



SME banking opportunity in MENA



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Contents of this presentation

Present business case for SME banking

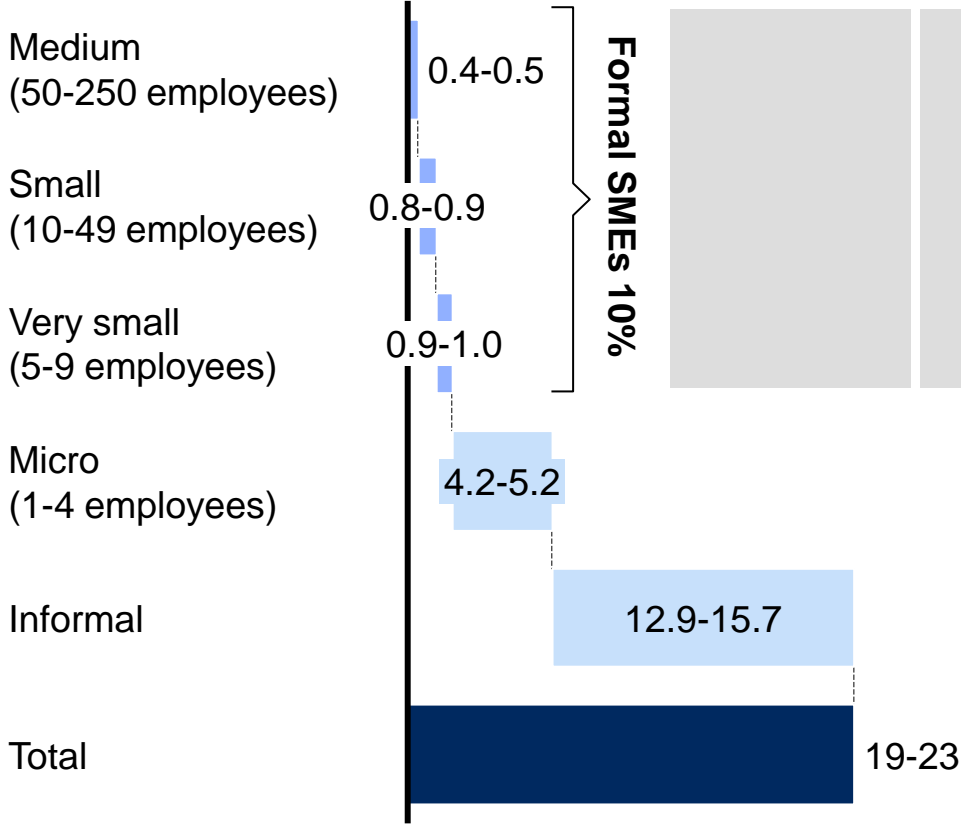
Discuss supply-side constraints in serving SMEs

Share leading practices in SME banking

There are 19-23 million Micro Small Medium Enterprises in the MENA region with only 10% formalized

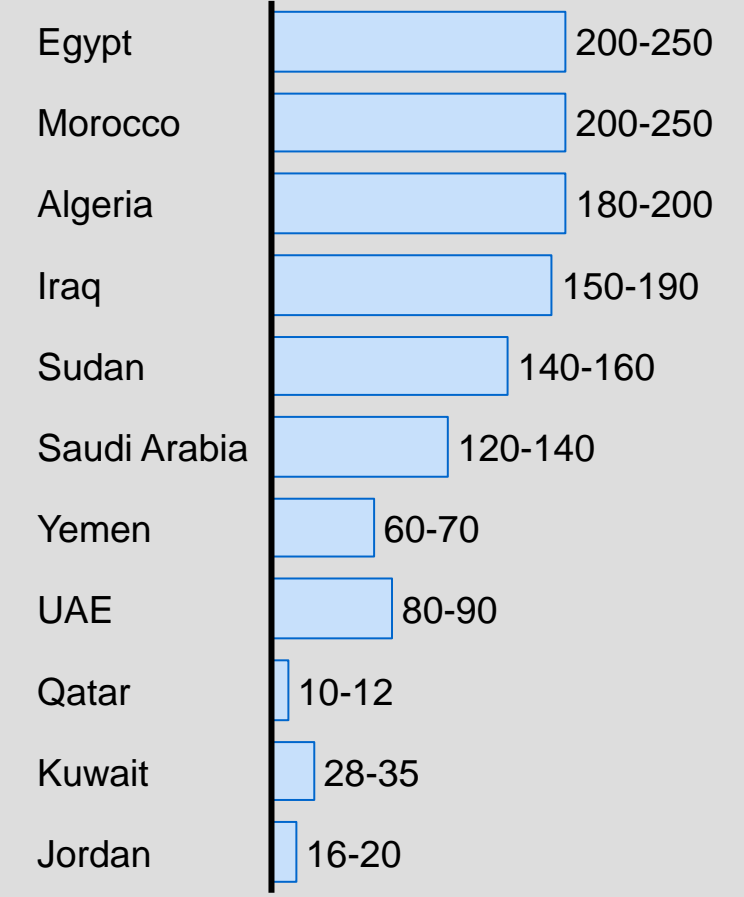
Number of MSMEs in MENA by size

Millions

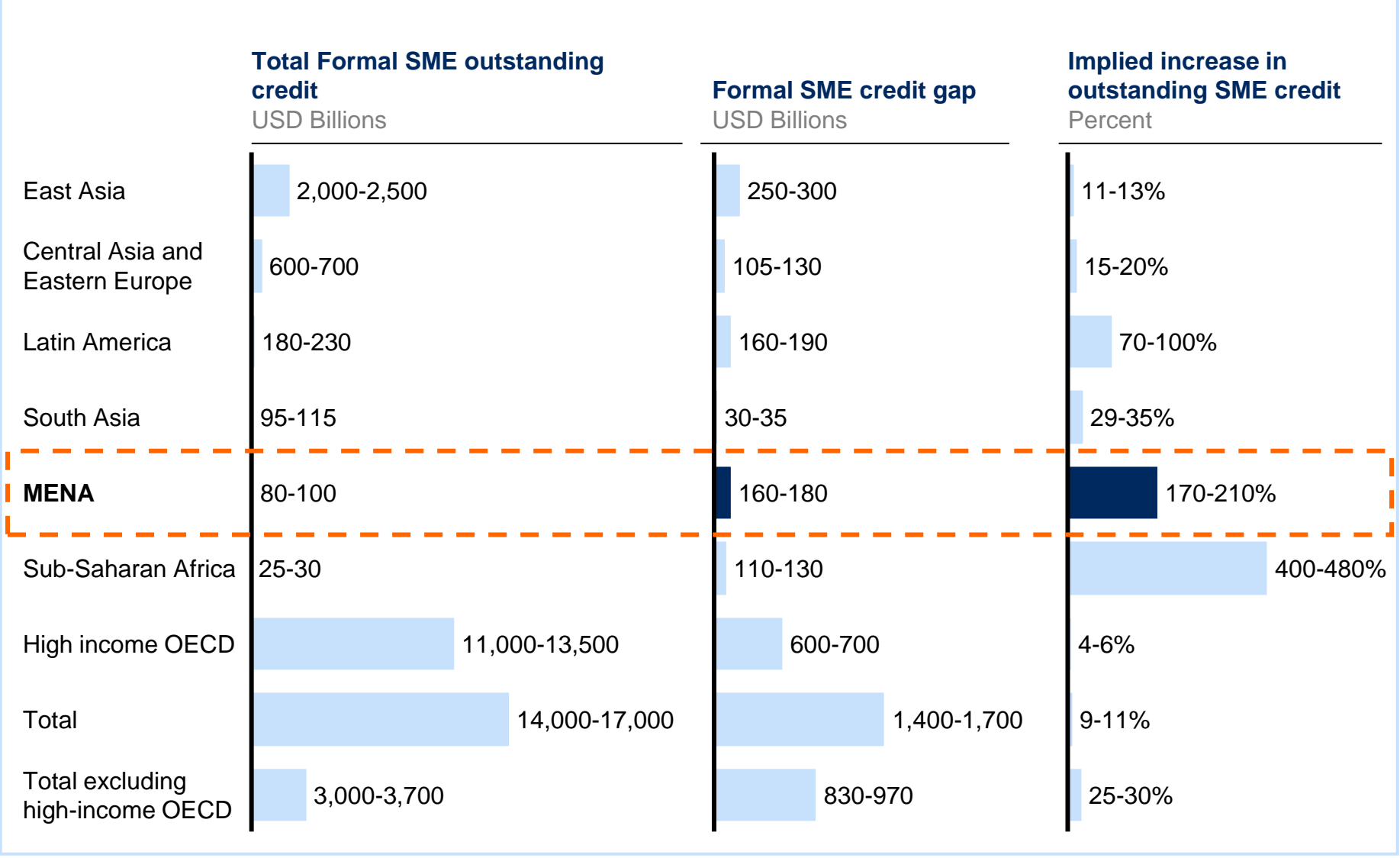


Formal SME's (>5 employees) by country

'000

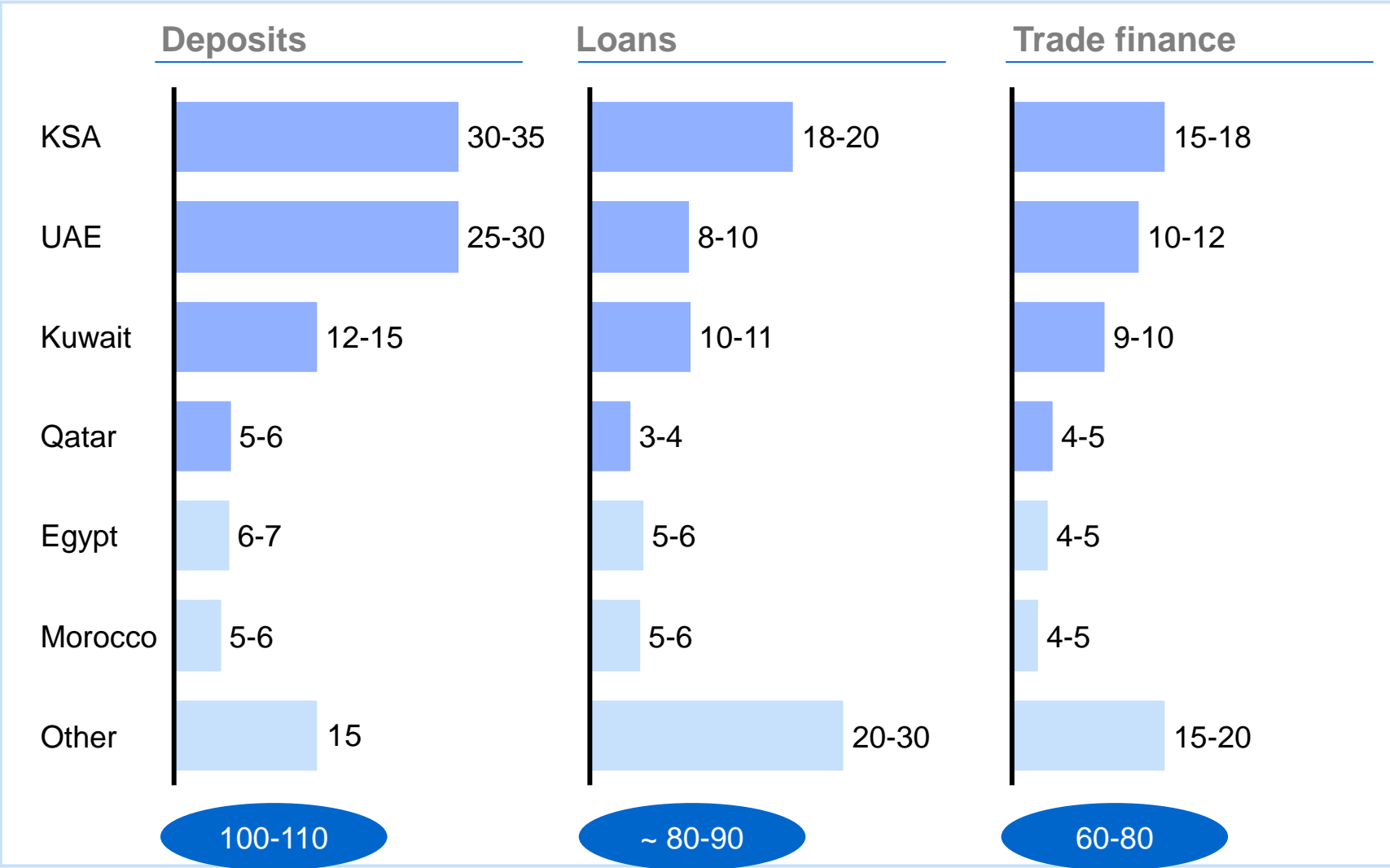


Credit gap relative to the outstanding SME credit is one of the worst in the MENA region compared to other regions



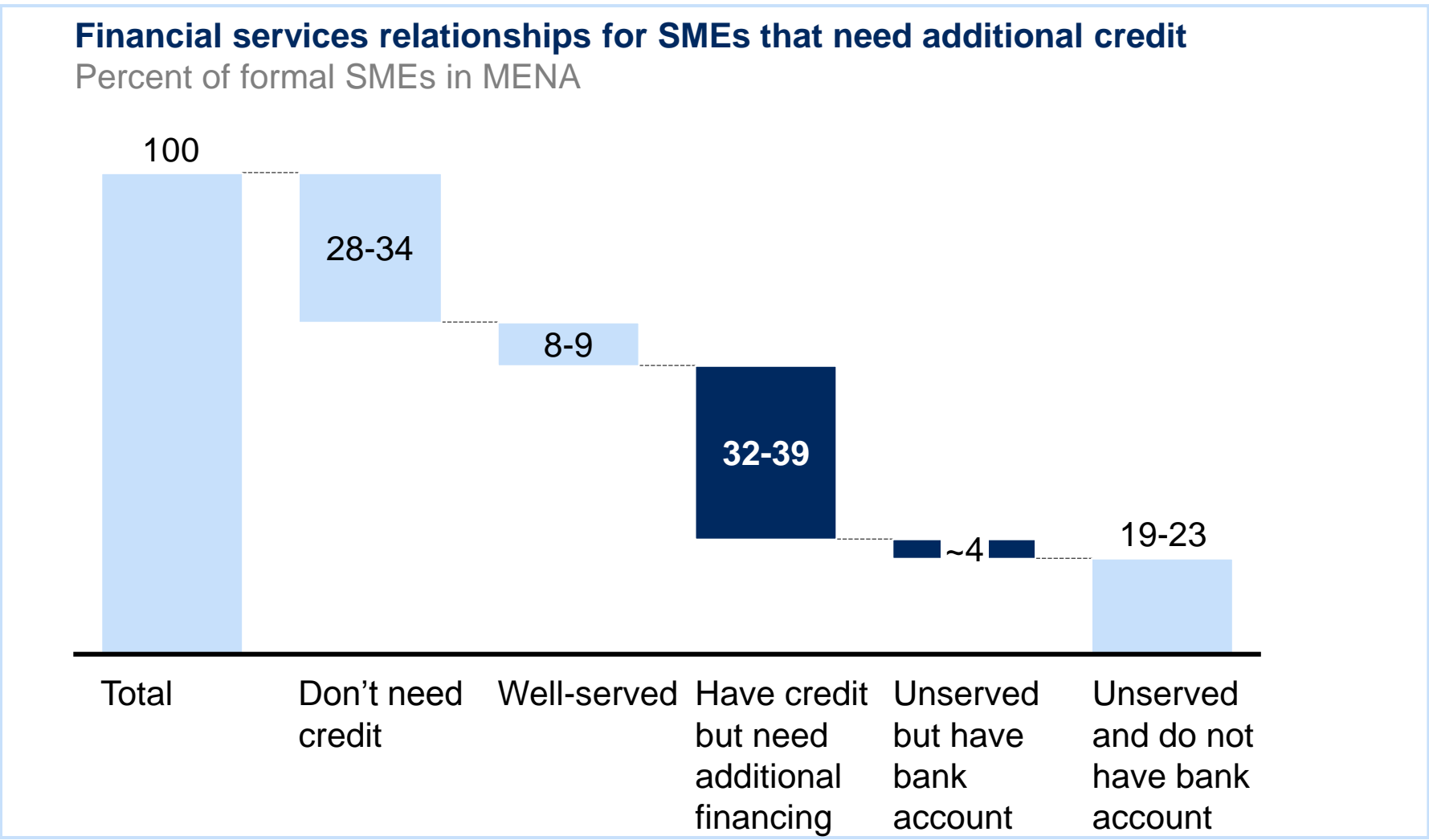
GCC alone drives 40-50% of the total SME banking volumes in MENA

Formal SMEs, 2011 USD b

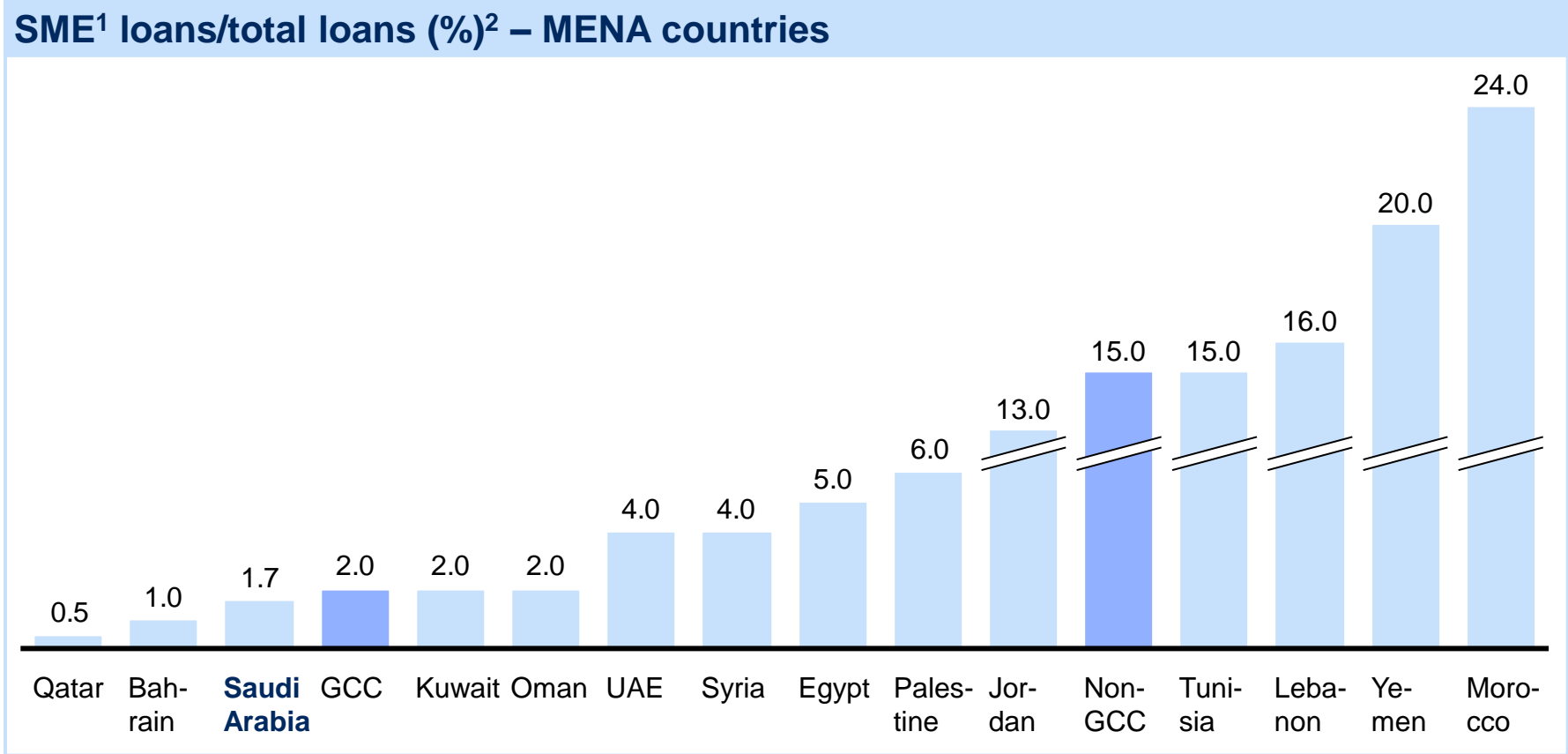


More than 50% of the formal SME's in MENA either un-served or need additional financing

■ Have bank credit but need additional credit



As a result, in MENA, we see low penetration of SME lending within the financial sector, especially in the GCC

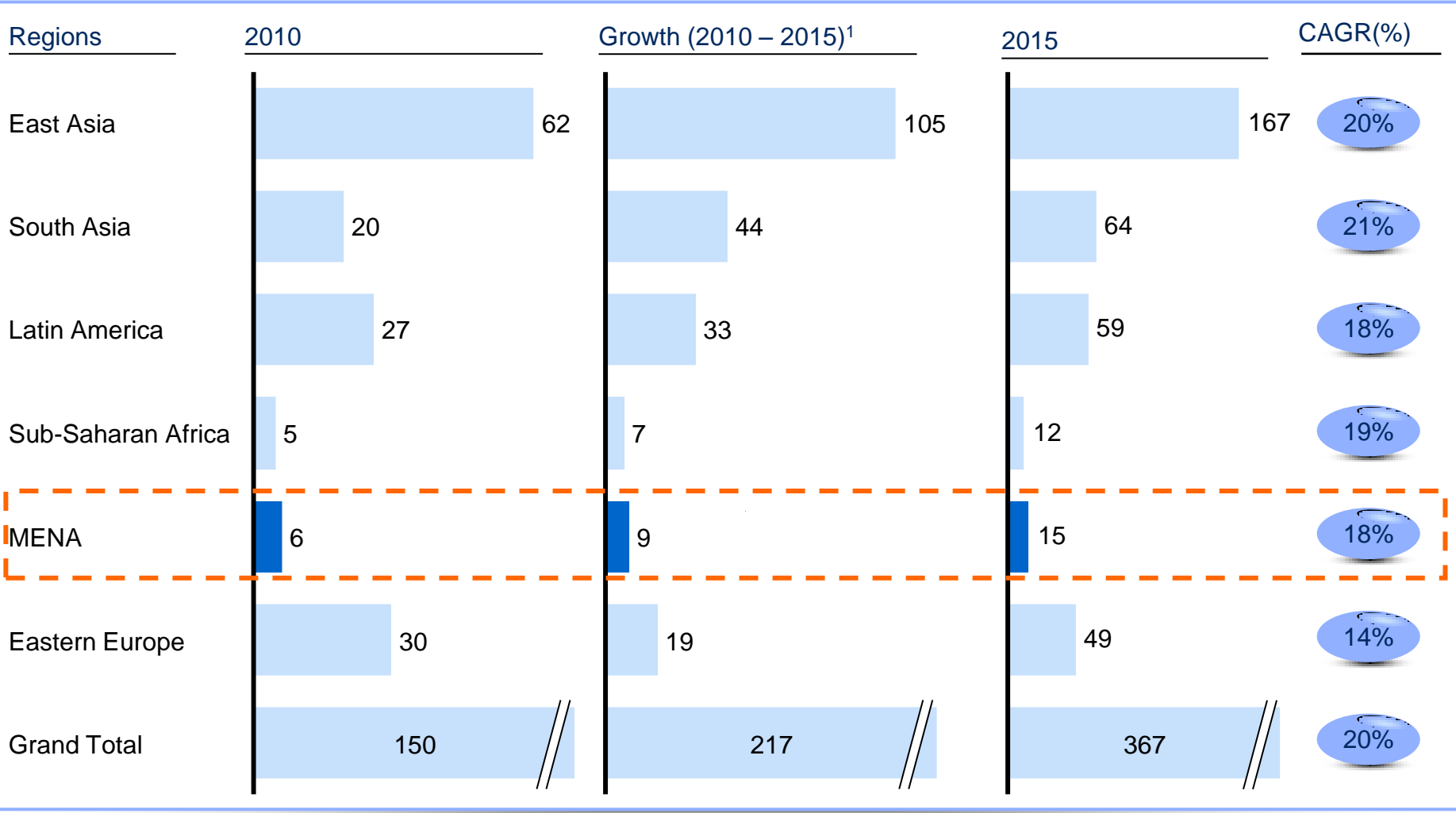


1 SME's defined as firms with up to 100 employees

2 Reported numbers are weighted averages and Non-GCC average includes Iraqi banks that were not reported in the graph as the coverage Iraq is not more than 30%

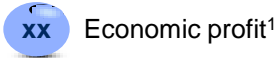
MSME banking revenues in MENA currently stand at USD 6b and are expected to more than double over the next five years

MSME Bank Revenue
USD Billions



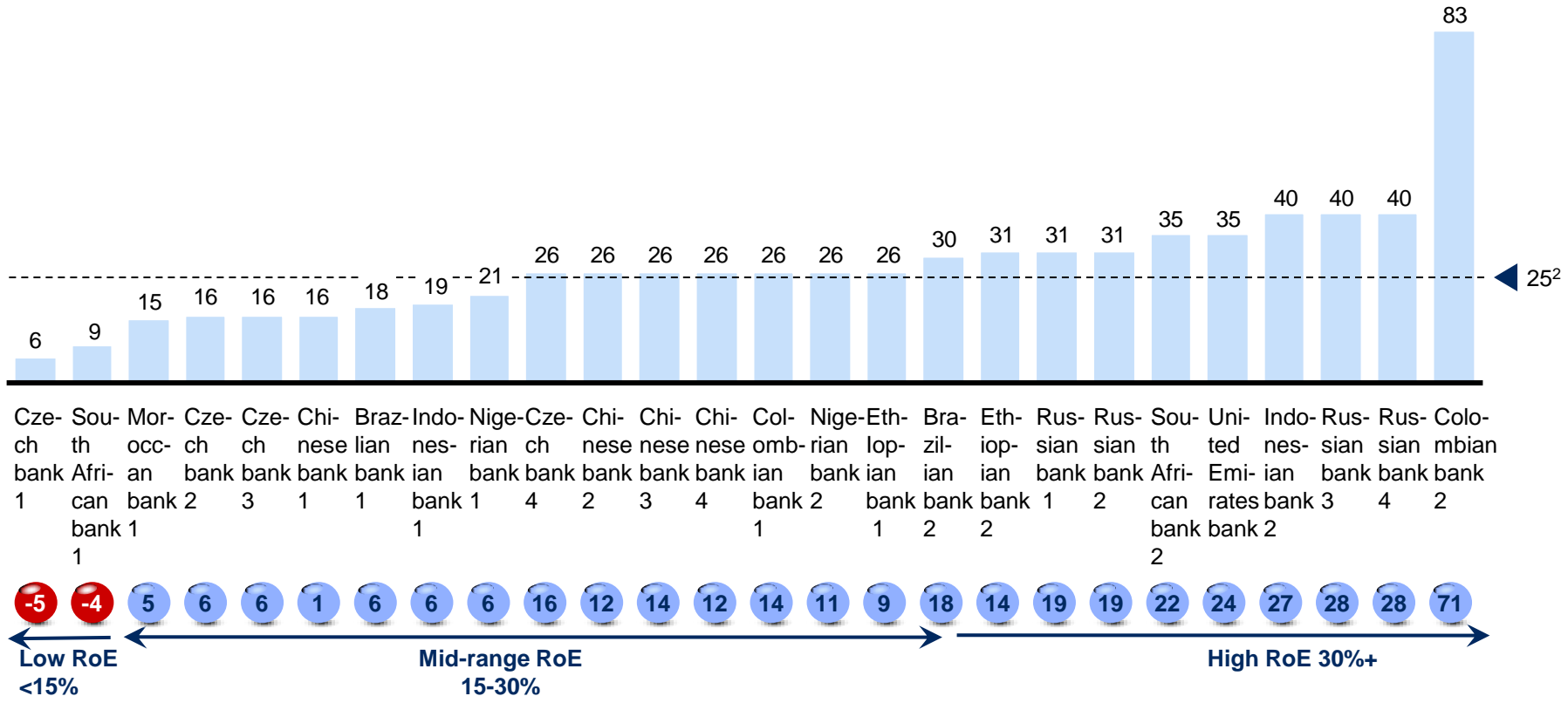
¹ 2010 – 2015 Nominal GDP growth plus growth in financial inclusion (growth 2005-2010 extrapolated to 2015) plus growth based on convergence between developed and emerging markets product penetration (Refer to technical annexure)

Serving SMEs can be profitable - a review of leading MSME banks suggests that ROEs from 20% to 40% are common



MSME segment return on equity, %

N=26 respondents



1 Return on Equity less country-specific Cost of Equity (Cost of equity used for the countries: Angola 15.4%; Brazil 11.8%; Colombia 12.4%; Czech Republic 10.5%; Ethiopia 17.4%; India 13.2%; Indonesia 12.9%; Kenya 13.9; Malaysia 10.7%; Mexico 11.6%; Morocco 10.2%; Nigeria 15.3%; Russia 12.3%; Saudi Arabia 10.9%; Singapore 9.9%; South Africa 13.0%; United Arab Emirates 11.1%; China (Used bank specific - Average 14.1%) 2 Average of all banks excluding the 83% ROE outlier



Challenge

1 **Dispersed clients** – urbanisation lower than in advanced markets e.g. 30% in India, 40% in Africa, 45% in China vs ~80% in Europe



2 **Low bank revenue per client** – bank revenue per client averages USD 2,100, so traditional distribution is unprofitable



3 **Poor data availability** – only 5-30% of emerging market SME borrowers are covered by credit bureaus



4 **Business/financially illiterate clients** – financial literacy in BRICS countries (most developed emerging markets) of ~50 to 60% compared to G7 countries of above 60%



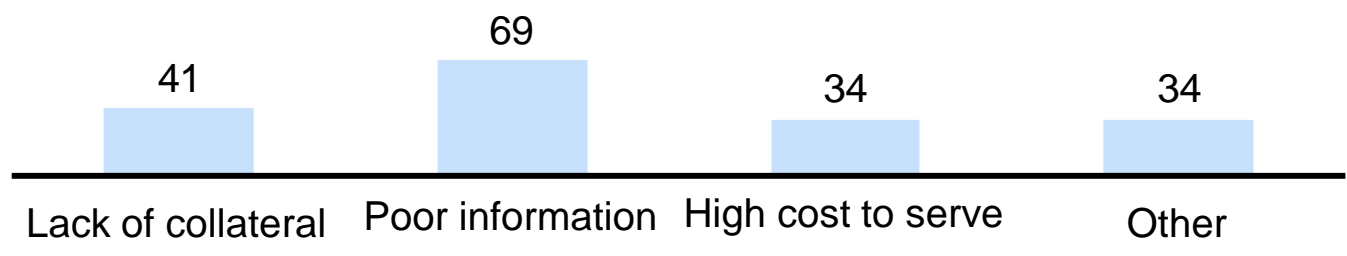
5 **Poor business environment** – emerging market nations rank in lower half of World Bank Doing Business indicators



Information and lack of collateral are key constraints to SME lending – and not enough banks are using credit tools

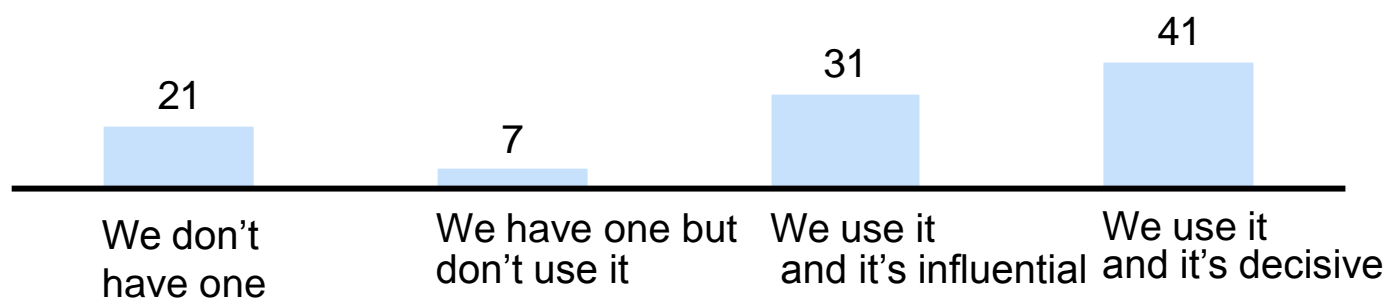
Most banks think the critical constraint to increased lending is poor information

Constraints to lending, % of respondents, n=29

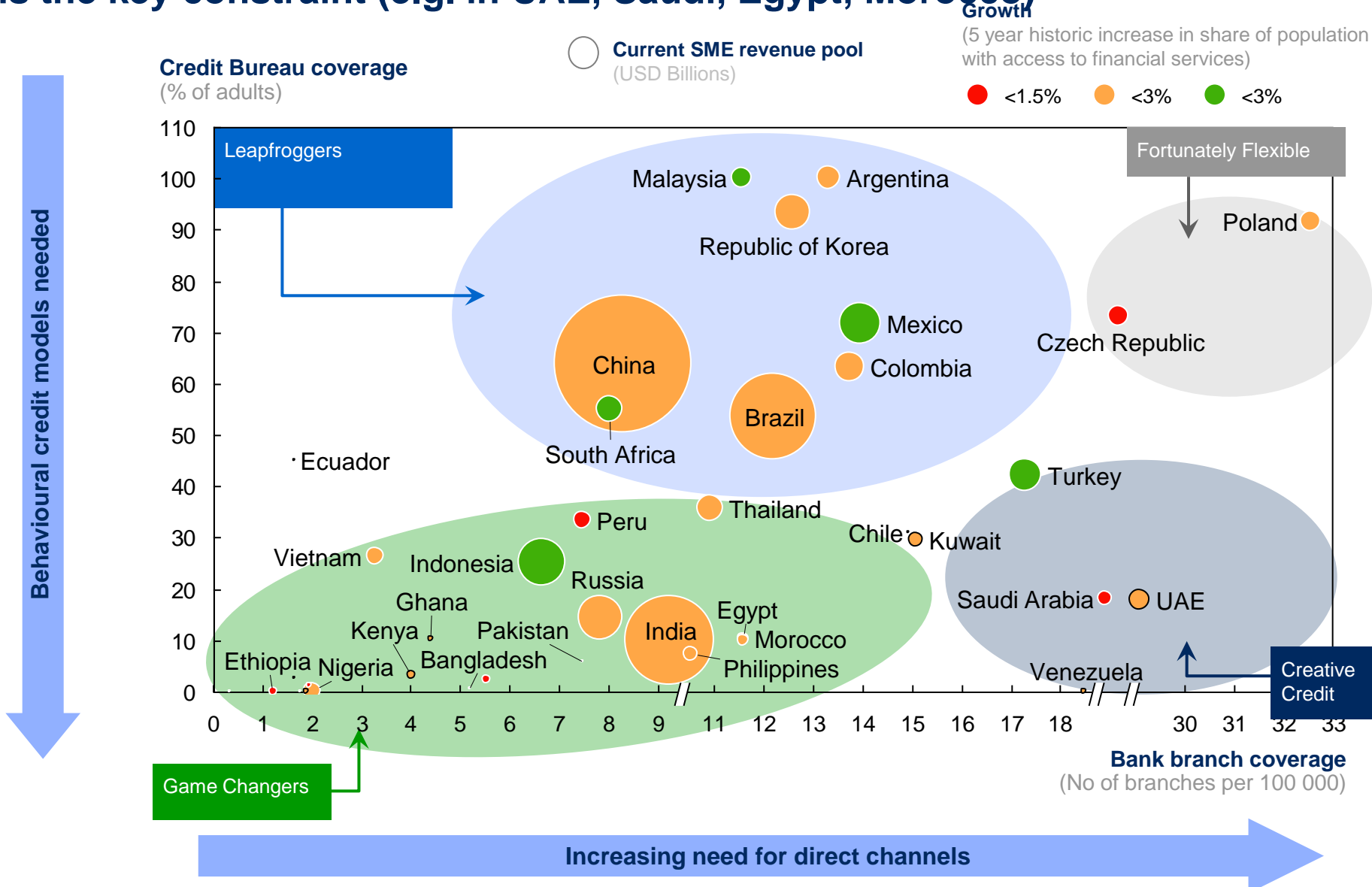


Credit scoring tools are widely used in credit decisions

Use of credit scoring tools, % of respondents, n=28



Relative to other regions, in MENA it appears, risk, rather than distribution is the key constraint (e.g. in UAE, Saudi, Egypt, Morocco)



SOURCE: McKinsey Global Banking Pool (GBP); World bank –Doing Business IMF Financial Access Survey 2006-2010; McKinsey analysis

Leading banks around the world are following 5 practices to overcome these challenges in the SME segment



Insight-based segmentation

- Granular sizing by:
 - Sector
 - Need
- Tailored products and solutions



Profitable coverage model

- Optimise coverage model to balance client needs, revenue and costs



Stimulate sales

- Use client data to generate and execute leads
- Free up frontline time



Innovate on risk

- For scoring use:
 - Qualitative metrics
 - Psychometric testing



Lower distribution cost

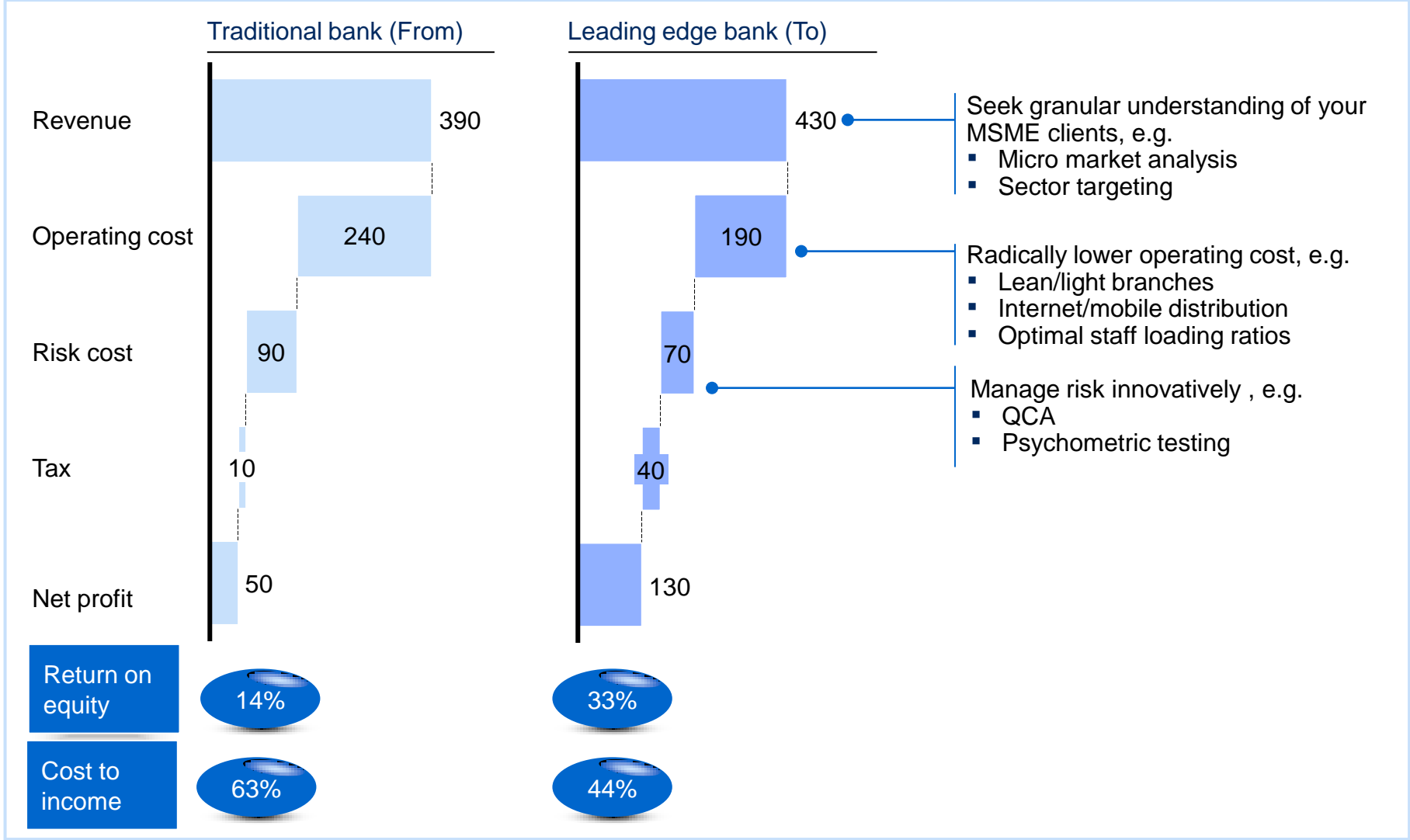
- Leverage low-cost channels e.g.
 - Contact centre
 - ATMs

Talent

LEADING PRACTICES

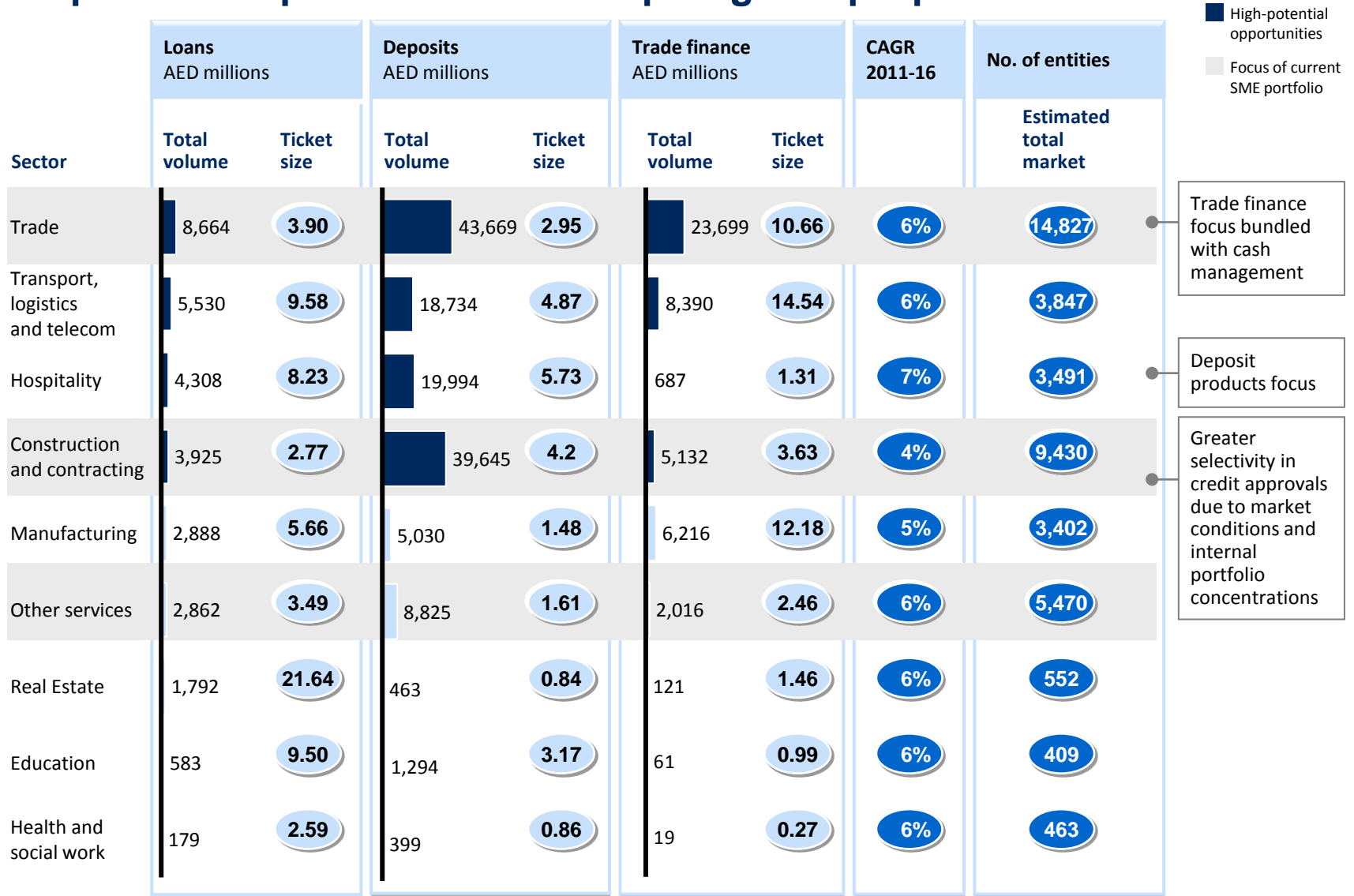
These practices can double the RoE of banks, as well as reduce cost levels by 1/3rd

Year five comparison for start up bank, USDm¹



1 Rounded to nearest USD 10m, 2 Rounded to nearest five %
 SOURCE: McKinsey analysis

For example, banks need to have a granular understanding of the SME space to help focus and develop targeted propositions



Source: Dubai Statistics Center; Abu Dhabi Chamber of Commerce and Industry; McKinsey CPAT database; Global Insights; Zawya; Team analysis

The Qualitative Credit Assessment approach has helped banks the world over reduce risk costs by ~35%

QCA uses nontraditional sources of information to increase predictive power of data light segments

Sources

Examples

Deposit relationship

- Checking account transaction history
- ATM usage history
- Tenure of customers

Third party information

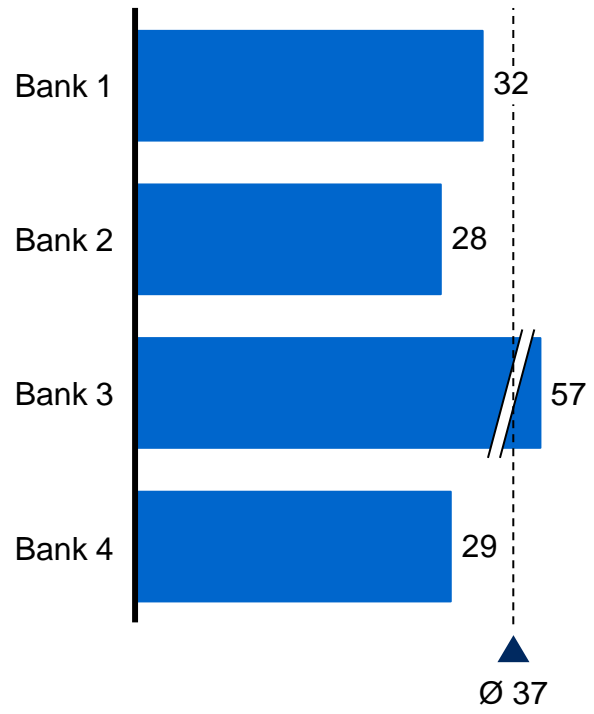
- Utility bills
- Rent payments
- Payday lending information
- Partner information

Qualitative information

- Expected PXL evolution
- Quality of operations

Resulting in lower credit loss once QCA integrated into PD rating

Credit loss reduction
Percent





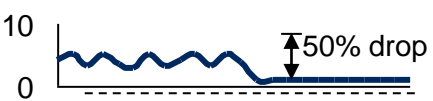
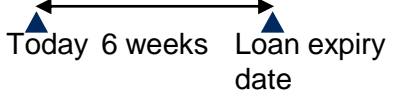


1 QCA was combined with statistical scoring model; impact includes both models but QCA by itself would also have achieved comparable impact

Transaction data can be used to develop algorithms to generate client- and product-specific leads

NOT EXHAUSTIVE

Example of triggers to look for

	What to look for	Action
Acquisition Potential BB customer in PB	Deposits 	<ul style="list-style-type: none"> > 6 deposits per month in a personal account <ul style="list-style-type: none"> Offer business account
Cross-sell Cash-rich customer Quick turnover Overdraft maximiser	Account balance 	<ul style="list-style-type: none"> Average cash balance > USD 50k over last 3 months <ul style="list-style-type: none"> Offer investment solution
	Account balance 	<ul style="list-style-type: none"> > 90% reduction in cash balance followed by regular deposits to replenish (3 cycles) <ul style="list-style-type: none"> Offer unsecured loan to grow business
	Account balance 	<ul style="list-style-type: none"> Consistent use of over-draft facility above a certain threshold <ul style="list-style-type: none"> Offer loan as cheaper alternative to grow business
Retention Disappearing cash balance Loan expiry		<ul style="list-style-type: none"> > 50% reduction in average cash balance over 3 months <ul style="list-style-type: none"> Persuade to keep business with bank
		<ul style="list-style-type: none"> WC finance and unsecured loans: 4 weeks, other loans: 12 weeks <ul style="list-style-type: none"> Offer loan renewal