



## **SME BUSINESS PLAN**

*Prepared for*

***UNITED BANK FOR INVESTMENT***

**ShoreBank International  
USAID/Iraq Tijara Program**

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## A. INTRODUCTION

The board of directors and executive management at United Bank for Investment (UBI) have signaled their intention to develop a market-leading SME business line in conjunction with a comprehensive effort to improve the bank's capabilities in line with best practices.

In response, consultants from ShoreBank International (SBI) working under the auspices of the USAID-sponsored *Tijara* project traveled to Baghdad in order to assist UBI in formulating a high-level roadmap leading to sustained profitability, leading market shares, superior portfolio quality, and market-leading service.

During a 3-week period (June 2-22, 2012), SBI consultants visited UBI headquarters for meetings with UBI executive management; on other occasions, UBI officers visited the Al Mansour compound. The findings gleaned from these meetings inspire many of the recommendations contained herein.

At present, UBI does not identify the SME segment as a preferred customer base or target market. To the extent that it makes loans to SMEs, these customers are walk-in customers, acquaintances of staff members or UBI senior management, or other targets of opportunity. UBI has neither attempted to segment the market, nor has it quantified its business objectives, whether for SME banking or other activities.

Thus, the task at hand involves the design and implementation of a *de novo* SME business line. Because the bank starts from scratch, it has the opportunity to base the design and development of its SME business line largely upon best practices in SME banking as described in Section C below.

In most cases, market data and financial information are largely unavailable. As such, the plan set forth in the following pages is necessarily high-level. It remains a work-in-progress, and it must be further detailed in the months ahead. Nevertheless, its recommendations respond in all cases to international best practice, and, in this regard, the document represents a useful roadmap for further planning.

## **B. THE CASE FOR SME BANKING IN IRAQ**

As they are in many developing countries, Iraqi SMEs are projected to be an important engine of economic growth: they generate employment and tax revenues; and, they are an effective training ground for the country's managerial and entrepreneurial classes.

The SME banking market in Iraq exhibits the characteristics found in many immature or underdeveloped markets worldwide: High demand, but low penetration on the part of established commercial bank players due to risk-averse lending policies; poor product design; and, inefficient distribution networks.

In time, the Iraqi market will evolve. If this process of evolution and maturation follows what has been observed in other markets, corporate banking will become less attractive as spreads narrow and competition will increase once foreign commercial and investment banks arrive bringing with them more sophisticated products, transaction skills, and financial technology that have special application in corporate banking. Typically, it does not take long for these banks to dominate the corporate banking sphere.

On the other hand, retail and SME banking become more attractive over time: The returns are greater, and indigenous banks enjoy a competitive advantage due to their more extensive market coverage and local market knowledge. The winners have been those banks which moved first and moved fast, i.e., built retail and SME business lines characterized by effective credit risk management; innovative product design; highly efficient and cost-effective business systems; and an organization aligned with their customers' business requirements.

Bottom line: The market is open, and no bank currently distinguishes itself as a market leader. UBI, if it emulates other first-movers, confronts an immediate opportunity to achieve market leadership defined in terms of both share and delivery quality.

## C. UBI TODAY

The outside consultants observed the following level of development during their visits to the bank and interviews with UBI staff:

### 1. *Strategy & organization*

- a. Business planning - related to overall corporate strategy or short/ medium-term tactical business planning - is not something UBI does today;
- b. Formulation of the SME business plan is the first such effort undertaken by the bank;
- c. With respect to SMEs, no attempt has been made to size or to segment the market or to establish financial targets for the SME segment;
- d. A commitment to SME banking is not reflected on the current organization chart—like most Iraqi banks, the organization is branch-driven, not product driven.

### 2. *Products & distribution*

- a. At present, UBI does not offer a set of products tailored to the unique circumstances and needs of SMEs; rather, it's a one-size, fits all strategy;
- b. Nor has the bank made an effort to structure the network in conformity with customer preferences or usage patterns—branches remain the primary (only) distribution channel;
- c. Senior management has contemplated the development of an online channel, but not development efforts have yet to be initiated;
- d. There is no question but that UBI confronts the requirement for extensive redesign its product offer, as well the requirement to leverage its technology platform for the purpose of developing alternative distribution channels.

### 3. *Credit risk management:*

- a. The role of the credit department is to prepare the request for credit approval for the credit committee;
- b. However, the analyses seldom evaluate borrowers' ability to repay on the basis of financial analysis, i.e., cash flow, debt capacity, capital adequacy, etc.;
- c. This matters little because credit decisions are reserved exclusively for members of the credit committee which are under no obligation to heed recommendations forwarded by the credit department;
- d. There is no clear separation between sales and credit risk management functions;

- e. The outcome of credit decisions is heavily (if not exclusively) focused on the value of collateral.

#### **4. Staffing & training**

- a. There is a dearth of trained, experienced people, both credit specialists and lending officers;
- b. There is no formal training program that goes beyond the short familiarization program at the time of first entry;
- c. Incentive systems geared to motivate desired behaviors and practices have yet to be put in place.

#### **5. Marketing & branding**

- a. There is little SME product differentiation between banks;
- b. It is not clear where responsibility for marketing resides in the organization (there does not appear to be a centralized corporate activity);
- c. There is little real understanding of the market in terms of size, configuration, trends & developments, customer preferences, etc. The bank's staff admits that no market research has been done, either in general or with specific reference to SMEs.

The sequence of slides in Appendix II (pages 11-16) also offer initial reactions concerning improvement measures and required actions. In turn, these are reflected in the plan's strategic planks which are discussed in the section following immediately below.

### **D. UBI VALUE PROPOSITION**

UBI proposes to deliver to its SME customers:

1. *High levels of service quality*
2. *Creative solutions to customer needs and requirements*
3. *Quick response to requests from customers*
  - a. Quick screening of credit requests
  - b. Expeditious processing
4. *Products tailored to the needs of customers and targeted industry sectors*
5. *A mix of distribution channels configured to provide*
  - a. Convenient access to the bank whether via the branch, mobile sales force, or alternative channels
  - b. Adequate geographical coverage

## E. STRATEGIC PLANKS

The gap between where UBI is today and where it proposes to go is discussed in the previous sections (Section C and D). Thus, the task going forward is straightforward: The gap between current capabilities and those necessary to fulfil expectations on the part of the bank must be measured and quantified; the SME strategy further detailed in line with the results of the gap analysis; and, an implementation plan setting forth the action steps required in order to achieve UBI's business objectives must be elaborated.

There are many banks which excel at retail banking or consumer finance. Likewise, there are many banks which have long traditions as wholesale corporate banks and are very good at it. However, there are relatively few banks which can boast of excellence in SME banking, and this despite the fact that the SME segment is frequently cited as a source of superior profitability—both interest revenues and non-funds income—as well a space where cross-selling opportunities abound.

There are a host of reasons to explain the failure of many banks to engage the SME segment: The credit risk issues are complex and sometimes thorny; the revenues from credit business alone are often not sufficient to justify the delivery costs (“I can make more money making a large loan to one large company than I can if I make many loans to many small companies”); SMEs are often unable to satisfy the information requirements of the bank, etc.

Even so, there is a sufficiently large sample of banks which have demonstrated a successful track record of lending to SMEs to be able to cull from their experience factors which have made them successful. Best practice SME banks are characterized by five success factors as illustrated in *Exhibit 1* below:

### Exhibit 1: Success Factors – Best Practice SME Banks

- 1. A laser-like focus on targeted customer segments**
  - Meaningful sub-segmentation based upon objective, measurable and accessible criteria
- 2. Products and channels tailored to the needs and preferences of targeted segments**
  - Effort to address both individual (personal) and business needs of the client
  - Careful attention to pricing strategy
- 3. Rigorous credit risk management**
  - A process that begins with an assessment of character and cash, not a demand for egregious amounts of collateral
  - Built-in incentives for maintenance of superior levels of assets and portfolio quality
- 4. Efficient lending processes**
  - From application to disbursement, processes geared for speed and low cost
- 5. A strong sales culture**
  - A dedicated sales force of well-trained, experienced, and properly-incented bankers

Implementation of UBI's SME strategy will adhere to these principles while responding to (a) the restructuring and transformation needs cited in Section C; and, (b) UBI's value proposition for SME banking described in Section D:

**1. Credit risk management:** UBI's processes should begin with rigorous assessment of character and cash, not a demand for egregious amounts of collateral:

a. *Approach:* In the short- and medium-term, UBI's capabilities will be limited to controlling risk:

- i. *Identification of risk:* Qualitative models, such as a Grading Model or Customer Limits will be used to identify riskier transactions and avoid the ones that generate certain risk types;
- ii. *Consistent measurement across all risks:* Over the longer term, UBI will develop EDF and/or LGD models (Expected Default Frequency, i.e., credit scoring, and Loss Given Default) in order to apply consistent (quantitative) risk measurement across all products and avoid those with higher relative risk;
- iii. *Find the appropriate mix between personal judgment in credit approval and automated scoring;*
- iv. *Emphasize credit training:* Immediate measures should be taken to assure that SME loan officers have experience in assessing credit-worthiness;
- v. *Data mining:* Leverage information from both the personal and business relationship of the customer in order to reduce risk.

b. *Organization:* At present, UBI's credit organization is largely a staff unit responsible for preparing the credit approval requests for action by the credit committee. There should be a determination on the part of senior management to establish the credit department as an independent unit responsible for - in addition to routine credit administration functions - detailed credit analyses, enforcement of credit and pricing policies, and, in certain cases, for credit approvals. Typically, these cases will involve smaller borrowing amounts and less complex structures;

c. *Process efficiency:* Banks have achieved significant cost reductions through process reengineering, e.g., centralization and shared processes. At the same time, more efficient credit procedures speed product delivery to clients who identify rapid response and quick disbursement as important factors in choosing a bank. UBI will look for opportunities to

achieve a scalable operating model: to automate processes; to leverage functions and transaction volumes across product groups to further reduce costs; and, to simplify operations and improve productivity through rationalized product suite;

- d. *Screening*: Credit scoring has utility in SME banking for the purpose of screening prospective borrowers. A rudimentary scoring system has been designed for the purpose of screening prospects in order to identify which prospective small business customers qualify for further assessment.

Five categories will be established and weighted on the basis of SME experience in other countries:

<b>Scoring System for Screening SME Prospects</b>		
<b>Category</b>	<b>Description</b>	<b>Weight</b>
<i>Character/ Integrity</i>	Do the owners and managers of client companies demonstrate character and integrity in the conduct of their business responsibilities?	30 points
<i>Quality of Management</i>	Are owners skilled in the disciplines required in order to manage their business successfully, e.g., financial literacy, sector knowledge, general management skills	30 points
<i>Cash Flow/ Debt Capacity</i>	Does the business generate a robust cash flow? On the basis of various ratios, (e.g. loan amount to net income, loan amount to capital, cost trends, etc.), can the business adequately support existing, or additional, levels of borrowing?	20 points
<i>Growth Potential</i>	Does the business have characteristics that suggest it will thrive in the future?; Does it operate in a sector that is either projected to be a growth sector or one strongly impacted by competitive pressure, external factors, etc.?	10 points
<i>Subjective Overall</i>	What is the appearance of the place of business? Does there appear to be a real, critical-mass-size business operated on the premises?	10 points

Each category is rated on a scale between 1 and 5, and the value is multiplied times the weight assigned each value. The score for the purpose of screening is the weighted total for all five categories (see Appendix II, pages 26-27).

2. **Customers:** A laser-like focus on targeted customer segments, to include sub-segmentation based upon objective, measurable, and accessible criteria:

- a. **Segmentation:** No step is more important in strategy formulation than the first step, segmentation. Having said that, it is important to note that banks reserve the right to segment the market in accordance with their unique market approach and business objectives. Offered below is a simple market segmentation derived from conventional practice. It is important to acknowledge that the term SME refers to both small enterprises (SEs) and middle-market or medium-sized companies (MEs). Accordingly, SEs and MEs are separated for segmentation purposes in the case illustrated below: SEs and MEs are assigned to the SME and corporate business lines respectively.

**Exhibit 2: Example of Segmentation**

Client Group	Segments	Description
Retail Banking	Mass market	Individuals with low to slightly-above average incomes and/or disposable assets
Private Banking	HNWI's	Individuals with significantly above average incomes and/or disposable assets
Micro-Entrepreneurs	Professionals	Individuals with special occupations such as medical, legal, financial/accounting, engineering
	Entrepreneurs	Start-ups or existing very small businesses with less than 10 employees and turnover < \$2MM
SME Banking	Small companies	Businesses with fewer than 50 employees and annual turnover < \$10MM
SME Banking	Medium-sized companies	Companies with up to 250 employees and annual turnover not exceeding \$50MM
Corporate Banking	Large Corporates	Companies with more than 250 employees and annual turnover > \$50MM
	Multinationals	Large corporations with operations in countries other than their country of corporate domicile

UBI Target Market

- b. **Targeted Industry Sectors:** It will be important for UBI to begin to develop expertise in industry sectors and sub-sectors which are perceived to have high-growth potential, are of strategic importance, and are prevalent in the bank's areas of operation. A relatively quick and simple evaluation of key industries based upon an evaluation of risk-reward (size of wallet) trade-offs is illustrated in the attachments (see Appendix II, page 31). For the

time being, the placement of the boxes representing various industries is illustrative.

It will be important to consider not only what exists today in Iraq but also the implications of future developments. For example, agribusiness lending might not be a specialty of UBI or an activity the bank wants to pursue; however, the future of the Iraqi agrarian sector will involve, among other things, the rapid development of greenhouse ventures which will represent from the outset a high-growth-potential prospect within the overall Iraqi SME segment.

- c. *Wallet-sizing*: Segmentation of industry sectors by wallet-size and risk parameters creates a foundation for development of a targeted approach to client acquisition. A wallet-sizing concept developed by Citibank represents an excellent budgeting and planning tool, and it is the recommendation of the consultants that UBI should develop a similar wallet-sizing tool for determining the revenue potential of major products groups in targeted customer segments and industry sectors (see Appendix II, pages 32-33);
  - d. *Client Acquisition*: Effective client acquisition (measured on the basis of the conversion ratio of prospects to actual customers) results from teamwork among the SME loan officer, the SME unit head(s), and staff from Credit Department (see Appendix II, page 34).
- 3. Products & distribution channels:** A value proposition tailored to the needs and preferences of targeted segments: efforts to address both individual and business needs of the client; careful attention to pricing strategy:
- a. *Product Bundling*: In best practice organizations, the number of products per customer is the new benchmark:
    - i. By selling products in packages, or bundles, banks have found that they can use one product that meets a priority need to secure the sale of another, e.g., using a loan to gain an SME's deposit business;
    - ii. Best practice norms: In the US, Wells Fargo reports a ratio of 8 products per customer. At one time in Europe, Société Générale promoted itself as a market leader (6.83 products/customer in 2004);
    - iii. While bundling can increase market share, its impact on profitability depends on the cost and revenues associated with each product;
    - iv. Leading banks are working to track and analyze the information they need to assess the profitability of all the products offered to SMEs.

They report, for example, that revenue from credit products represents only a fraction of total income from SME clients;

- v. Since deposit and transaction products can often be provided at lower costs than loans, it is sometimes worthwhile to provide a low-value loan to an SME if it is linked with other, more profitable products;
  - vi. Cross-subsidization of this sort is one way that banks have been able to increase the size of the addressable SME market and lend to SMEs that previously may not have warranted a loan.
- b. *Credit Lines:* Credit lines for the SME segment will be configured in accordance with conventional banking practice:
- i. The line would be a pre-approved global line with sub-allocations for various purposes and needs:
    - Overdraft (Short-term revolving line of credit for basic working capital needs: Inventory, accounts receivables, miscellaneous payments);
    - Medium-term loan (3-5 years, amortizing) for purchase or acquisition of fixed assets (P&E--buildings, warehouses, manufacturing equipment);
    - Documentary credits (L/Cs, discounted bills);
    - In the event a particular sub-allocation is fully utilized, Relationship Managers are authorized to approve applying over-line amounts to another sub-allocation;
  - ii. *Example:* Global line of 100 with sub-allocations of 70/20/10: If the short-term line is fully utilized, and if the customer needs an additional 10, the term-loan sub-allocation is reduced to 10 = 80/10/10;
- c. *Pricing:* Pricing will be aligned to the target segments in accordance with price-sensitivity and a willingness to pay for value-added services such as specialized advisory services in accordance with the levels of service as indicated on the attachment (see Appendix II, page 36);
- d. *Channel strategy/management:* In order to be effective and offer a “quantum leap”, UBI must reduce channel costs and improve its sales and service delivery capabilities:
- i. To reduce costs through channel management, UBI needs to go beyond a “one size fits all” customer migration strategy and tailor migration tactics segment-by-segment. This will require an

understanding of customer segment profitability and channel preferences;

- ii. To maximize sales through channel management, UBI needs to integrate customer information across all channels, expand cross-channel sales capabilities and develop an effective sales force;
- iii. Succeeding in reducing costs and enhancing sales requires coordinated channel strategy and management whereby each channel's responsibilities are well defined in terms of the segments, products and activities they focus on;

e. *Alternative distribution channels:* As the market matures, UBI will be forced to develop a broader channel mix in response to customer demands. For the time being, branches will continue to be UBI's primary channel. However, the bank should immediately initiate efforts to assess the utility/demand for alternative channels: ATMs; Kiosks; Mobile phones, etc. Two alternative channels merit special mention because of their special relevance in SME banking (see discussion in Appendix II, pages 44-47):

- i. *Mobile sales force:* A mobile sales force addresses the trade-offs between efficiency for the bank and SME clients' needs related fast turnaround, proximity, and convenience;
- ii. *On-line banking:* Online banking has proven to have special application in SME banking because of the preference expressed by SME owners for accessing their bank via the Internet.

**4. Staffing and training:** UBI must go about building a dedicated sales force of well-trained, experienced, and properly-incentivized bankers (see Appendix II, pages 49-51):

- a. *Qualifications:* SME loan officers should combine sales and relationship management skills; industry/sector-specific expertise; in-depth understanding of the SME product offer; excellent credit skills; experience in structuring and loan pricing. In particular, they should be adept at understanding the interplay between the personal and business needs of SME owners and senior managers;
- b. *Motivation/Incentives:* Stature will be important. UBI should put its SME lenders on par with other areas in the bank in terms of compensation, career opportunities, and prestige;

- c. *Training:* Training programs should be geared to bolster the skills necessary for success in SME banking:
  - i. *Train effective salesmen* able to identify client priorities and “hot buttons”, position the offering, and negotiate the right conditions;
  - ii. *Prepare teams of competent bankers*, able to credibly discuss financial matters with clients with particular emphasis on definition of financing and other product requirements, analyses of the client’s business, and sound product knowledge;
  - iii. *Create goal-oriented culture* and high urgency awareness through experiential learning and other techniques

## **5. Marketing and branding:**

The UBI brand for SMEs will be differentiated by price, image, and media strategy while linking to UBI’s overall reputation and image. A discussion of critical success factors and implementation priorities is found in Appendix II, page 53.

It is worth highlighting the fact that market research might determine that UBI is advised to establish a new or unique brand for its SME offer. This would not be unusual—many banks find that their reputation in the market is at variance with SME banking, e.g., a bank whose reputation is defined in terms of a traditional corporate bank or one known as a consumer finance company. The larger point is that UBI should not hesitate to initiate market research effort for the purpose of revealing how UBI is perceived in the market, what products and services SME customers want, and how UBI needs to reposition its brand image in response to the SME initiative.

## **F. ORGANIZATION**

There are many approaches to organization: centralized vs. decentralized; staff-driven vs. business line-driven; etc. Various approaches have proven to be successful. In fact, it is easier to identify characteristics which generally lead to lack of success, such as: silo-based structures where top-down communication is promoted at the expense of bottom-up or horizontal communication; or, structures characterized by over-lapping authority and duplication.

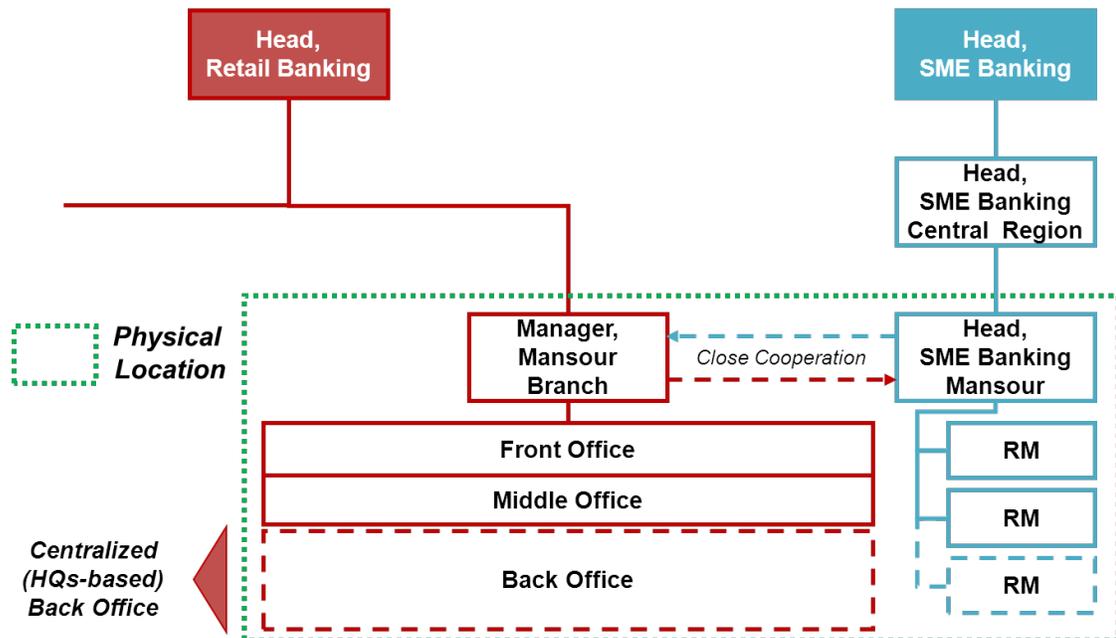
In establishing its SME business unit, UBI will be guided by conventional practice and best practice norms and standards:

1. **Best practice in SME banking:** Experience reveals that success is more often achieved when the SME business line is segregated as a discrete business unit

or profit center. This is not to say that the SME unit cannot be incorporated within larger corporate or retail banking departments; however, the segregation of the business line facilitates (a) the deployment of resources trained in the special skills required to do the business successfully, (b) a more rigorous segmentation of SMEs, and (c) more precise measurement of the SME unit's profit contribution (account profitability and product profitability);

2. **Matrix management:** At the branch level, SME units will share premises with retail banking, but reporting lines will reflect the establishment of SME units dedicated to serving the unique needs of the SME customer groups (see *Exhibit 3* below);

**Exhibit 3: Matrix Management**



\* Assumes (1) primary responsibility for managing branch network has been assigned to Head, Retail Banking; and, (2) SME Banking established as a discrete business line

3. **Matrix principles:** The following principles will characterize UBI's organization with respect to the relationship between SME Banking and UBI branches:
  - a. Branch managers will be responsible for all retail businesses as well as branch operations (in time, the bulk of the back office functions lodged within the branches should be centralized/regionalized);

- b. Relationship Management teams will be organized both at branch locations and at head office. The former will be dedicated to developing relationships with companies in the SME sub-segments, which are found in the region where the branch is located. UBI may also consider specialized industry teams, e.g., construction lending, that can be centralized (located at head office);
- c. Branches will serve as the “landlord” for SME personnel assigned to the branches, and they will provide operational support to SME customers (some branches might be fully dedicated to SME business);

## **G. SME FINANCIAL MODEL**

The concepts discussed below in Sub-paragraphs E.1, E.2, and E.3 are more fully developed in Appendix II, pages 60-69.

1. **Methodology:** There are many ways to develop a financial model. In this case, the consultant determined that estimating the size of the SME market in terms of supply and demand is likely to yield more reliable results than, say, a model based upon loan officer productivity (number of loans per officer per month).

The process involves the following steps:

- a. Estimate supply and demand of SME loans in the market using the total number of economic enterprises in Iraq and average SME loan size;
- b. Apply conservative assumptions to determine addressable demand:
  - i. Demand in the formal sector;
  - ii. Demand in the segment of the SME portfolio to be addressed by private banks;
  - iii. Demand on the part of creditworthy SMEs;
- c. Apply market share aspiration in order to project UBI’s SME loan portfolio;
- d. Apply further assumptions to estimate costs and resources required:
  - i. Interest rates
  - ii. Product characteristic
  - iii. Staffing structures

- iv. Staffing levels
- v. Salaries and other employee-related expenses
- vi. Occupancy expense
- vii. Transportation
- viii. Other income and expenses
- ix. Fixed assets

e. Develop full financial projections.

**2. Market Size / Portfolio Growth (2012-17):** UBI's potential SME loan book at Year 5 is driven by assumptions for credit demand, asset quality and market share aspirations:

- a. 2.4 million enterprises countrywide x 88% (based upon average penetration rate of 12% reported in Reference a) = 2.112 million non-banked SME enterprises;
- b. 2.112 MM non-banked SMEs x \$15,000 average SME loan (estimate) = \$31,680 billion total demand in the system;
- c. \$31,680 billion total demand x 50% (estimated demand in the formal sector) = \$15,840 billion total demand in the formal sector;
- d. \$15,840 billion x 50% (volume handled by state-owned banks) = \$7,920 billion demand in the system available to private banks;
- e. \$7,920 billion x 33% (estimated number of creditworthy enterprises) = \$2,614 billion demand on the part of creditworthy SMEs;
- f. \$2,614 billion x 5% (UBI market share aspiration) = **\$130.7 million (volume of SME loans at the end of year 5).**

If one assumes that the total loan book in the Iraqi banking system roughly doubles between now and 2017 from \$1.721 billion in 2010 (see Reference b) to \$3.5 billion, UBI's \$131 million SME loan book at Year 5 represents a ~ 4% market share. This figure roughly correlates to UBI's market share aspiration of 5% (the fact that it is slightly less than 5% derives from the fact that the assumptions used in this analysis are very conservative).

Another method for estimating the size of the SME loan book at Year 5 is to calculate the number of *borrowing* relationships (32 SME loan officers x 120 accounts x 75% estimated borrowing ratio = 2,880 borrowing accounts) and apply an average borrowing amount (\$30,000 = 2 loans of \$20,000 average loan size with one paid down to \$10,000) = \$86.4 million in total SME outstandings.

At this point, these numbers are rough estimates. Both the low and high estimates are the result of conservative assumptions. However, the important

point is that both estimates represent feasible targets, e.g., \$131 million in Year 5 with 32 SME loan officers, average loan size 20,000: (a.) 6,550 loans; (b.) ~205 loans/per officer; (c) 120 accounts/officer = 1.7 loans/account.

3. **Next steps:** These concepts have been discussed with UBI's general manager and members of the senior management team. The same discussions will be organized to include UBI's chairman during the consultant's next visit after Ramadan. In the meantime, it remains to gather additional market data and financial information in order to finalize the business (financial) plan. This is the task between now and the return visit of the consultant in September following the Ramadan period. The specific information required has been conveyed to the bank during meetings and in written form (see Appendix III, memorandum to Saif al-Halfi dated June 19, 2012).

## H. IMPLEMENTATION

1. **Implementation Tasks:** Following the development of the plan for the SME business line, the following implementation tasks will be undertaken in sequence:

- a. Board and Senior Management: Accept/approve the proposed SME strategy, changing as required;
- b. Communicate the SME strategy to both internal and external constituencies on the basis of a carefully considered communication plan;
- c. Constitute a Project Team empowered to drive implementation of the SME strategy;
- d. Initiate credit training at beginning (entry), intermediate, and advanced levels for SME lenders.

### 2. *Value-based Segmentation Work Plan*

- a. *Customer Segmentation*
  - i. Classify customers into profitability groups
  - ii. Measure customer preferences
  - iii. Develop segment profiles
  - iv. Assess Net Present Value of each segment
  - v. Select the most promising ones to target

- vi. Build customer knowledge (surveys)
- b. *Product Definition*
  - i. Prepare offer tailored to customers needs
  - ii. Develop standardized, packaged products
  - iii. Develop standardized commissions and fees structures
  - iv. Recognize synergies with personal lending
- c. *Risk/Pricing Management*
  - i. Institute measures to bolster efficiency of credit risk management system
  - ii. Portfolio management of risk (secured only)
  - iii. Implement risk-based pricing
  - iv. Define customer loyalty and performance incentives
  - v. Individual credit risk management (Medium Enterprises/ME)
  - vi. Risk and relationship based pricing (ME)
- d. *Relationship Management*
  - i. Align customer relationships with the strategy
  - ii. Develop mass marketing approaches
  - iii. Target “profitable” clients through marketing campaigns (ME)
  - iv. Ongoing relationship management (ME)
- e. *Channel Rationalization*
  - i. Rationalize channel usage
  - i. Migrate least profitable customers to less expensive channels
    - ii. Agressively move transactions and servicing to remote channels
    - iii. Encourage low-profitability clients to improve by charging higher fees
    - iv. Motivate sales reps to have face-to-face meetings in order to increase cross-sell ratio (ME)
    - v. Develop relationships with associations and industry groups (ME)
    - vi. Develop telephone banking and electronic channels (ME)
- f. *Lending Effectiveness*
  - i. Segment specific lending processes
    - ii. Mass market mailings
    - iii. Applications through mail
    - iv. Credit scoring as a “screen”
    - v. Calls on high priority client leads
    - vi. Simplify underwriting techniques by segments
    - vii. Target “profitable” relationships (ME)

- viii. Dedicated sales officer assigned to call/convert prospects into relationship (lead generation and monitor call performance) (ME)
- ix. Sales officers to manage and grow relationships (ME)

**3. *Special Challenges:*** The challenges in SME banking are most often expressed in terms of segmentation (the need to rigorously segment the market) and asset/portfolio quality:

- a. Generally, there is a lack of experience and knowledge about the SME segment (customer group), in particular, their special needs. Too often, SMEs are treated either like individuals or like large companies;
- b. The relationship between the business and personal needs of SME owners is often imperfectly understood. When facilities are granted, little effort has been made to distinguish between them;
- c. Increased fees, lack of client readiness to use e-channels, inaccurate segmentation, and misunderstandings related to customer needs and preferences can lead to customer defections;
- d. Care must be taken to gear sales force incentives to profitability and customer retention, not only loan volume. The idea is to acquire a permanent relationship while making good loans;
- e. Pricing is too often driven by “market share” considerations rather than an evaluation of risk and creditworthiness;
- f. Credit processes are frequently inefficient (manual) due to a lack of advanced scoring tools.

**4. *Risks:*** UBI is exposed to (a) systemic risks which, in the case of Iraq, are significant; and, (b) enterprise risks which derive from UBI’s unique circumstances

- a. *Systemic Risks:*
  - i. Subsidized lending rates offered by state-owned banks;
  - ii. Political instability/security issues;
  - iii. Weak/immature regulatory regime;
  - iv. Corruption; and,
  - v. Under-developed infrastructure.

b. *Enterprise risks*

- i. Underdeveloped technology platform;
- ii. Dearth of experienced lenders;
- iii. Funding shortfalls/mismatches; and,
- iv. Defection of skilled staff to other banks

To some extent, risks can be mitigated through training and operational improvements, some of which are outlined in this document; however, risks will not abate in the near- or medium term. It remains for UBI to be alert to evolving market conditions, to assess how these changes impact UBI's SME business model, and to define immediate responses.

**References:**

(a) USAID/Iraq, Market Assessment Summary, Section 4.2 Access to Finance Constraints, ppg 47-59 (June, 2010)

(b) Iraqi Exchange, "Perspectives on Iraq's Private Banks" (September 15, 2011)

**Appendices:**

I. "A Plan for Achieving Market Leadership in SME Banking in Iraq" (Discussion Document (Part I), June 6, 2012)

II. "A Plan for Achieving Market Leadership in SME Banking in Iraq" (Discussion Document (Part II), June 22, 2012)

III. Memorandum to Saif al-Halfi, General Manager, UBI, entitled "Next Steps" (June 19, 2012)