Self Sustainability of SME Banks - A Myth or Reality? Evidence from Selected Developing Economies across Asia

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AIMAL
SME Banking for Development

- Development is utopian
- Improving life for the lower and middle classes of the society
  (Peet & Hartwick, 2009)
- Institutional approach or the welfare approach
  (Woller, Dunford, & Woodworth, 1999)
- Institutional approach is taking lead with SME Banks
- SME banks are a practical instrument to achieve the goals of development
  (Harper, Fisher, & Sriram, 2002)
SME Banks

“Small and medium enterprise banks - extend small amounts of collateral-free institutional loans to liable poor group members and businesses for their self-employment and income-generation”

• Focus on those banks whose sole charter is SME development
• Important tool for sustainable growth and development

(Muhammad & Alan, 1998)
Contribution of SME Banks

- Empower women
- Increase employment opportunities
- Serve new businesses
- Reduce poverty
- Minority groups
SME Banking in Asia

- SME industry is in a transitional condition
- Asia is vast region and people remain deprived of financial services
- Demand has exceeded the available supply
- SME banking sector has different degrees of sustainability
- It is very expensive business due to higher transactions and high information cost

(Pollinger, Outhwaite, & Cordero-Guzmán, 2007)

- In 2015 it reported a loss of PKR 282 million
- Total loss available for appropriation of PKR 2.29 trillion
- Auditors have raised doubt on the going concern of the bank
Sustainability of SME Banking

• Unsustainable SME banks can facilitate now but unable to facilitate them in future as SME banks will be gone
  (Schreiner, 2000)

• To attract the underserved market, to raise capital from different sources and to ensure the organizations survival
  (Vinelli, 2002)

• Operational sustainability only exist when the financial institutions are able to cover their operational cost and financial sustainability
  (Morduch, 2000)

• Higher returns are important but not sufficient for the sustainability
  (Copestake, 2004)
Objective

• To investigate the sustainability of SME banks in Asia
• To investigate those contributory factors that affect the sustainability of SME banks in Asia, especially Pakistan, India, Sri-Lanka, Nepal, Malaysia, Bangladesh and Thailand.
Research Methodology

- **Sample Selection**
  - **Time period:** 2005-2015
  - **Data Type:** Secondary & Annual data
  - **Sources:** Financial Statements of 20 SME banks in Asia.
Model

\[ OSS_{it} = \beta_0 + \beta_1 GLP_{it} + \beta_2 PAR_{it} + \beta_3 D_E_{it} + \beta_4 DP_{it} + \beta_5 ROA_{it} + \varepsilon_{it} \]

- **Dependent**
  Operating self-sufficiency
- **Independent**
  Gross loan portfolio
  Portfolio at risk > 90 days
  Debt to equity ratio
  Deposits
  Return on assets
## Descriptive Statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Observations</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating self-sufficiency</td>
<td>63</td>
<td>0.741</td>
<td>1.395</td>
</tr>
<tr>
<td>Gross loan portfolio</td>
<td>63</td>
<td>21.752</td>
<td>2.988</td>
</tr>
<tr>
<td>Portfolio at risk &gt; 90 days</td>
<td>63</td>
<td>13.557</td>
<td>1.656</td>
</tr>
<tr>
<td>Return on assets</td>
<td>63</td>
<td>0.073</td>
<td>0.350</td>
</tr>
<tr>
<td>Debt to equity ratio</td>
<td>63</td>
<td>2.862</td>
<td>2.508</td>
</tr>
<tr>
<td>Deposits</td>
<td>63</td>
<td>24.529</td>
<td>25.266</td>
</tr>
</tbody>
</table>
Regression Analysis

Table 3: Regression Results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Dependent variable: Operating Self-Sufficiency</th>
<th>Coefficient</th>
<th>t-Statistics</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross loan portfolio</td>
<td></td>
<td>0.129</td>
<td>1.84</td>
<td>0.071*</td>
</tr>
<tr>
<td>Portfolio at risk &gt; 90 days</td>
<td></td>
<td>-0.0002</td>
<td>0</td>
<td>0.998</td>
</tr>
<tr>
<td>Return on assets</td>
<td></td>
<td>-0.288</td>
<td>-0.67</td>
<td>0.503</td>
</tr>
<tr>
<td>Debt to equity ratio</td>
<td></td>
<td>-0.118</td>
<td>-1.77</td>
<td>0.083*</td>
</tr>
<tr>
<td>Deposits</td>
<td></td>
<td>26.298</td>
<td>1.71</td>
<td>0.094*</td>
</tr>
</tbody>
</table>

R square = 0.392
Adj.R-square = 0.339
F-statistics = 7.38***

This indicates that higher deposits, higher the sustainability. The SME banks should have a method to generate funds more in line with deposits rather than debt.

This suggests that higher the debt to equity ratio, the more financing cost the bank has to pay, which inherently is decreasing the bank’s ability to be sustainable in the long run.

Gross loan portfolio indicates the bank’s ability to lend and to attract borrowers. This implies that gross loan portfolio acts as an indicator of scale efficiency for SME banks.
Conclusion

- The funds should be more deposit based rather than reliance on funding from external parties.
- To achieve this, the bank should start offering its deposit holders worthwhile returns.
- One solution for this is partnering or offering services to their entrepreneur customers, the beneficiaries, that they should open deposit accounts with the SME bank as well. This pool of deposits will then be available with the SME bank. The bank will only receive this pool if it offers good deposit services to its clients, such as reliable ATM, quick and costless inter-bank transfer etc.

Deposits

- The SME bank can also generate a pool through making endowment through government and donor funds.
- This is a radically new idea as SME banks have just utilized their funds to give loans have ignored their own income generating capacity.
- For this purpose, the aim of SME banks should shift from development at current period to maximum development in temporal setting.
- Offer better products to entrepreneurs and improved product development.
- Strive to decrease the cost of this funding can give operational advice to entrepreneurs. Can offer sale and lease back options. Can offer investment advisory and quality check services through out the business cycle for the entrepreneurs.
- The funds should be more deposit based rather than reliance on funding from external parties.
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THANK YOU