Small Business
Financial Services

Best Practices Benchmark

Small Business Banking Network

A CAPITALPLUS EXCHANGE INITIATIVE

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For SBBN membership information or to contact us, please visit our website at www.sbbnetwork.org.

ABOUT SMALL BUSINESS BANKING NETWORK

Small Business Banking Network (SBBN), launched by CapitalPlus Exchange in 2010, is a global industry-building initiative and community platform across emerging economies that strengthens financial institutions as they significantly scale their services to small businesses. SBBN works to accelerate the success of financial institutions (FIs) that target underserved entrepreneurs by providing high quality operational and strategic services, peer learning opportunities and access to best practices and industry initiatives. This powerful combination of reinforcing services dramatically increases the scale, profitability and development impact of the client FIs that we serve.

SBBN currently has over 45 members (both banks and non-bank finance companies), as part of its network. Network members receive access to the following services—all directed to strengthen their SME operations:

- An assessment using our best-in-class diagnostics tool which includes a scoring on each of the 30+ drivers of successful SME operations
- An efficiency and productivity benchmark of SME lending operations
- SME strategic and operational consulting services
- Peer learning, CEO roundtables, practical trainings and forums
- Best practices, tools and data

ABOUT THE SMALL BUSINESS FINANCIAL SERVICES BEST PRACTICES BENCHMARK

SBBN conducted the benchmark survey in the summer and autumn of 2011. It is designed to provide valuable information on productivity and the strategies that leading financial institutions use to achieve superior performance in financing small businesses, with a specific focus on lending. The results of the survey have been used to compile granular detail on drivers of small business finance success and profitability. The report shows how successful institutions achieve high productivity and lower costs while maintaining or improving revenue, credit quality and service quality. Any unintentional errors or omissions made are our own.

We are extremely grateful for the contributions from the financial institutions that participated. Along with a copy of this report, they will receive a detailed supplemental analysis comparing their productivity levels and strategies to those of the other organizations surveyed. We would also like to thank European Investment Bank (EIB), Netherlands Development Finance Company (FMO) and OeEB, the Development Bank of Austria, for their generous support. Without this support, this benchmark would not be possible.

Any financial institution that intends to succeed in the long run needs to understand methods for increasing productivity and how to maintain a streamlined cost structure. We hope you find the information in this report useful in achieving your goals and we welcome your comments.

Yours sincerely,

Lynn Pikholz
President and CEO

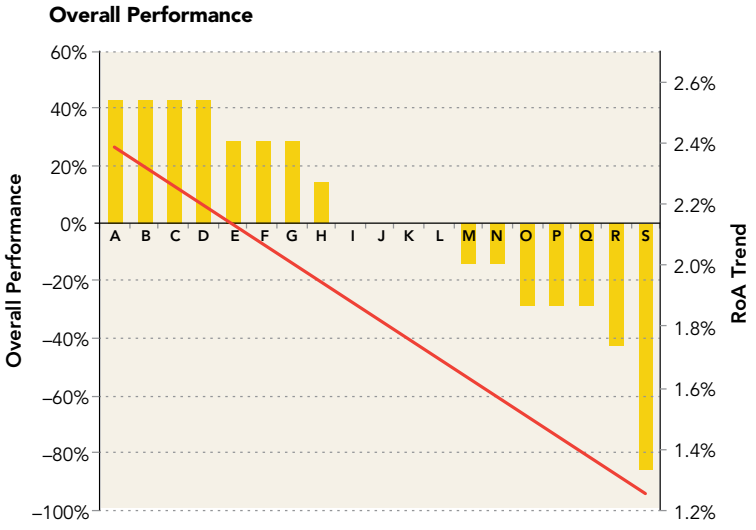
EXECUTIVE SUMMARY

The SBBN Small Business Financial Services Best Practices Benchmark uses newly gathered data for 20 financial institutions from nine countries to focus on processes and strategies successful in boosting productivity, lowering costs and responding to the factors, which characterize the small business finance sector. Institutions' perceptions of the small business sector are assessed, including the regulatory factors driving and impeding small business financing.

OVERALL PERFORMANCE STATISTICS

Financial institutions (FIs) with a higher proportion of SME lending in their portfolio also reflect a higher Return on Assets (RoA). Five of the highest performing institutions, based on their RoA (median 2.14%), had SME assets comprise 36% of their total portfolio, on average. They also reported an average Return on Equity (RoE) of 18.3%.

Across all the individual measures of performance for successful SME finance, as described later in this study, seven of the FIs surveyed achieved high performer status 40% or more of the time and five of the FIs achieved low performer status 40% or more of the time. The seven also reflected a higher median RoA than the five. Similarly, when looking at overall performance, which takes into account the incidence of high and low performance across all measures separately, RoA is lower for low performers, as seen in the trend line on the graph below. Further explanation of performer status and rankings can be found in the following 'Introduction and Methodology' section.



The SBBN team found that instituting strategies of high performing institutions could drive productivity in every area covered in the survey. High-level summary findings from these sections reveal:

HIGH PERFORMING FINANCIAL INSTITUTIONS:

- Have a higher RoA when they have a higher proportion of SME lending in their portfolio;
- Are more than 20 times as productive than low performers in SME account origination (13.9 vs. 0.6 loan applications per month for average account officer);
- Significantly outperform low performers in loan preparation and disbursement rates;
- Have 6% fewer past due loans; and
- Experience 3% less loan losses.

THIS HEIGHTENED PRODUCTIVITY OF HIGH PERFORMERS OCCURS BECAUSE THESE FIS:

- Follow standardized processes, forms and documentation for account origination, underwriting, loan approval, loan documentation, booking and funding;
- Use dedicated SME staff and SME specific methodologies for loan origination, underwriting, recovery and monitoring, but not for loan booking and funding;
- Focus more than twice as much on cross-selling opportunities through servicing of other products;
- Focus on providing customized in-house training except for loan collection and recovery, where experience is a key driver; and
- Use more centralization of process and management.

HIGH PERFORMERS NOTED THAT FOR THE FUTURE, THEY WILL SEEK:

- Increased reliance on technology and automation such as credit-scoring.

INTRODUCTION AND METHODOLOGY

The financing of small enterprises, often included with their much larger medium-sized counterparts in the SME literature, is of great interest to both policymakers and researchers primarily due to the significance of global SME growth. In line with our commitment to small business finance, we embarked on a process to understand better what distinguishes high performers, with the expressed objective of bringing these findings to the banking community. It is our hope that this knowledge of how institutions are financing small businesses around the world, and the nature of processes adapted by them from origination to remedial management will in turn be a factor in developing this important banking sector.

CONTEXT SETTING

As problem loans from the 2008 crisis persist on the books of many banks and the unrelenting Eurozone pressures continue to compound global financial and economic recovery, new challenges from non-bank financial competitors and the expanding number of SMEs, particularly in developing economies, introduce numerous and complex challenges to maintain and grow margins and market share in SME finance. To compete and excel, SME funders must understand the nuances and special characteristics of their market, be able to deliver products within compressed timeframes, and do so at lower costs.

Data collected by Ayyagari, Beck, and Demirgüç-Kunt (2007) for 76 developed and developing countries indicate that, on average, small businesses account for close to 60% of manufacturing employment. More importantly, a number of studies using firm-level survey data have shown that small businesses not only perceive access to finance and the cost of credit to be greater obstacles than large firms, but these factors constrain small businesses (i.e. affect their performance) more than large firms (Schiffer and Weder, 2001; IADB, 2004; Beck, Demirgüç-Kunt, and Maksimovic, 2005; and Beck, Demirgüç-Kunt, Laeven, and Maksimovic, 2006). While these studies have advanced our understanding of the demand side of small business lending, little research exists on the supply side of institution financing to small businesses across countries. The 2009 International Finance Corporation (IFC) SME Banking Benchmarking Survey of 12 banks reported as follows: "Pressured by increasing competition, due to globalization and disintermediation, banks have started successfully implementing profitable SME operations in a number of developing countries. However, much remains to be achieved."

These pervasive and persistent challenges intensify the need to better understand the factors that lead to improved productivity, lower costs and effective risk management. The Small Business Financial Services Best Practices Benchmark provides reliable insight into how these essential objectives may be best achieved.

REPORT STRUCTURE

The report is broken into five sections corresponding to each of the core SME lending and portfolio management processes addressed in the survey. Each section starts with an outline of characteristics of high performers and lists key findings including the core environmental factors and categories of business processes associated with small business lending. Graphs, charts, and tables are included to facilitate understanding.

SURVEY PARTICIPANTS

SBBN developed a comprehensive, web-based questionnaire (the survey instrument) and invitations were sent to over 40 financial institutions in nine countries, which have SME banking services. These ranged from super-regional/multinational institutions to small, non-institution specialized lenders. We sought the participation of chief executive officers and the heads of the affected functional areas.

The following table shows how the larger and smaller survey respondents have been classified for this survey as well as the number of institutions by country, which completed the entire survey.

Of the 29 financial institutions that responded, nine were not included in the final analysis due to incompleteness of the responses. Many of the executives who

Survey Participants

Country	Large Institutions (Assets > US $1 Bn)	Small Institutions (Assets < US $1 Bn)	Total
India	7	2	9
Kenya	1	3	4
Bangladesh	1		1
Oman	1		1
Philippines		1	1
Belarus		1	1
Rwanda		1	1
Zambia		1	1
Sri Lanka		1	1
Total	10	10	20

did not respond cited a lack of productivity or a lack of SME specific and staffing data as their primary reason for not participating or only responding to specific questions. This, in itself, is telling as financial institution CEOs will track what they believe to be important. Unless the productivity and profitability benchmarks of high performing SME financial institutions are established, many FI CEOs will likely not prioritize collecting and analyzing their SME portfolio with the same rigor as their retail and corporate portfolios are tracked and managed.

METHODOLOGY

The survey instrument was divided into five sections, and the same methodology was used in each section:

1. Account Origination
2. Underwriting and Loan Approval
3. Loan Documentation, Booking and Funding
4. Loan Collections and Recovery
5. Loan Portfolio Monitoring

Key performance or productivity measures are used to evaluate performance in each section. Using tabulated data, respondents are ranked and divided into quartiles. There are two groups identified for each section: high performers for those that fall in the 1st quartile and low performers for those that fall in the 4th quartile. It follows, therefore, that a high performer in one section may not be a high performer in another section. Performance characteristics for high and low performers presented in the benchmark, thus, relate specifically to individual sections.

Of the 20 institutions included in the benchmark, 19 were ranked in one or more sections as either a high or

a low performer. Fifteen institutions were ranked as a high performer at least once, and 15 were ranked as a low performer at least once. Twelve institutions that were high performers in at least one measure also ranked as a low performer at least once, and 12 institutions that were low performers in at least one measure also ranked as a high performer at least once.

In terms of obstacles, the importance of competition in the segment is examined, as well as of macroeconomic, regulatory, contractual, small business specific, and institution specific factors. The SBBN team also studied the role of government programs and prudential regulations in driving and deterring small business finance. Other variables that we analyzed include: institution size, portfolio size, credit quality, and degree of centralization. These variables help identify possible sources of disparity in levels of productivity or performance. The quality of service and its relationship to productivity was also examined.

Survey respondents were asked to rank the three most important strategies they use now or plan to implement in the future (the next three years) to improve productivity. The degree of importance is always ranked on a scale of three, with a 1.0 rating conveying the greatest degree of importance.

Variances within the overall methodology and the specifics of the response group in each section are detailed. Productivity and performance measures are explained at the beginning of each section.

SECTION 1

ACCOUNT ORIGINATION

CHARACTERISTICS OF HIGH PERFORMERS

In account origination, high performing institutions:

- Boost productivity by following standardization of originating processes and forms
- Centralize the processes more at the head office
- Appoint dedicated relationship managers who get and stay close to their market
- Track key productivity measures
- Place strategic emphasis on training
- Look forward to increased reliance on technology and automation

NOTE FROM THE FIELD

Small business customers are increasingly sensitive to both quality of service and speed of response. These factors oftaen are more important than price to some customers, mimicking some of the now well-understood fundamentals of microfinance institutions' success.

KEY FINDINGS

SME specific regulations encourage lending

85% of respondents believed that the regulatory incentives encouraged small business lending originations while the remaining 15% believed that regulatory incentives neither encouraged nor discouraged SME financing. Similarly, 60% of the respondents believed that the regulatory environment enhanced competition among lenders given the stipulations and the incentives.

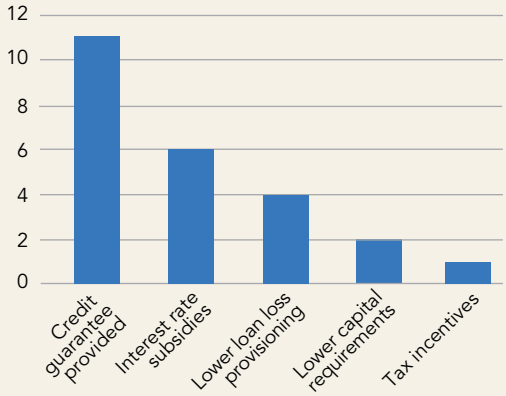
Regulation is both a driver and a challenge for SME banking

There are no clear or standard regulatory definitions or lending criteria for SMEs across the countries surveyed. Where they exist, different agencies have set varying definitions for SMEs. These act as guidelines and often include turnover as a qualifying criterion.

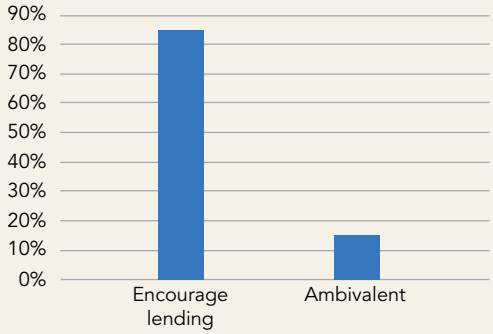
This categorization is flawed as it permits high turnover or high revenue enterprises to be classified as SME, allowing FIs to meet a regulatory requirement and take advantage of its incentives, while essentially engaging in typical commercial and corporate behavior.

Credit guarantees and interest rate subsidies account for over 70% of SME incentives from the regulator

SME Incentives from the Regulator



Effects of Regulatory Incentives on SME Lending



SME Criteria

Country	Regulatory SME Criteria
India	Investment in Plant & Machinery, No. of Employees & Turnover
Philippines	Level of Exposure
Belarus	No. of Employees
Bangladesh	By sector: No. of employees, Fixed Assets

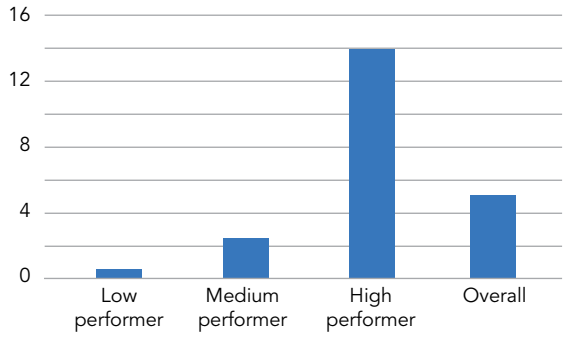
Given this lack of consistency, the number of FIs that truly want to focus on the 'S' of SME banks have responded by adopting their own definitions, which are driven primarily by loan size rather than the characteristics of the borrower. This bank self-categorization helps in targeting previously un- or under-banked market segments—the social and regulatory imperative.

High performers are significantly more productive

An average account officer generates 5.1 applications per month, with high performers averaging 13.9 applications per month. The highest performing institution operates in a niche market concentrated with SMEs and is staffed with over 1,000 loan officers, generating over 30 applications per account officer per month. The other high performers, on average, generate 10 applications per account officer per month.

The number of account applications generated by a bank is also a function of the SME population, access to finance, branch network, and sophistication of the banking sector. SBBN believes that the will, incentive structure of the FI and its capability to find good quality SME deals to finance is at the heart of an FI's success. The productivity of loan officers, for example, will mimic the commitment to SME finance origination from the CEO and senior management. Large Indian banks in our survey, for example, generate the largest number of applications per month due, in part, to the sheer market size of the opportunity, but they mostly fall in the medium to low performer category based on applications per employee.

Applications per Account Officer



Bank Size and Performance

Performance	Large Banks	Small Banks
Low Performer	4	1
Medium Performer	5	5
High Performer	1	4
Overall	10	10

Average Number of Staff and Experience

	Small	Large	High	Low
Average No. SME Account Officers	20	917	40	847
Average Years Experience SME Account Officers	6	10	8	8
Average No. SME Lender's Assistants	6	867	11	1188
Average Years Experience SME Lenders' Assistants	1	6	3	2

Size matters, with small banks originating 40% more loans than large banks

High SME finance performers are typically small banks or FIs, with only one large bank in the top quartile. A small bank SME account officer handles an average of seven new applications per month and large banks handle an average of five applications.

The larger banks generate over 2,000 applications on average per month and are supported by over 1,100 account officers. Small banks generate nearly 450 applications on average per month supported by 30+ account officers. High performers tend to decentralize their origination activities. While economies of scale are not as present as expected, survey results indicate that the smaller banks are more concentrated in SME lending than the larger banks, which may account for the difference.

Tenured staff not a key driver

High performers in account origination did not have staff with many more years on the job, indicating that tenure is not a differentiator for this area of the process. The average experience of SME account officers for both high and low performers was eight years, while that for assistants was three and two years, respectively.

Considering their client profile, large banks employ more senior account officers with average experience of around 10 years, compared to the smaller banks with six years. This is likely due to the higher sophistication of the medium-sized clients that these larger banks tend to serve.

Large banks (assets greater than US $1 billion) average over 900 SME dedicated account officers and almost the same number of lender assistants. On the other hand, given their limited operations, smaller banks average just 20 account officers dedicated to SME account origination. Most of these banks do not employ lender assistants given the small size of their operations.

High performers look to standardization, automation and cross-selling

We used the measure of percentage of time spent on various account origination activities in a typical work month and found that high performers originate significantly more accounts than the average lender and their loan officers spend more than twice the time on preparing underwriting documents (26%) than low performers (9%), and seven times less on booking and funding loans (2% for high performers, compared to 14% for low performers).

Low performers spend over 35% more time on direct SME sales activities, but less than half of the time a high performer does in cross-selling through servicing of other products.

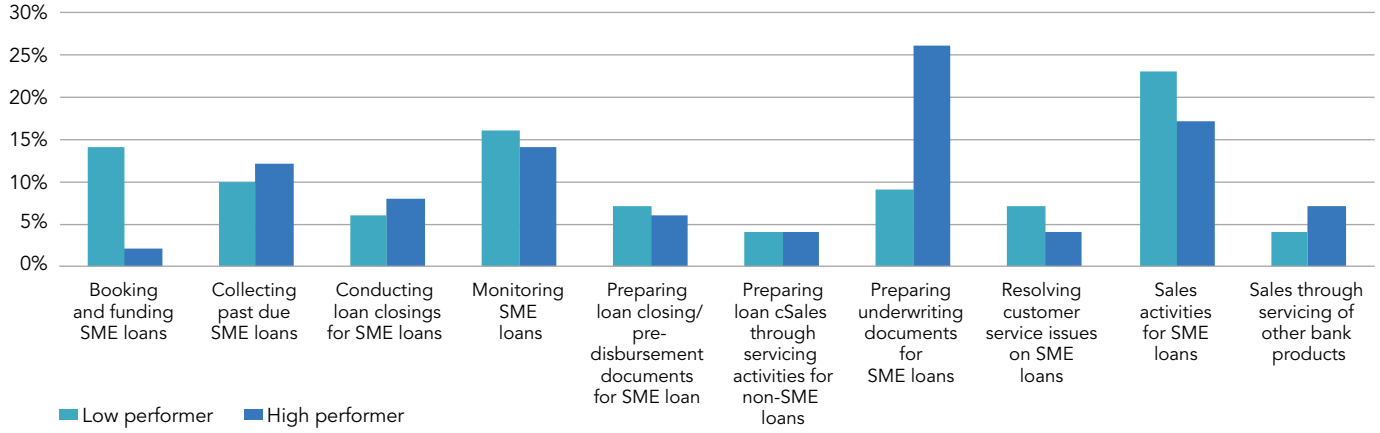
High performers spend only 4% of their time on resolving customer service issues, with low performers spending almost twice that time on service issues. This implies that low performers have to deal with proportionately more issues, likely a result of less standardization and focus.

Consistent with our experience, standardization, automation, and use of central support staff are more important drivers than total portfolio size is.

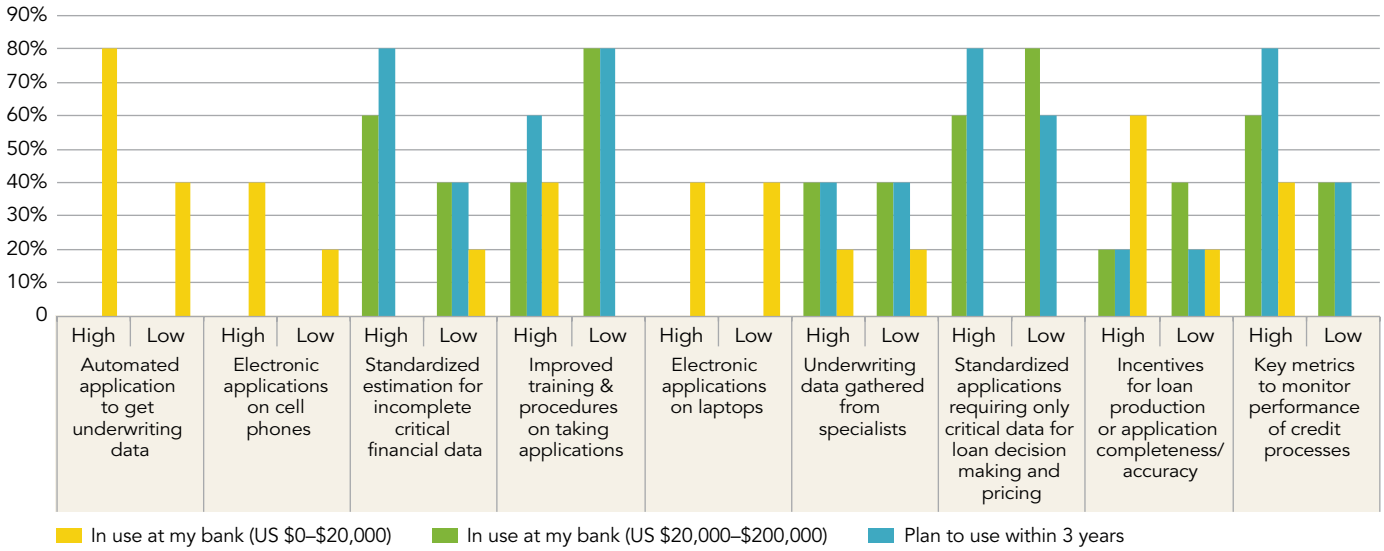
Standardization, training and use of performance metrics are strategic imperatives of high performers with the future based on automation

High and low performers focus on standard application forms that request only critical data for loan decision making and pricing. High performers also have applied a standardized methodology for estimating critical financial data in cases of incomplete financial records.

Average % of Work Month Hours Spent on Account Origination Activities



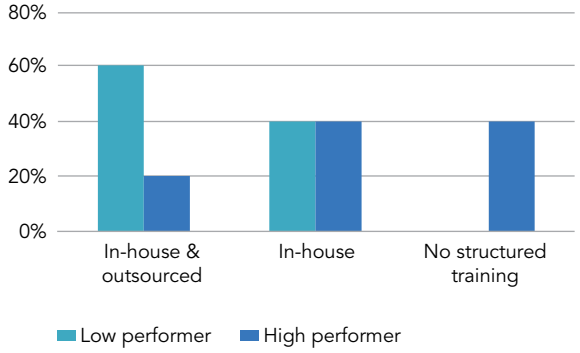
Implementation of Strategic Imperatives



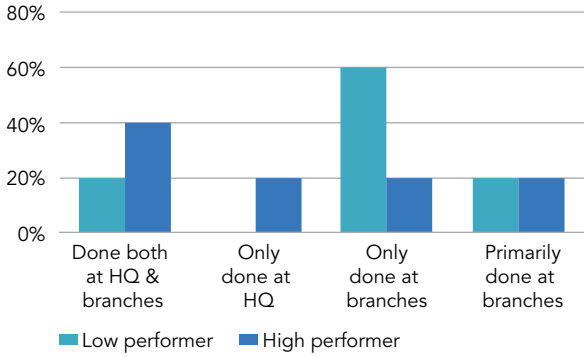
Other strategic imperatives of high performers impacting account origination are:

- Improved training procedures on application taking. However, almost 40% of high performers do not have a structured training program.
- Use of key metrics for monitoring the performance of credit processes.
- Expectations that automation will offer productivity improvements in the future. The use of automated officer workstations, automated workflow and documentation preparation contribute significantly to productivity improvements, eliminating manual and redundant processing of loan packages and expediting the paperwork process.
- A belief that in the future, incentive-based compensation supported by existing tracking of productivity measures will drive results. This indicates that significant opportunity exists within SME banking to improve productivity by linking officer compensation more directly with performance.

Training Program Structure



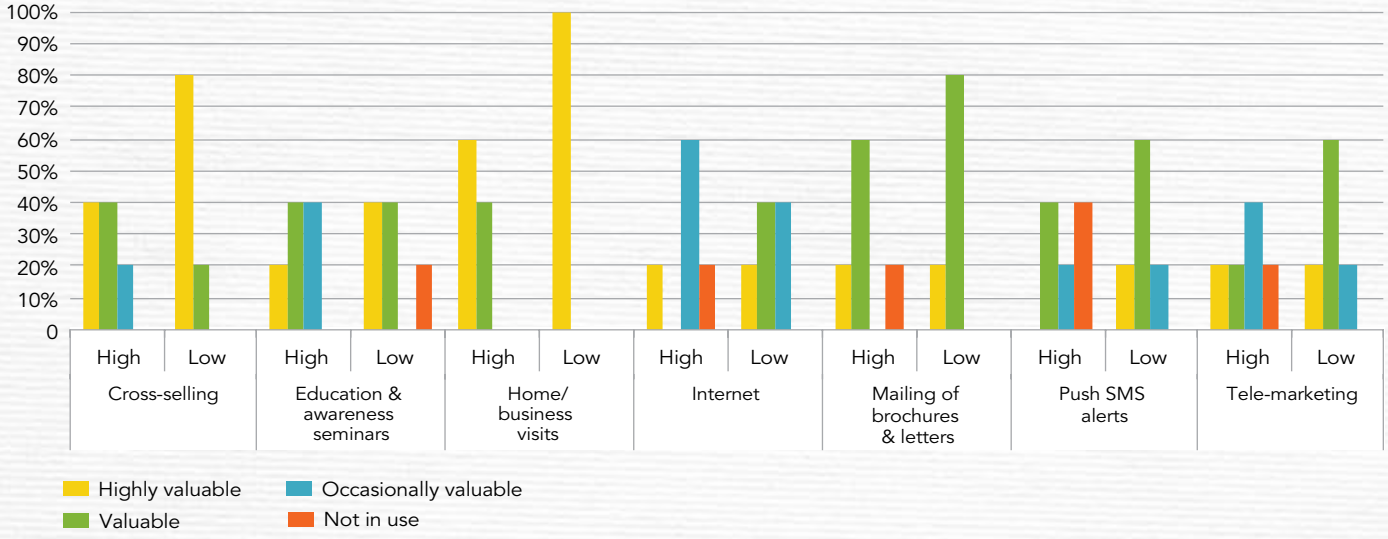
Location of Account Origination Activities



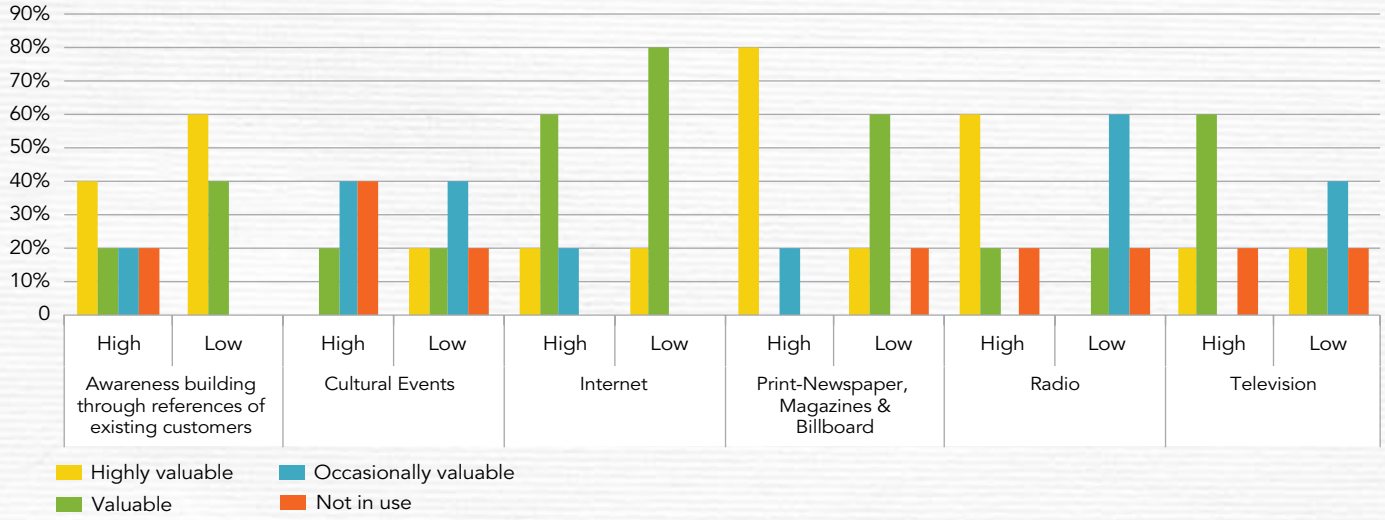
High performers are also looking beyond centralization and standardization

High performers centralize their account origination activities at the head office more than low performers. This implies that high performers have been more successful in consolidating into fewer locations and realized economies of scale from this strategy. High performers also stress the use of key metrics for monitoring the performance of credit processes as a top current strategy. This indicates low performers have not been as successful as high performers in consolidating operations, which leads to increased centralization and standardization of functions.

Value of Direct Marketing Strategies



Value of Indirect Marketing Strategies



Direct marketing strategies focus on home/business visits and cross-selling to existing customers

Focused marketing strategies such as personal visits and cross-selling to existing customers are considered more valuable compared to the mass marketing strategies and technologically advanced strategies like the Internet and SMS alerts. The strategies are also a reflection of the literacy levels among SMEs, which may be relatively low and hence the preference toward customer focused strategies.

High performers favor traditional media for indirect marketing

Indirect marketing strategies adopted by the high performers were mainly print media such as newspapers, magazines, and billboards as well as radio-based marketing. Overall, the traditional strategies of existing customer reference and using print media are found to be more effective than the other strategies.

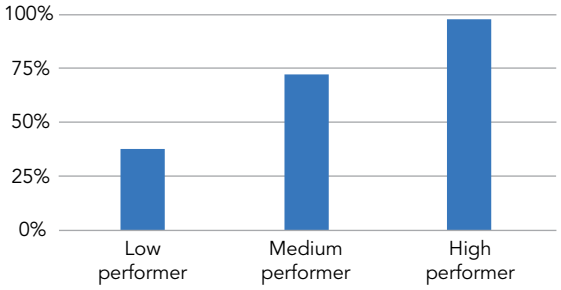
SECTION 2 UNDERWRITING AND LOAN APPROVAL

CHARACTERISTICS OF HIGH PERFORMERS

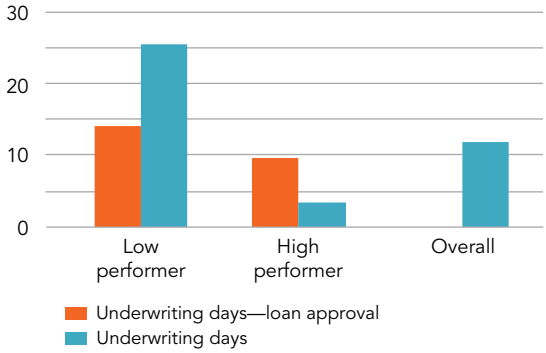
For underwriting and loan approval, high performing institutions:

- Boost productivity by following standardization of underwriting processes, market segmentation, and focusing on training
- Centralize the processes more at the head office
- Have robust and comprehensive credit evaluation processes
- Rely less on pre-screening and have slightly lower collateral requirements
- Leverage their staff better and allocate more time to underwriting
- Have borrowers less likely to have written records and rely more on verbal representation and cross-checks

Approval Rates for New Loans



Average Elapsed Days to Underwriting



NOTE FROM THE FIELD

'SME' is a very large 'catch-all' group of customers. SMEs' needs, characteristics, and risk profiles vary. A strong knowledge of SME segmentation and characteristics is essential to make informed underwriting decisions. The benefits of cross-selling and customer relationship management come with knowing your customer. Marketing in a customized way does not undermine the benefits of operational standardization.

KEY FINDINGS

High performers approve more than twice as many loans as low performers

The average high performer approval rate (percentage of loan applications approved) for new loans is almost 98%, compared to 38% for low performers (average for the survey is 70%). Four of the high performers had a 100% approval rate. For loan renewals, the average approval rate was 95%. High performers *do not pay any incentives* to their staff to drive the approval process.

High performers enjoy higher financial literacy in their regions, but not significantly so

Written literacy levels of small businesses vary across geographies, and there is no clear trend in the written literacy levels across respondents. However, high performers in the underwriting category do report higher financial literacy levels. This often means larger businesses are targeted (more the 'M' of SME), which in turn, often have higher levels of collateral.

Productivity in loan approval does not always reflect in underwriting efficiency

The elapsed days to underwriting measures the number of days from receipt of application to the credit decision. Only 40% of high performers in loan approval also are high performers in underwriting efficiency. High performers in loan approval spend 9.6 days to underwrite a new loan. On average, banks take 11.7 days for the entire process. The most efficient underwriters make the

credit decision, on average, in just 3.4 days. The average low performer takes 25 days to make a credit decision leading to increased delays in asset creation.

High performers in loan approval rely more on verbal representation than low performers

50% of the respondents accept or are willing to accept verbal representation (with crosschecks) of a borrower's financial position in lieu of written financial records. High performers are four times more likely to accept verbal representation than low performers, and they place higher reliability on the information. This is likely due to high performers assigning underwriters specifically to different market segments, allowing them to become specialized in their specific markets and applying effective crosschecks. Overall, verbal representation is accepted with a low to moderate level of reliability.

Institutions with a higher approval rate also have slightly lower overall collateral requirements

75% of high performers and 77% of low performers require over 80% loan-to-value collateral. 80% of these are small institutions. Low performers have higher collateral requirements than a medium performer, likely due to their inability to underwrite deals primarily based on cash-flow rather than collateral, rather than the lower credit quality of their borrowers. 44% of the respondents reported having an over 100% collateral requirement.

There is a clear trend among most FIs in asking for high levels of collateral before lending to SMEs. The highest performer, however, in loan productivity genera-

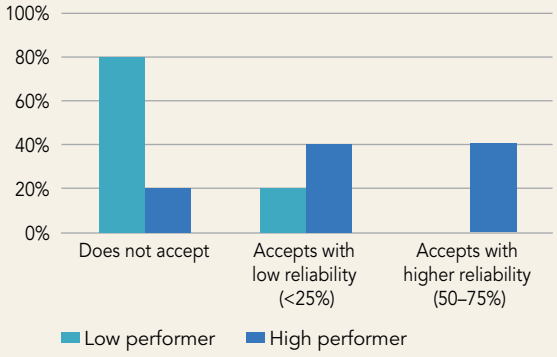
Large banks outperform small banks in loan approval rates

Performance	Large Banks	Small Banks
Low Performer	0	5
Medium Performer	6	4
High Performer	4	1
Overall	10	10

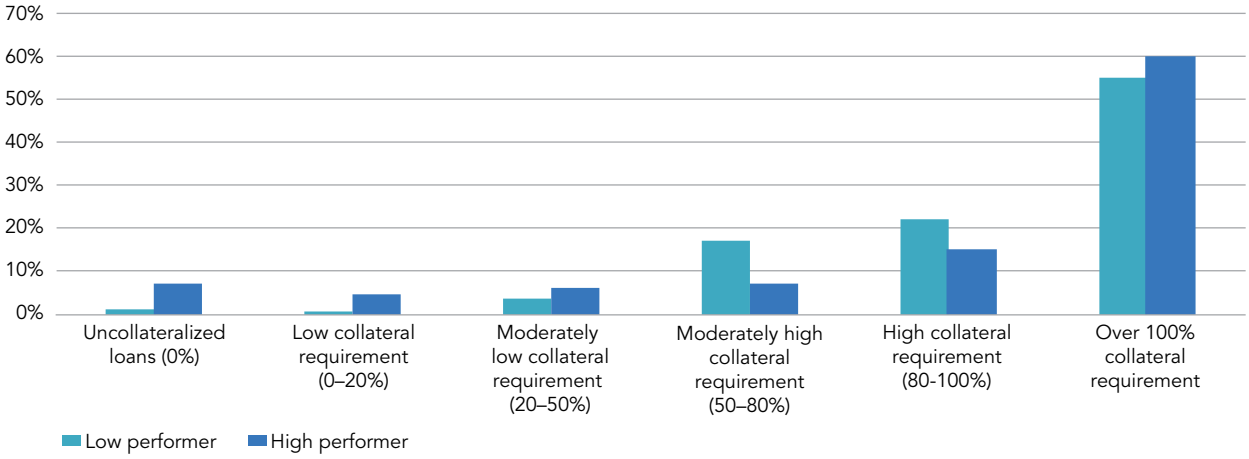
Small banks outperform large banks on underwriting

Performance	Large Banks	Small Banks
Low Performer	4	1
Medium Performer	3	6
High Performer	3	3
Overall	10	10

Acceptance of Verbal Representation



Collateral Requirements for SME Lending



tion does not! Over 80% of the respondents require more than 50% collateral. Again, this most likely points to the lack of willingness or expertise to underwrite based on cash flow when enterprises do not have 'ready financials' or the inability for a variety of reasons to use more of a credit scoring methodology. The SBBN team has learned over the past decade, however, that some of the fastest growing and most successful small business finance providers *have* figured out that the size of the market opportunity increases dramatically if one knows how to lend without requiring or relying on such high levels of collateral. It is this profitable opportunity that so many FIs that are bent on following a more traditional approach to small businesses are missing.

High performers in loan approval lend more to borrowers without, or with very few, written records

Not surprisingly, the availability of written financial records generally is low compared to other banking business. High performers, thus, also place emphasis on verbal representation with crosschecks and insist on high levels of collateral to compensate for their actual or perceived unknowns.

A distinct difference between high performers and low performers is the use of bank statements, where available, by high performers (i.e., it occurs 20% more often with high performer borrowers than low performer borrowers). Having bank account information is a key underwriting tool to learn more about the customer's risk profile. It also is likely to be a stricter requirement for high performers when lending than for low performers, providing more information on client activity.

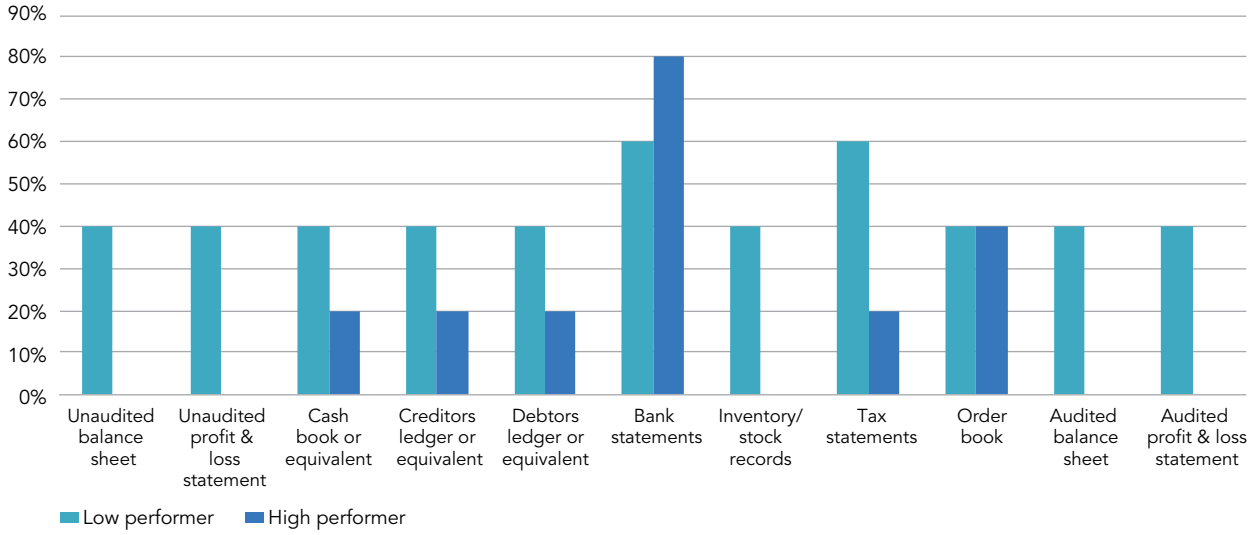
33% of respondents have borrowers who maintain a low level (< 50%) of written records.

Demographics, literacy, and availability of banking services prevalent in the markets served by SME lenders are clearly factors to which borrowers must respond effectively. The data revealed that high performers appear to adjust better to these factors.

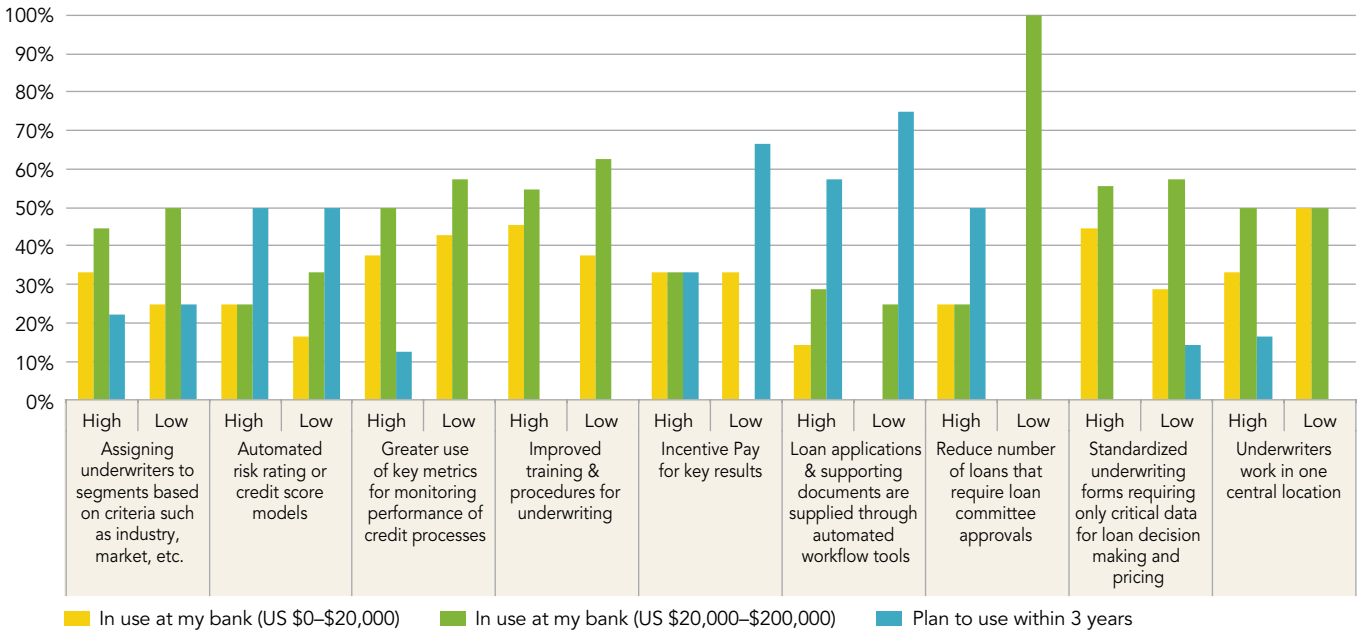
When underwriting loans, high performers have adopted strategies focusing on training, standardization and market segmentation, and look to automation in the future

Improved training and procedures for underwriting, including standard, brief, underwriting forms that focus only on critical data for loan decision making and pricing are key strategic initiatives of high performers. Having underwriters work in one central location was the third most important strategy selected. They also assign underwriters to segments based on criteria such as industry, loan size and market.

>75% Written Records Maintained by Borrowers



Implementation of Strategic Initiatives



Future underwriting strategies include automation of workflow tools and risk rating/scoring models.

Most of the institutions have not adopted any structured scoring model for evaluating small businesses, though few of them intend to adopt the same in the next three to five years.

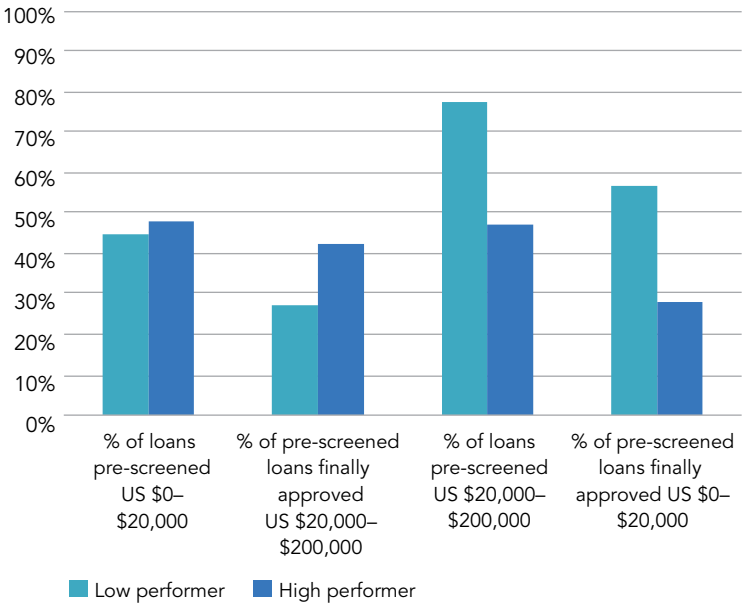
High performers in underwriting have robust and comprehensive credit evaluation processes

The high-performing banks in underwriting have confirmed credit evaluation based on quantitative and qualitative metrics relying on bank statements, unaudited balance sheets and profit and loss accounts, which are peculiar to the SME segment. This differs from the high performers in loan approval who rely predominantly on bank statements. The underwriting criteria adopted by the banks also signify the level of implementation of the underwriting strategies. This indicates that the level of collateralization is not the only driver of the approval rate in high performers, but also the credit quality of the borrower.

Almost half of both high and low performers pre-screen small loans, but high performers subsequently approve relatively more small loans than large loans

77% of low performers pre-screen larger loans, 30% more than high performers. Of these, low performers approve 57% and high performers 28%.

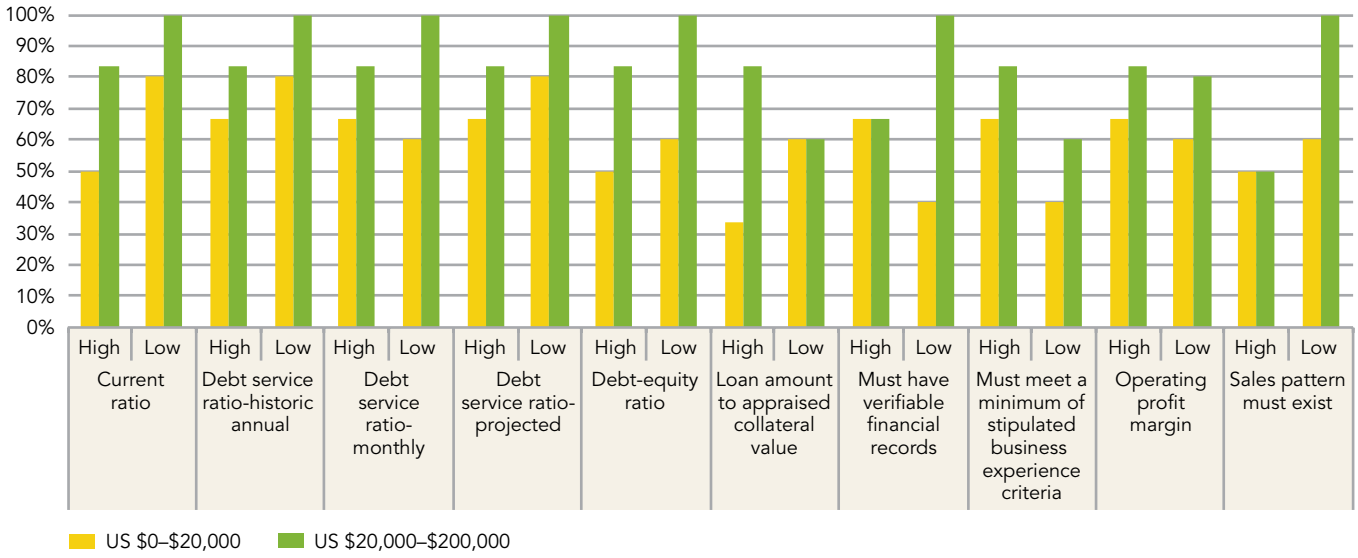
% of Loans Pre-Screened/Approval Rate of Pre-Screened Loans



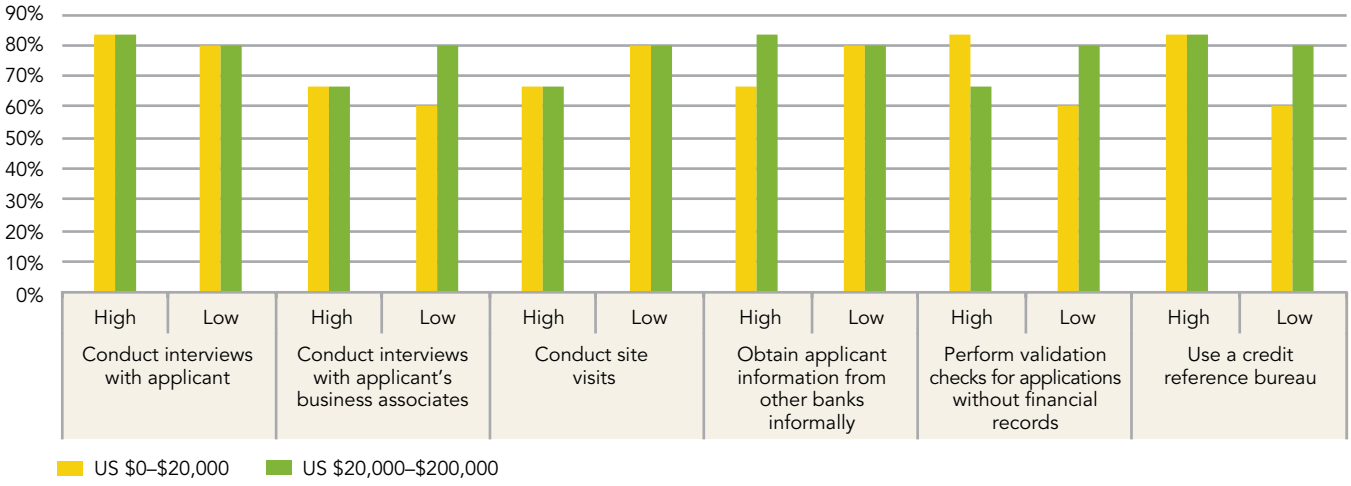
For small loans pre-screened, high performers approve 42% and low performers 27%.

The lack of consistency between low performer standards for small and large loans indicates high performers apply more standardized and consistent underwriting standards to the pre-screening process.

Application of Underwriting Criteria



Application of Underwriting Criteria—Qualitative



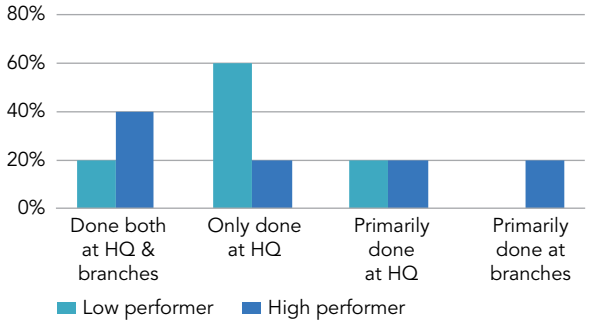
More low performers in underwriting efficiency responded that they apply more underwriting criteria than high performers

A consistent pattern emerges with more low performers claiming they apply more of the criteria listed than high performers. Exceptions are that high performers require borrowers to meet a minimum of business experience criteria and, marginally, a specific operating profit margin. The survey revealed high performers underwrite loans on average seven times faster than low performers do and rely more on verbal representation. These findings are, therefore, consistent with the pattern observed between high and low performers when applying underwriting criteria, with high performers relying on standardization, market segmentation, and collateralization to better manage their exposures.

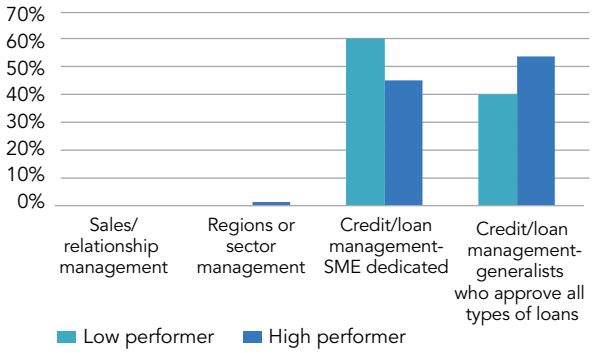
High levels of consistency exist between high and low performers in applying qualitative underwriting criteria

Exceptions are, for small loans under US $20,000, high performers are 23% more likely to perform validation checks for applications not supported by financial records. This trend reverses for loans over US $20,000, where high performers are 13% less likely to validate these applications. High performers also make more use of credit reference bureaus, which again points to a high level of sophistication in the marketplace.

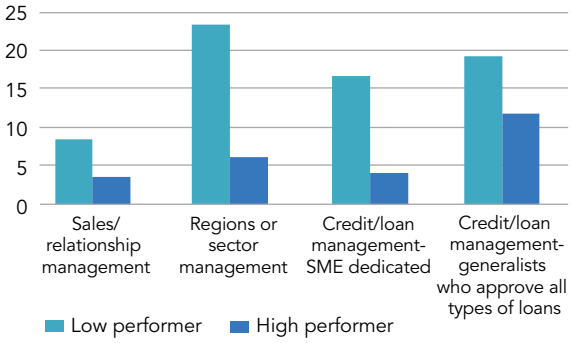
Location of Loan Approval Processing



% of Loans Approved



Years of Experience



Centralization of processing is varied with high performers in loan approval being more decentralized

Although pre-screening of loans is conducted primarily at branches, the loan approval process is spread between HQ and branches, with 20% of the high performers being entirely decentralized, and the same amount centralized at HQ.

High performers make greater use of non-SME dedicated credit/loan managers to approve loans

High and low performers use credit and loan managers to approve SME loans. High performers use region or sector managers to approve just 1% of their loans.

Underwriting is conducted mainly by experienced resources and high performers have better leverage

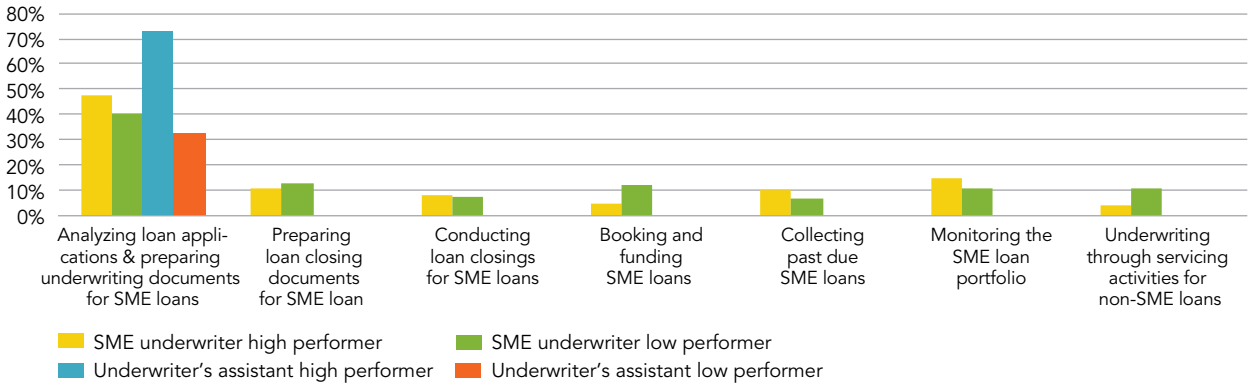
Low performers assign significantly more tenured staff (to be distinguished from skilled or experienced) to loan approval than high performers at every level surveyed. This is not surprising as lower performers are usually less focused on low-performing staff. The survey average years of experience of credit/loan managers is 15 years;[1] with the high performer average nine years, and low performer 18 years.

While the years of experience play an important role in effective underwriting, the amount of time spent on underwriting activity also impacts efficiency. An average SME underwriter spends close to half of their time on underwriting activities whereas an underwriter assistant spends around 60% of his time.

50% of high performers use underwriting assistants, compared to 60% of low performers, but high performers assign over 70% of underwriting assistants' time to underwriting activities, compared to 33% for low performers

Use of outsourcing in the area of underwriting has been reported to be negligible by all of the respondents.

Time Spent on Underwriting Activities in Average Work Month



1. Observation based upon 16 of the 20 respondents on account of non-availability of response.

SECTION 3

LOAN DOCUMENTATION, BOOKING AND FUNDING

CHARACTERISTICS OF HIGH PERFORMERS

In loan documentation, booking and funding, high performing institutions:

- Boost productivity by focusing significantly more of their booking and funding staff time on core booking and funding activities and less on other activities
- Standardize documents and covenants and apply strict change control
- Centralize the processes more at the head office
- Use more non-SME dedicated staff
- Assign more closing responsibility to more senior staff
- Look forward to increased reliance on technology and automation
- Place emphasis on training

NOTE FROM THE FIELD

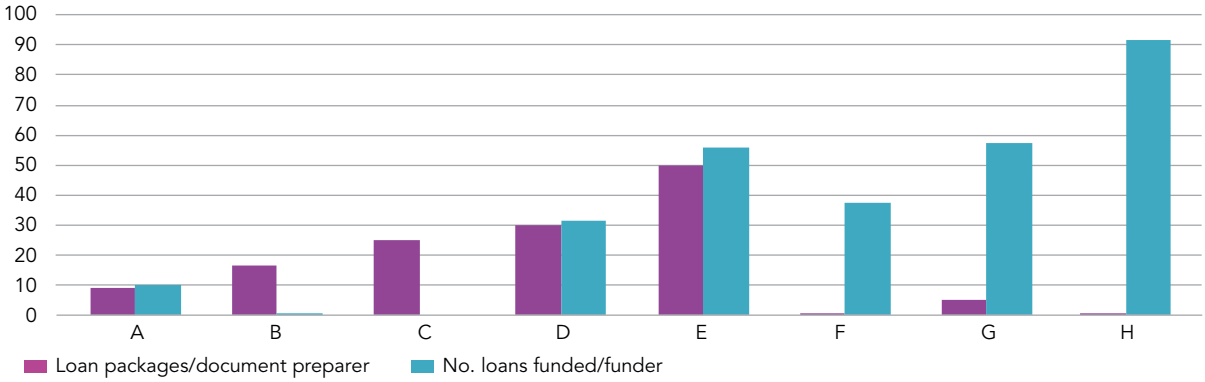
Too often, emphasis is placed on time intensive processes and tasks required to prepare loan documentation. This deviates from the value added tasks of conducting loan closings and disbursing. The challenge is to balance resources and time effectively and make effective use of standardization, centralization of core processes and automation.

KEY FINDINGS

High performing banks at document preparation (A–E) are more likely not to be high performers at funding the loans (D–H)

Using the measure of the number of loan-closing documents prepared per document preparer per month, an average loan document preparer processes 10 packages per month, with the high performers averaging 26 packages per month. This analysis is based on a sample of 17 banks, as three did not provide sufficient information.

Loan Packages Prepared per Document Preparer/ No. of Loans Funded by Funder

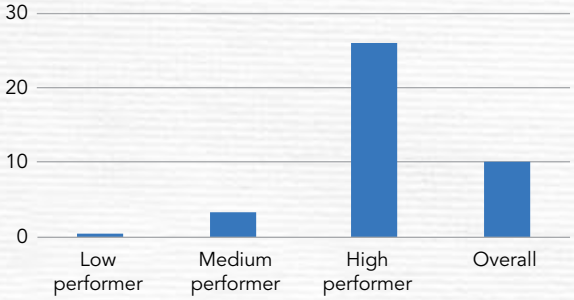


Document preparers and funders include sales/relationship managers, region or sector managers, credit/loan management (both SME dedicated and generalists), and their assistants.

An average loan funder funds nearly 21 cases per month, with the high performers funding over 60 cases, measured as loans funded per employee. Disbursement processes for high performers primarily are managed centrally at the head office/regional office, thereby improving efficiency and effectiveness in the processes. This indicates centralization and reduces processing turnaround time. This analysis is based on a sample of 15 banks, as five did not provide sufficient information.

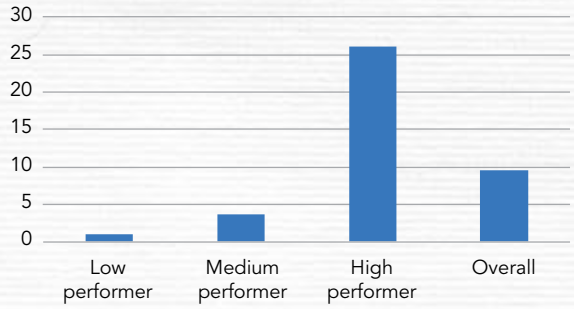
High performers are three times as efficient at funding loans than the average

Loans Funded per Employee



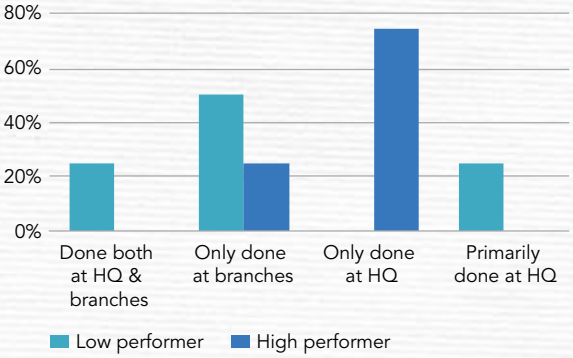
High performers also outperform low performers in loan-closing document preparation by a multiple of 26

No. of Loan Packages Prepared per Document Preparer



High performers significantly outperform in funding loans by adopting a centralized strategy, further reinforcing the trend toward centralization favored by high performers.

Location of Documentation, Booking & Funding Loans



Large banks outperform small banks in funding loans

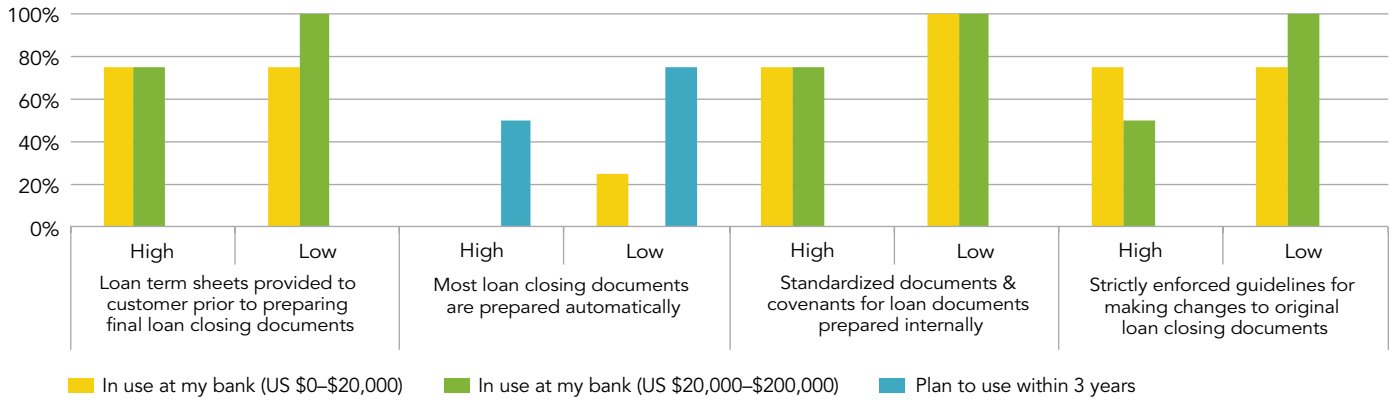
Performance	Large Banks	Small Banks
Low Performer	1	3
Medium Performer	3	4
High Performer	3	1
Overall	7	8

Small banks outperform large banks in preparing loan-closing documents

Performance	Large Banks	Small Banks
Low Performer	2	2
Medium Performer	4	4
High Performer	1	4
Overall	8	18

Standardized documents and covenants and strict change control are the most important strategies for efficient loan closing, booking and funding

Implementation Rate of Loan Closing, Booking & Funding Strategies



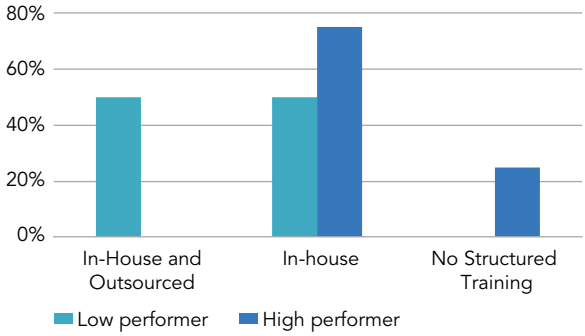
High performers differentiate themselves from low performers by not preparing most loan documents automatically, and 25% fewer high performers use standardized documents and covenants than low performers. 75% of low performers are looking to automate the loan closing process, compared to 50% of high performers. Strategies generally are consistent between loan sizes.

Providing loan term sheets to customers prior to preparing final loan closing documents was selected as the third most important strategy.

The higher incidence of use of these strategies by low performers indicates they are not as efficient in their implementation as high performers are. The level of automation is still very low among all of the respondents with only 7% of the respondents indicating some level of automation in loan package preparation.

Large banks effectively leverage their established branch networks and disbursement processes.

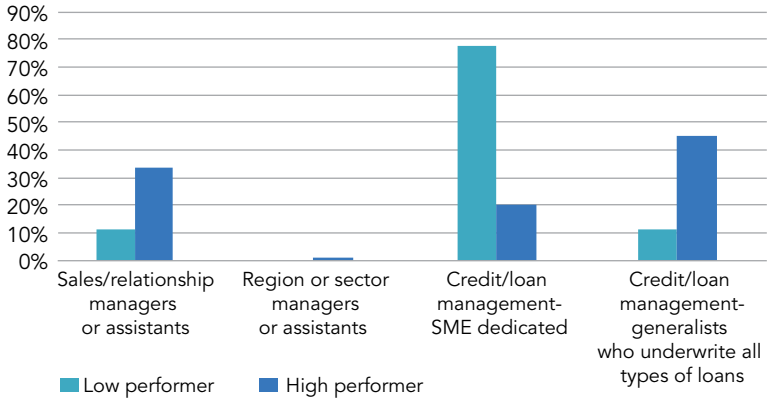
Type of Operational Efficiency Training Programs



Most of the banks employ both in-house and outsourced training programs to train their employees to improve operational efficiency

Surprisingly, all low performers indicate they have training programs for loan documentation and disbursement, and 25% of high performers do not.

Staff Types Used to Book, Fund & Close Loans



High performers use more non-SME dedicated staffers to book, fund and close loans

This is a consistent result to the use of generalists by high performers in underwriting SME loans.

High performers also assign a third of booking and funding responsibility to sales and relationship managers and staff, where low performers assign almost 80% to credit/loan managers. The reason is not clear but may reflect the SME focus of the low performers.

High performers assign more closing responsibility to more senior staff

The loan closing, booking and funding activities are not just about operational efficiency but also require an in-depth understanding of the regulatory guidelines and internal policies and procedures. To ensure this, experience plays an important role. This is evident from the average years of experience of the various staff involved in closing and booking SME loans.

Experience levels of staff who perform most of the booking and funding functions are almost the same for both high and low performers

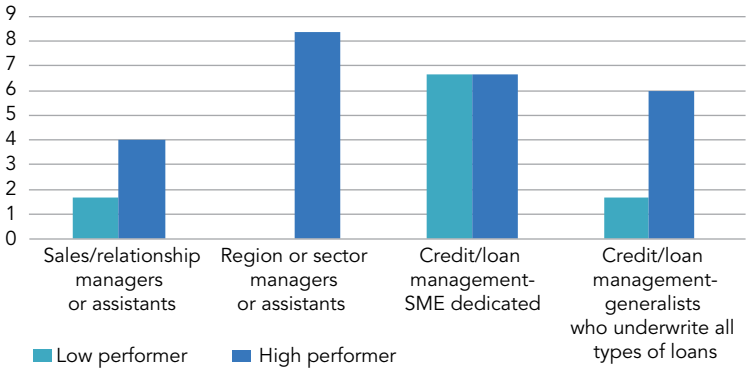
High performers use non-SME dedicated staff for most loan booking and funding activity, with an average of six years of experience. Low performers use dedicated SME credit/loan staff with an average of seven years.

High performers have staff who focus on, and are specialized in, loan closings, bookings and fundings versus other activities

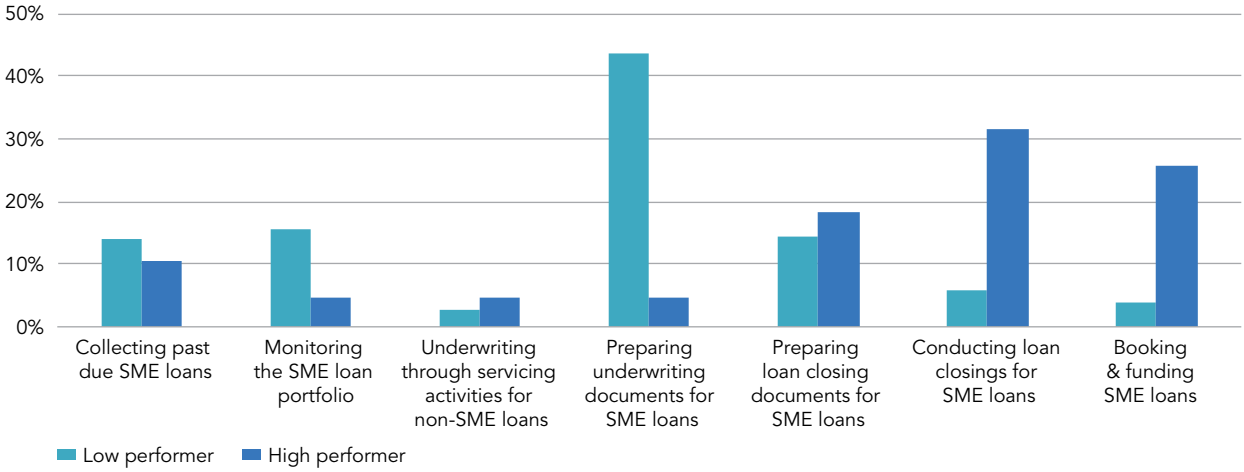
Low performers spend almost half of their booking and funding staff time on preparing underwriting documents. Low performers also allocate three times more booking and funding staff time to monitoring the SME loan portfolio.

These are key factors in determining efficiencies in loan booking and funding, in addition to adopting a more centralized approach. The use of outsourcing in booking and funding loans is almost negligible among high and low performers.

Average Years of Booking & Funding Staff Experience



Booking & Funding Staff Time on Loan Activities



SECTION 4 LOAN COLLECTIONS AND RECOVERY

CHARACTERISTICS OF HIGH PERFORMERS

In loan collections and recovery, high performing institutions:

- Increase productivity by assigning experienced staff to collections and recovery activities and ensuring they focus their time on these activities
- Incur significantly fewer additional past due loans
- Tend toward more centralized management

NOTE FROM THE FIELD

While every bank strives to ensure that there are minimal losses on its books, it is also a fact that every bank will suffer some level of losses because of non-performance of its customers or poor underwriting by staff. The most productive and successful small business banks have figured out that having a great collections system is no substitute for getting things 'right' at the front end. However, high performers also know that having a sound collections and recovery practice is of utmost importance to ensure that losses are minimized.

KEY FINDINGS

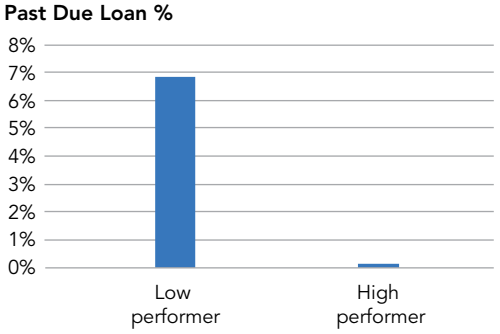
High performers incur additional past due loans 40 times less often than low performers

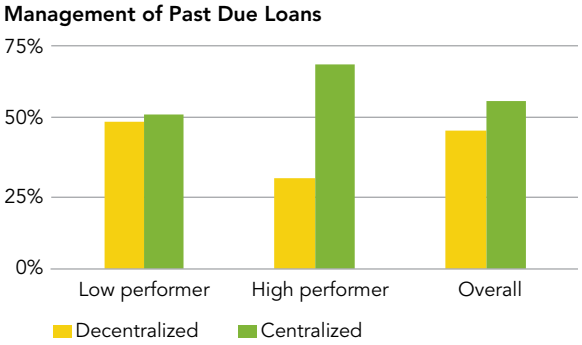
Measured as additional past due loans (PDLs) per month, high performers reflect significantly better performing SME portfolios. All high performers in collections and recovery were also high performers in underwriting and loan approval, reflecting a strong and expected correlation. There was one exception, a large bank, which ranked highly in underwriting but poorly in collections and recovery.

The next step was to understand better the extent of centralization of these functions and where the responsibility lay.

Past due loans (PDLs) managed centrally have performed significantly better

High performers manage 69% centrally and low performers manage 51% centrally.





SME focus and experience are key in assigning responsibility

Almost 90% of responsibility is assigned to SME dedicated loan managers and relationship managers to collect and recover past due loans. This is common for all respondents, with high performers using slightly fewer generalists and slightly more SME dedicated and relationship managers than low performers do.

Assigning experienced and well trained staff to these key activities is crucial. The weighted average of years of performance for high performers is higher at nine years, compared to six years for low performers.

High performers spend 83% of their collectors' time on collecting, 10% more than low performers

Measured as a percentage of their average work month, high performers ensure their collectors spend more of their time collecting than low performers, and less on monitoring the portfolio. Low performers spend, on average, 11% more of their collector's time on portfolio monitoring than high performers.

Low performers outsource collections five times more than high performers

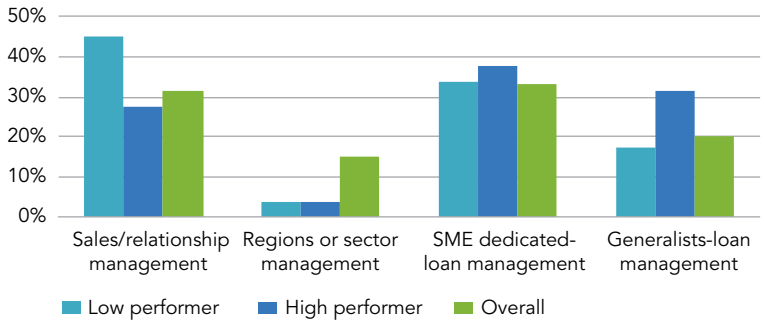
This is the only activity that has any real level of outsourcing. The much better performance of high performers as measured by their very low additional PDLs per month reflects that they are containing these activities in-house, where low performers are not.

High performers mostly provide in-house training

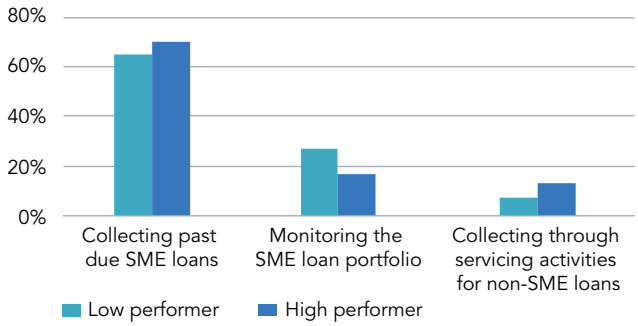
Of the high performers that provide training, all is provided in-house, compared to 25% of low performers. A quarter of both high and low performers provide no training at all for collections and recovery.

It is apparent high performers have learned that effective recovery requires internal development of recovery and loan workout methodologies supported by in-house training.

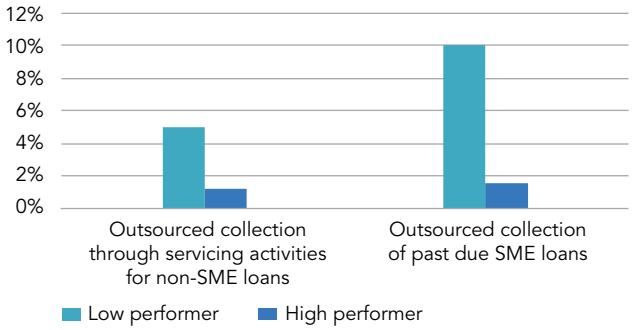
Staff Assigned Collection & Recovery Responsibility



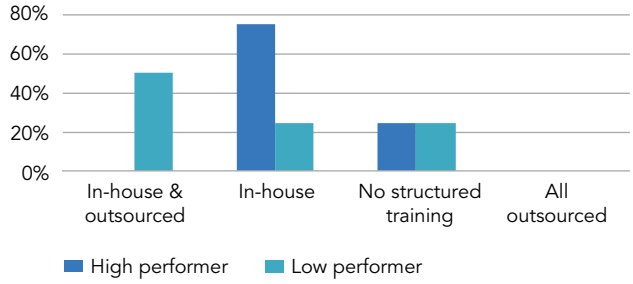
Collectors' Time Spent on Loan Activities



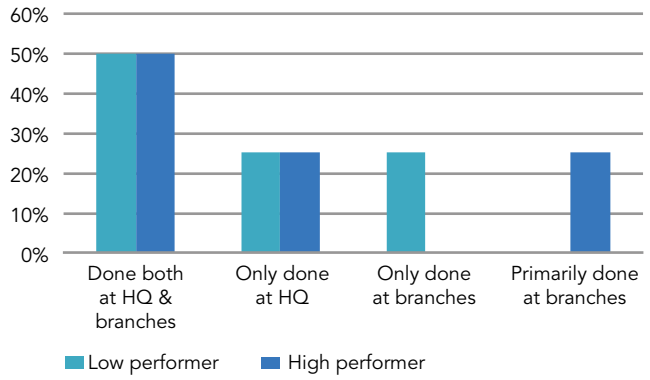
Rate of Outstanding Collections



Type of Collections & Recorvery Training Programs



Location of Loan Collection & Recovery



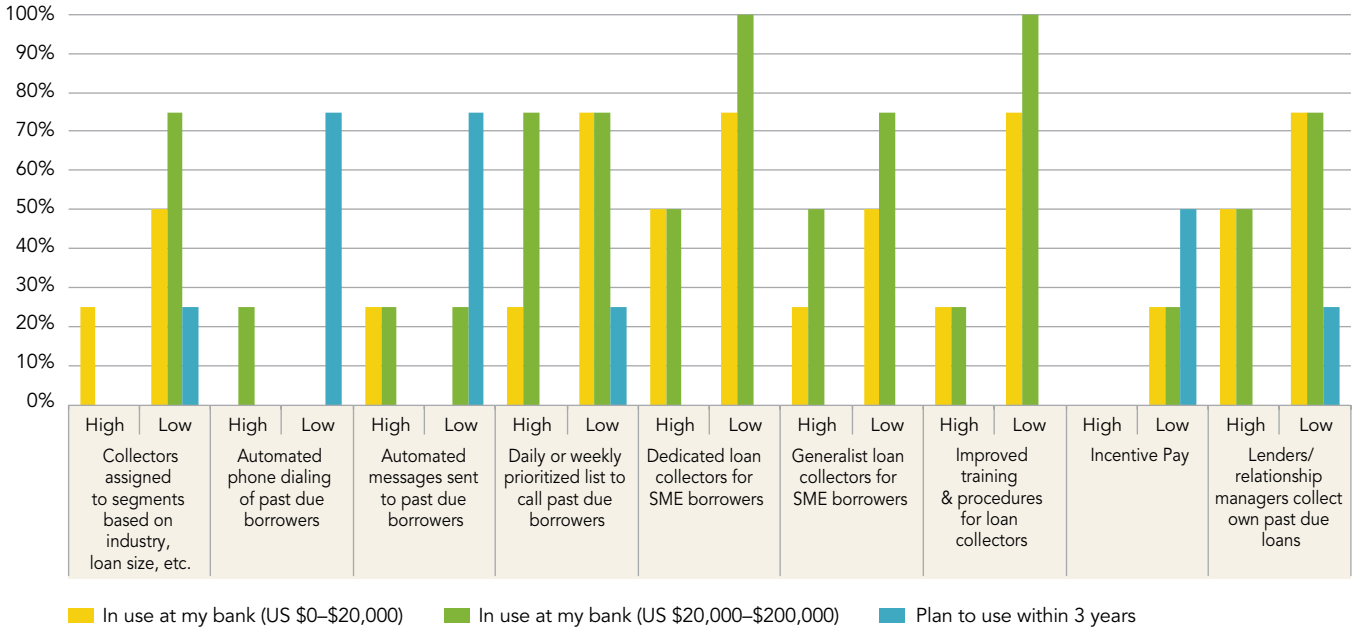
High performers tend toward more centralized remedial management

The level of centralized loan collection and recovery management is not significant but centralization remains a consistent theme for high performers.

Maintaining prioritized calling lists of past due borrowers is the top current strategy of high performers. The top future strategy is automating the calling and messaging processes

Other strategies selected as having the most current focus across all of the banks surveyed are assigning dedicated SME loan collectors and improving training and procedures for loan collectors. Automation of collections activities has been reported to be very low with only 17% of the borrowers using automated means to make the first contact with customers.

Implementation Rate of Collection & Recovery Strategies



SECTION 5

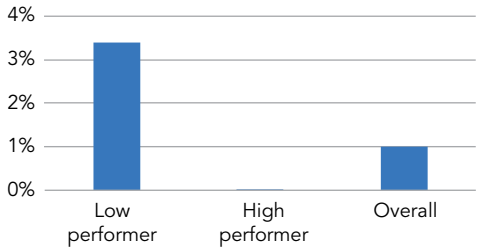
LOAN PORTFOLIO MONITORING

CHARACTERISTICS OF HIGH PERFORMERS

In loan portfolio monitoring, high performing institutions:

- Adopt more monitoring methods and apply them more effectively
- Re-rate more loans in the portfolio more often
- Focus on training
- Use credit management generalists to monitor the portfolio

Expected Loan Losses



Bank Size and Performance

Performance	Large Banks	Small Banks
Low Performer	2	2
Medium Performer	5	5
High Performer	3	3
Overall	10	10

NOTE FROM THE FIELD

Evaluating risk exposure across the portfolio to determine shifts in the risk profile and changes in risk quality remains a leading area for bank leadership to address.

KEY FINDINGS

The move to high performance reduces loan losses by over 3%

On average, banks reported expected loan losses of 1% on the SME loan portfolio with high performers reporting close to 0% on the portfolio. Low performers averaged 3.4% expected loan losses with the worst expected loan loss at 7.5%.

Efficient loan monitoring leads to early detection of bad loans and reduces provisioning requirements by almost a percentage point.

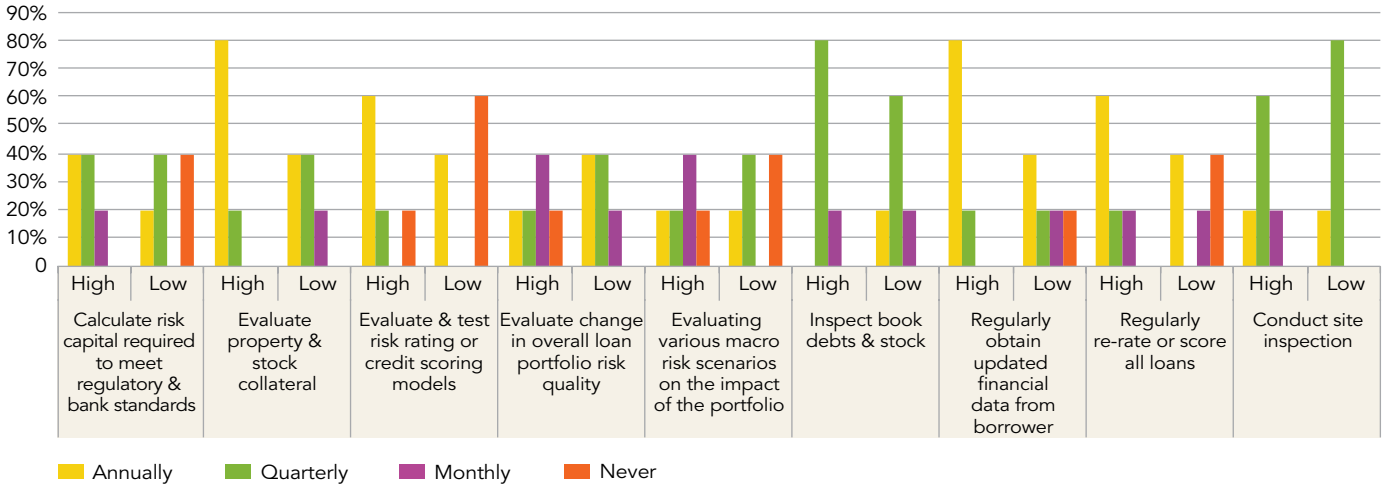
Large banks do not perform any better than small banks

A number of factors and activities were analyzed to determine the key drivers supporting superior performance.

High performance is driven by adopting effective monitoring methods

22% of the total available monitoring methods included in the survey are not used by low performers. 7% are not used by high performers.

Implementation Rate of Monitoring Methods



Performing inspections of debt and stock, evaluating collateral and regularly updating borrower financial data are the top three methods adopted by high performers

This is closely followed by re-rating or scoring all loans on a regular basis.

Portfolio risk evaluation requires significantly more focus

A key function that requires attention by all banks is evaluating risk exposure across the portfolio to determine shifts in the risk profile. Only 40% of high performers do this monthly, and 20% never perform any portfolio risk analysis to determine changes in risk quality. Low performers evaluate risk even less frequently.

High performance is driven by more frequent loan re-rating

Based on 17 banks' responses, high performers re-rate more often. This was measured in two ways: the loan balance re-rated as a percentage of the total SME portfolio, and the number of loans re-rated also as a percentage of the total SME portfolio.

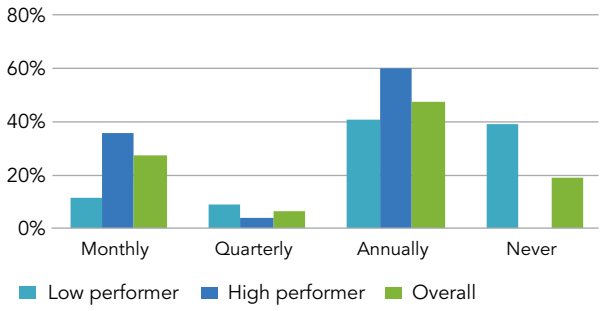
High performers re-rate monthly at least three times as many loans as low performers and seven times the value of the loans outstanding.

However, 60% of the portfolio is re-rated annually by high performers and 65% for low performers.

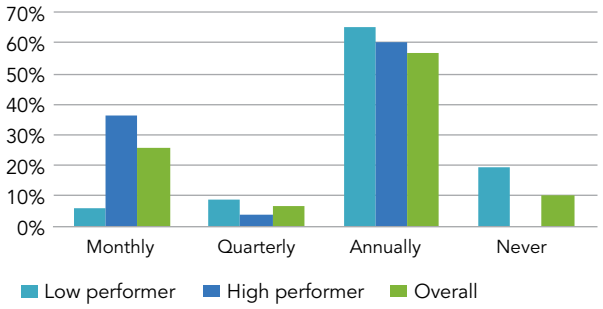
Centralization of portfolio monitoring does not dictate performance

Where portfolio monitoring takes place is, surprisingly, exactly the same for both high and low performers. 20% report that it takes place exclusively at HQ, and the remaining 80% reporting it takes place at both branches and HQ.

No. of Loans Re-rated as % of Total SME Portfolio

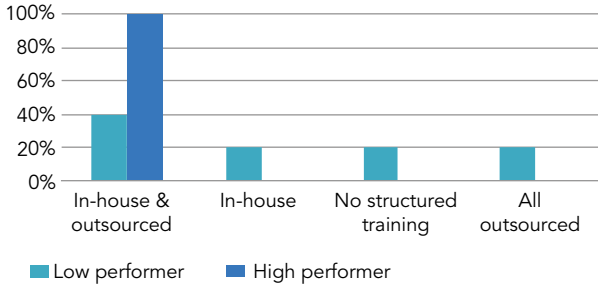


Loan Balance Re-rated as % of Total SME Portfolio

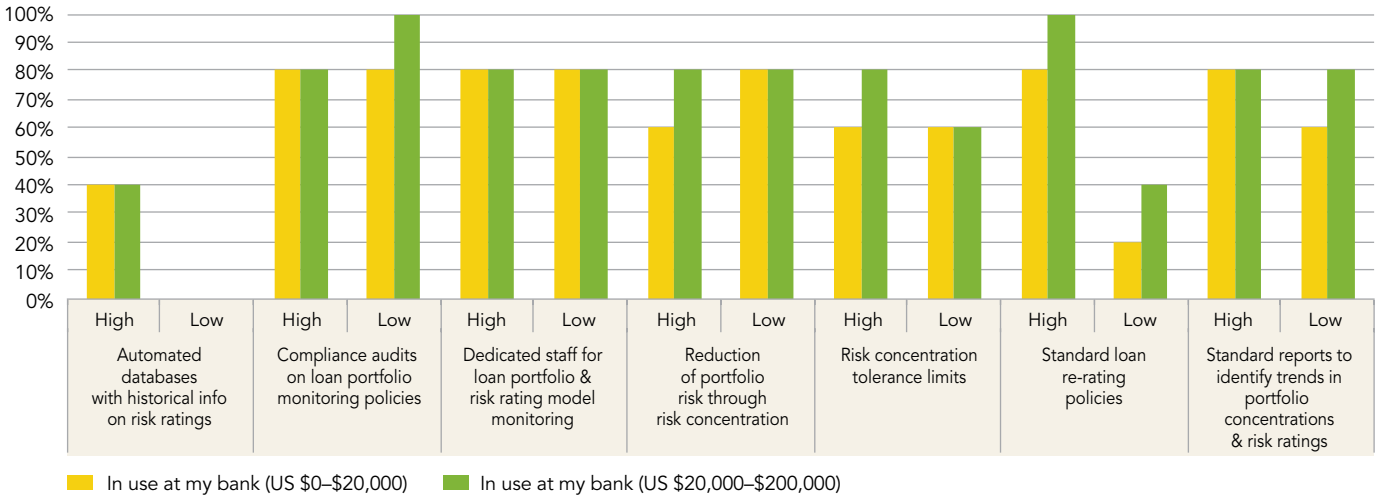


All high performers provide training on portfolio monitoring, compared to 80% of low performers

Type of Portfolio Monitoring Training Programs



Implementation Rate of Loan Portfolio Monitoring Strategies



Use of automated databases with critical historical information on risk ratings is the differentiating current and future high performer strategy

Loan portfolio monitoring strategies generally are well adopted by most high and low performers, with the exceptions of the use of automated databases of historical risk information and applying standard policies for re-rating loans. No low performers make use of automated databases and less than half have standard policies.

The leading current strategies in order of priority are assigning dedicated staff for monitoring the loan portfolio and risk rating models, using standard reports that identify trends in portfolio concentrations and risk ratings, and performing compliance audits to assure loan portfolio monitoring policies are adhered to.

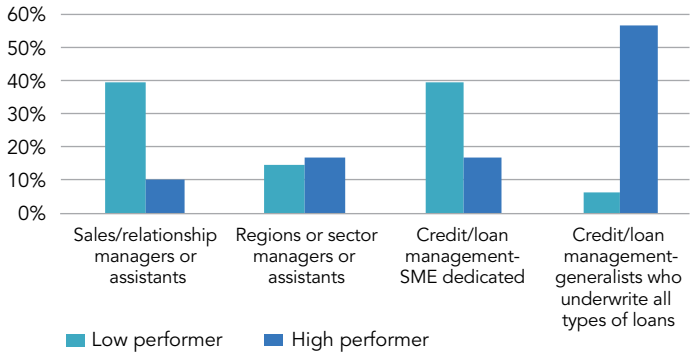
High performance is driven by using monitors from the credit management group

Low performers have significantly more SME dedicated staff for portfolio monitoring, more than double that of high performers. Again, it is apparent this is due to their SME concentration.

Low performers also assign four times the responsibility to sales/relationship management staff.

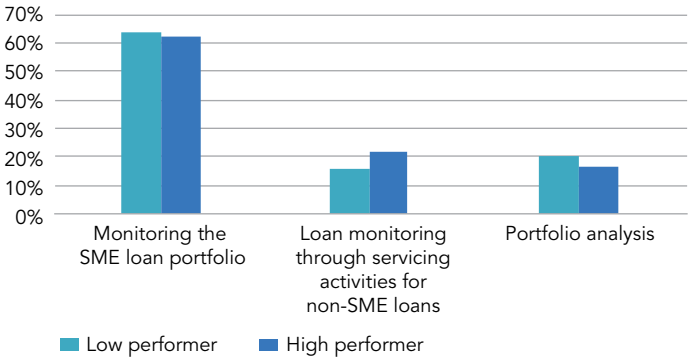
The level of outsourcing the monitoring process is very low with, surprisingly, one respondent reporting complete outsourcing of SME portfolio monitoring.

Time Spent on Portfolio Monitoring



High and low performers assign these SME monitors to tasks with very little difference in focus

Time Spent by SME Monitors on Tasks



THE SURVEY TEAM

An experienced team drawn from SBBN's own professionals as well as experts in the field designed the survey methodology, analyzed the results, and produced the report. The field experts were from Crisil, a Standard and Poors company based in India, and Allan Immelman, an independent consultant. All contributors have decades of deep financial market and banking experience in both emerging and developed markets. SBBN's CEO, Lynn Pikholz, and Capacity Building Manager, Ellen Har, contributed to and managed the assignment.

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