kenya) has partnered with a local TV station to host the 'Lions Den' competition which is Kenya's equivalent of the globally successful Dragon's Den and Sharks Tank investment pitching programs. This program aimed at both new and existing business provides an opportunity for Kenyan entrepreneurs looking for investment and mentorship to showcase their potential for growth. Barclays Kenya, KCB, and Family Bank promote business clubs for their SME clients whilst I&M Bank has introduced an 'online business club' for all its business account customers.

Success & Model Story of Turk Ekonomi Bankasi (TEB), Turkey

Turk Ekonomi Bankasi (TEB) have been providing comprehensive non-financial services to SMEs in Turkey. This approach could be considered as the success story for both, bankers and clients.

Despite being a latecomer to the Turkish SME banking sector, Türk Ekonomi Bankası (TEB) is now a market leader among Turkish banks in experimenting with new approaches to help small and medium enterprises (SMEs) improve their business practices and achieve growth.

When launching SME banking in 2005, TEB set out the goal of becoming one of the top names that would first come to the SME's minds as for SME bank in Turkey.

Since then TEB Bank has launched a lot of initiatives in non-financial services for SMEs, such as SME Academy, SME consultants, SME Hotline, TEB SME Club and TEB SME TV. All these services are targeted both for existing customers (as retaining tool) and prospects (as hook product).

TEB believed that providing capacity-building support to small and medium companies could have enormous potential in building a client base of healthy businesses, gaining new SME clients, increasing customer loyalty, and decreasing credit risk in the SME sector. With visionary leadership and steadfast commitment from TEB's CEO, board, and senior management, the bank has developed and implemented training, consulting, and information-sharing services for the past six years.

The results are impressive. The number of the bank's SME clients increased from under 20,000 in 2005 to just over 700,000 in 2011;1 its SME loans as a share of total loans grew from 25% in 2006 to 44% by 2011; and loan delinquency rates in its SME portfolio decreased. Driven by the success in Turkey, BNP Paribas (one of TEB's larger shareholders) replicated some of TEB's non-financial services in Algeria and is looking to further replicate this model in select European markets. This case study reveals how TEB's leadership made the decision to enter the SME market with a different banking approach centered on the provision of non-financial services. It also describes key aspects of this approach and how it has generated strong bottom-line results for the bank.

A SME Client's Snapshot on Non-Financial Services by TEB, Turdy

One of TEB's SME clients, Mr. Ibrahim Afyon of Afyon Etas Poultry Company, was facing such challenges. Since childhood, Mr. Afyon helped his father with the family egg business and learned everything about egg production. When he inherited the egg production company in 1990, he helped grow the company and increase the number of chickens from 5,000 to 150,000, exponentially increasing the business's production capacity.

For many years, Mr. Afyon wanted to move his company to international sales, but lacked the business know-how and confidence. In 2009, he decided his company needed to export in order to survive financially. At the time, the Turkish domestic market was shrinking because of the global economic crisis, and his business sales were also shrinking. He turned to TEB SME Consultants to help him expand to international markets.

One of TEB's SME consultants visited Mr. Afyon's firm and conducted a diagnosis of the firm's foreign sales capacity, which included detailed international market research for the capitalization of its production in foreign markets. TEB's diagnosis suggested that the firm should begin exporting at a small scale to see if it could compete internationally. As a result, Afyon Etas Poultry sent its first container of eggs to Iraq as a trial. After initial success, Mr. Afyon began exporting on a larger scale and sold 20 containers of eggs. The company's annual export value is now approximately US\$2 million, and the profit on the trade is 43 percent. Currently, 20 percent of the company's production is for local markets and 80 percent is for export.

Looking to the future, Mr. Afyon wants to begin exporting regionally to new markets such as Azerbaijan and to become a larger integrated company. Feeling loyalty and trust toward TEB, he says he plans to continue working with TEB SME Consultants for advice as he expands his export production, and he will continue to use TEB financial products for all of his financing needs.

TEB has developed a highly successful and innovative range of non-financial services geared toward the SME market. One of the most compelling aspects of TEB's approach is how it has been able to successfully integrate the delivery of financial and non-financial services to SMEs. TEB's demand-driven approach to non-financial services has helped to differentiate the bank from its competitors and advance its position in a highly competitive market. By offering innovative and high-quality business development services TEB has significantly expanded its client base.

Looking ahead, TEB plans to continue to innovate by developing new non-financial service offerings and expanding the reach of existing ones. For example, TEB is considering designing business support services and counseling for start-up enterprises. According to the Turkish Ministry of Industry and Trade, 80% of newly established firms in Turkey close within five years. TEB wants to help start-up businesses be more successful and increase their chances of survival. As another example, TEB management also wants to build a set of non-financial services tailored to the needs of agribusinesses and farmers.

Tunisia Experience

In recent years, the Banque de Financement des Petites et Moyennes Entreprises (BFPME), Tunisia's state-backed small and medium-sized enterprise (SME) bank, has sought to design new products and services to better support the growth of its SME clients. Aside from providing loans, BFPME is seeking to support SMEs throughout their lifecycle by providing non-financial services, such as training. It requested Financial Services Volunteer Corp (FSVC) assistance in identifying suitable non-financial services for SMEs in Tunisia.

FSVC provided three volunteer experts with significant experience in SME products and services. Over the course of five days, the FSVC volunteer experts conducted in-depth consultations in Tunis to help BFPME identify critical non-financial services they can provide to SMEs, in line with international best practices at banks in developed countries. These include business coaching and mentoring; consulting/advisory services; and assistance in accounting and financial planning. The volunteer experts also met with SME clients of BFPME to better understand their needs, and with the Tunisian Ministry of Industry to discuss the current support provided to SMEs in Tunisia.

As a result of these consultations, the FSVC volunteer experts developed a concrete and detailed action plan and timeline that BFPME can follow to provide a full range of services to SMEs. The volunteer experts evaluated the bank's current services to clients, and then provided suggestions on how to incorporate non-financial services to the current product mix. These new services will not only help to strengthen the bank's value proposition, but will ultimately help SMEs in accessing vital non-financial services.

In addition to the non-financial services suggested, FSVC volunteer experts provided recommendations that could help expedite banking services for SMEs at BFPME. These included reforms to the pre-loan approval process, post-loan approval monitoring, and financing process support.

Role of Donor and Development Agencies

(Donor agencies general term such services as BDS or Business Development Services)

European Union: The overarching goal of EU support to Business Development Services (BDS) in developing countries is to help create a better business environment and investment climate in the countries in question, strengthen their micro, small and medium-sized enterprises (MSMEs) and support an eco-system favourable to Private Sector Engagement in pursuit of positive development outcomes.

Support to BDS in partner countries aims to help MSMEs in these countries to develop their business, innovate and increase their market access, with the ultimate aim of increasing productivity, revenue and profitability, with trickle down benefits for local communities in terms of job creation and improved living standards. By supporting BDS/NFS in partner countries, the EU promotes these countries' own capacity to provide services to their private sector sustainably, for the long-term.

When providing this support, the EC aims to achieve a balance between demand-side and supply-side interventions and instruments, based on a BDS market assessment to identify constraints and opportunities. Examples of demand-side interventions include raising MSME awareness about the potential benefits of BDS, while supply-side interventions include capacity building and institutional strengthening for BDS providers.

Significant Role of Bangladesh Bank

Bangladesh Bank as the regulatory bank could play significant catering and promoting role in encouraging as well as ensuring banks and FIs to launch and practice non-financial services for their clients particularly the MSMEs. Bangladesh Bank may

have clear-cut policy directions with incentives in different forms which might encourage the banks in taking such initiatives.

Meanwhile, Bangladesh Bank took some effective means and measures for leading banks and FIs in providing non-financial service to their clients. Bangladesh Bank, in their 'SME Loan Policy' clearly instructed the banks for providing training and other capacity building supports through different business development service providers. Banks and FIs have been providing dedicated supports through setting up dedicated 'SME Help Desk' and 'Women Desk' and recently they have started providing capacity building supports (training) to their existing and potential women entrepreneurs. Bangladesh Bank also instructed the Banks and FIs for establishing separate 'Women Entrepreneurs Development Unit' in their Head Office and Regional Offices.

Bangladesh Bank took another effective measure to promote women entrepreneurs through their SMESDP Circular No. 2 of 2015. Under the circular, Banks and NBFIs have been directed to provide loans (by each bank branch) to at least three new women entrepreneurs along with necessary capacity building supports for them.

Still, Bangladesh Bank has much to do for the MSME entrepreneurs as banks are yet not interested for funding to new and startup entrepreneurs, male, regional and tribal entrepreneurs are yet to get the adequate financial and non-financial supports from the Banks and so on. So, Bangladesh Bank could take some more catering and promoting measures for MSMEs and in this connection, they may tag CSR funds of the banks in utilizing for different non-financial services.

SME Foundation could play the Facilitating and Intermediary Role

SME Foundation, a government owned SME promoting, catering and supporting agency in Bangladesh have been playing important role in providing different non-financial services for MSMEs. In fact, the nature and types of activities of the Foundation leading them to design and implement the program for preparing the demand side, i.e. the entrepreneurs. But still they may take some tailor-made programs that would directly be linked with the demand of banks (the supply side) like loan facilitation, loan match making, loan readiness, bankable project proposal, financial literacy etc.

SME Foundation, supplementing the Bangladesh Bank directives and bankers demand, could however develop a 'combining MSME supports model' in partnership with the banks and NBFIs to provide different non-financial services to existing and potential SME clients of the banks. This will, in one side, ensure the bankers in getting ready and eligible clients and in another side, avoiding their further cost in searching the clients and also providing supports with arranging set up.

SME Foundation may also offer regular and continuous training and capacity building supports to the existing and potential clients of banks and NBFIs. This could be a win-win deal for both, SMEF and the banks and NBFIs.

Non-Financial Services: Win-win Position for Bankers

The core business of banks is to provide financial services and products to clients. It is told that banks face difficulty in profitably serving SME clients because of information asymmetry problems, high transaction costs and high credit risk among other reasons. Through providing non-financial services, banks could obtain detailed information about the SMEs' business, financial situation, and banking needs, replacing to some degree the hard information gained through credit reports or audited financial statements. Therefore, the information asymmetry and other related problems are mitigated as banks gain more accurate information on SME loan applicants.

NFS are an increasingly prevalent aspect of the banking offer to SMEs throughout the world. It is an aspect of support to SMEs that continues to evolve, enabled not in the least, by the use of new technology and social media which make such services accessible to many. However just as with all new products and services, FIs need to give due consideration to the factors and issues discussed in this Note, if they are to deliver NFS successfully for both their bottom line and those of their SME clients.

What is apparent from international experience to date is that the effective provision of such services, both for the bank and its SME clients, depends upon the bank considering a number of factors. If you are working within or acting as a consultant to a FI that is seeking to introduce or extend their NFS offer, then there are 6 key factors to consider and steps to take in your discussions about this.

Concluding Remarks

There should be an enabling environment and sustainable model for providing non-financial services to banking clients. It should neither be imposed to the banks nor be accommodated the entrepreneurs as a free opportunity. It should not however be considered simply as a CSR activity. This is very much crucial and important for the entrepreneurship development and also for sustainable financing particularly for MSMEs. We strongly believe, a joint public-private partnership with holistic approach and efforts would definitely lead us in achieving different Government targets including the MSME development.

References:

1. IFC Publication, titled 'Why Banks in emergency market are Increasing Providing Non-Financial Services
2. Growth cap, a project technical paper

[Seminar arranged by the SME Foundation on 20 March 2017; Monday at 3.30 pm]

Venue: Media Bazar, BICC, Agargaon, Dhaka