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FORMATION OF A SME LOAN DEPARTMENT

A Report for the Bank of Jordan

September 27, 2007

This publication was produced for review by the United States Agency for International Development. It was prepared by Kevin O'Brine Consultant to BearingPoint Inc and Eman Malkawi Subcontract to BearingPoint.

FORMATION OF A SME LOAN DEPARTMENT

A REPORT FOR THE BANK OF JORDAN
SUSTAINABLE ACHIEVEMENT OF BUSINESS EXPANSION AND
QUALITY (SABEQ)

CONTRACT NUMBER: 278-C-00-06-00332-00

BEARINGPOINT, INC.

USAID/JORDAN ECONOMIC OPPORTUNITIES OFFICE (EO)
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DELIVERABLE 1.5.3.1 LOAN APPLICATION AND
ADMINISTRATION DIAGNOSTICS TO IDENTIFY MEASURES
TO ENHANCE EFFICIENCY (UP TO 5 BANKS)

DISCLAIMER:

The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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ACKNOWLEDGEMENT

We wish to acknowledge the superb direction we received from Mr. Mohammad A. Hamdan, Deputy General Manager, and from Mr. Abdel Hameed Al-Saeed, Executive Manager.

We also wish to thank Mr. Mohammad A. Hamdan for making his professional staff available for meetings.

EXECUTIVE SUMMARY

The Bank of Jordan has invested management and resources to form a separate SME Loan Department and part of its strategic plan was shared with the Advisors.

The Scope of Work assigned to the Advisors was to identify challenges to efficiently operating the new department and to pricing new loans. Our analysis follows:

- Strategic Plan: The bank is developing a strategic plan.

Recommendation: Consider having an outside expert review the final strategic plan before significant actions are taken or funds are invested.

- Market: Substantial analysis was performed on the SME market and the bank's loan portfolio.

Recommendation: Consider having Relationship Officers verify certain assumptions made for Micro, Small and Medium sized loans.

- Loan Process: The bank is in the early stages of credit scoring and knows this holds the key to efficient processing. It is considering scoring small, Micro size loan applications.

Recommendation: Credit scoring could proceed on a pilot basis for Micro loans until critical scoring tools are available, e.g. Credit Bureau.

Recommendation: Before/after credit scoring, consider performing a time study on the loan application process and identify ways to speed processing and lower costs.

- Products:
 - (i) Some work was performed on financing products for borrowers that offer private sector receivables as collateral.

Recommendation: If priced properly for risk and monitoring costs, receivables financing can be a solid contributor to the SME loan portfolio.

(ii) HSBC's new SME loan product appears attractive and inexpensive to the borrower since no collateral is required.

Recommendation: Consider a collaborative agreement with HSBC or risk losing customers and market share.

- Pricing: The bank wants to develop a pricing model for SME loans.

Recommendation: Consider building a SME pricing model or adapting an existing model using Base Rate Cost Components and Risk Adjustments as shown in this Report.

- Service Capability and Issues: Changes in loan processing have resulted in customer complaints.

Recommendation: New loan processing issues are best addressed with an active communication and education campaign starting with staff and customers.

- Staffing: As the bank hires new officers, it needs better “market” information on salaries and other incentives offered at other financial institutions.

Recommendation: Consider a collaborative effort among the banks to survey and obtain salary information on a confidential basis.

BACKGROUND AND SOW

Two Credit Advisors (Advisors) worked in Jordan between August 25 and September 28 on the broad topic of access to financing for Small to Medium Size Enterprises (SMEs). The Scope of Work (SOW) was assigned under the USAID funded Sustainable Achievement of Business Expansion and Quality Program (SABEQ). This report (the Report) is one of the deliverables required under the SOW.

Tasks Under SOW:

- Meet with additional banks (up to 2)¹ at their invitation to review their SME lending functions for efficiency. Include pricing of SME loans in the analysis.

Meetings and Issues:

- The Advisors met several times with Mr. Mohammad Hamdan and with Mr. Abdel Hameed Al-Saeed who is responsible for managing the new SME Loan Department
- The Bank of Jordan (the Bank) invited the Advisors to comment on issues facing the new department regarding strategic planning and cost/pricing methodology
- This Report covers specific issues and the information herein is subject to SABEQ's non-disclosure and confidentiality letter to the Bank, which is shown in APPENDIX A.

Another report was written as part of the Advisor's SOW for the banking sector on the subject of SME access to financing and formation of a SME Loan Department.² Brief sections of that report are repeated herein and will be referred to as the "Bank Report".

¹ The original SOW stated "up to 4 banks"; time limitations and observance of Ramadan limited this work to 2 banks

² Formation of a SME Loan Department; A Report for Banks in Jordan, September 27, 2007

THE SME MARKET

{ Summarized from the Bank Report }

1. Size

One estimate puts the current size of the SME market in excess of 105,000 registered firms.

2. Definition

The SME market has no common definition or parameters set among the banks.

3. Women Owned Businesses

Women Owned Businesses are particularly challenged when accessing financing even though this segment holds much promise. Jordan is not alone in resolving this issue.

4. Banking Sector

Banking trends and statistics bode well for SME borrowers. The presence of a relatively large number of banks means more choices for SMEs and more competition among banks to service SMEs. A high ratio of branches to residents on a country-wide basis should lead to higher levels of service and greater convenience for SMEs. Why? Because branches are normally the sales and distribution points for SMEs clients. Finally, narrow lending margins are predicted, which means cheaper interest rates for many SME loans.

SOURCES OF FINANCIAL INFORMATION

{ Summarized from the Bank Report }

1. Business Development Center

One major advantage of the Financial Bridge Software is it ushered in “Credit Scoring” to several key banks. Credit Scoring models are used to help predict the likelihood of timely loan repayment. These models were used for many years by banks in developed markets to score consumer or individual loan applications. Most models have been deemed statistically valid and acceptable to regulators. Credit Scoring for SME loan applications took hold in the US in the early 1990s and brought large cost savings to banks offering SME loan products on a volume basis. If similar scoring models can be used effectively in Jordan, BDC and its Software is responsible for at least introducing the concept to many of the same banks that want to develop scoring models.

2. Credit Information

The current practice of gathering credit information on prospective borrowers is inadequate.

- The Central Bank of Jordan (CBJ) will provide information about prospective borrowers to the banks. However, the information is provided for loans reported to the CBJ in excess of JD 30,000. This means that many smaller loans are not reported thereby rendering the CBJ data base incomplete
- Many bankers we visited feel the minimum reporting threshold should be reduced substantially for banks wishing to use CBJ’s data base for SME related loan applications
- Banks can make informal credit inquiries with other banks but, though well-intended, these inquiries many times are ignored, or the responses are of little value. Moreover, inquiries on a formal basis may run afoul of current law or regulation.

Studies in the US have shown that SME owners that pay their mortgage loans, credit card bills, utility bills and other home-related bills are highly likely to repay their business loans. Consequently, credit scoring models favorably weight and score SME loan requests when a Credit Bureau report shows timely payment of home-related loans. Unfortunately, the banks in Jordan and potential SME loan applicants must proceed without this kind of service.

SUMMARY OF BANK FINDINGS

{ Summarized from the Bank Report }

1. Organization and Commitment

For the purposes of this Report we will place banks into one of two categories:

- Category One Banks plan to focus on the SMEs market but have yet to form a separate Department, or
- Category Two Banks now focus on the SME market and operate under a separate SME structure, or will do so soon.

2. Sales, Service and Delivery

The majority of Category Two Banks are planning sales outreach to existing and new customers through their branch system. Credit decisions are generally centralized.

3. Human Resources and Training

Category Two Banks are recruiting actively but more than one bank cited problems finding qualified candidates in Jordan. Most have provided some level of training.

4. Credit Guarantee

The Advisors performed a preliminary assessment of the SME Guarantee Programs offered through the Jordan Loan Guarantee Corporation (JLGC) and Development Credit Authority (DCA). That assessment has not undergone review by the client.

5. Strategic Planning

Both Category One and Category Two banks need assistance to formulate strategic plans for servicing the SME market, to design a special loan department and to introduce competitive loan products. Pricing the new loan products and forecasting operating costs are only two of the challenging tasks involved. Some banks have consulting firms providing assistance.

A Case Study

(See Appendix B)

RECOMMENDATIONS

{ Summarized from Bank Report }

1. Credit Scoring

Valid Credit Scoring models present the greatest hope for efficient processing of SME loan applications. The widespread use of scoring models within banks depends on:

- Upward mobility on the “Learning Curve”
- Sharing Credit Information (a short term solution to no Credit Bureau)
- Enhancements to existing scoring software (bank or BDC models)
- Speed of Conversion to Scoring Models
- Trust in Credit Scoring by Using a Pilot Phase

2. Assistance with Strategic Planning

3. Better Define SME Parameters

4. Alignment with Microfinance Institutions

THE BANK OF JORDAN

Background:

The following information was provided by the Bank:

Market

The Bank's customer mix over the past three years has changed from SME & Retail loans 60% and Corporate loans 40% to about 50% each. Bringing distribution back to former levels would better diversify risk since SME/Retail loans are for lower amounts and are spread among more borrowers.

The Bank has researched the SME market using several sources including the Chamber of Commerce. It also performed a thorough review of its loan portfolio. SMEs were segmented based on industry category and loan size. The Bank will now use this data to establish maximum exposure for new products. Some of this information is shown in Table 1.

Table 1.

Size	Micro	Small	medium
% of SME Portfolio	55 %	31 %	14 %
Max Product Exposure	Not determined	Not determined	JD 500,000 funded 1,000,000 unfunded

SME Loan Process

Branch staff with support of Service Centers will obtain loan applications and send to Risk Management at the Bank's headquarters. Risk Management is responsible for analysis and recommending loan decisions to senior management. The Bank will consider limited loan authority for each Service Center to allow for approval or denial of Micro sized loan amounts. The Bank is in the early stages of assessing credit scoring and knows scoring will play an important part in SME loan decisions. For now, it's well settled that all Small and Medium sized loan decisions will go through Risk Management.

Loan Products

No new SME loan products are ready for roll-out. Some are under discussion along with risk mitigation measures such as a more diversified Accounts Receivable financing facility. Good market opportunities exist for financing receivables from government entities because terms of payment are relatively easy to verify and payment is more certain. The current product for financing private sector receivables is limited to one receivable at a time as opposed to financing several receivables. Although several reasons were given, the main reason is lack of a Credit Bureau to analyze credit histories of obligors.

Pricing

Management would like to study a “clean” pricing model.

Costs

Building efficiency into the loan process is a major issue for the new department.

Service Capability

There are 82 branches in Jordan; 24 branches in Amman. The Bank decided recently to have 6 to 8 Service Centers dedicated to the SME market that will support branch sales and service in Amman. A pilot is now in process for 6 Centers supporting branches in west Amman, which is where the bulk of existing clients is located. Relationship officers would be assigned roughly 50 – 60 existing/prospective customers.

Service Issues

At least one service issue has come up and more are expected. As the Bank converts to a new loan process, some existing SMEs complain the “new” process is less convenient and takes more time.

Staffing

Staffing is considered a major issue. Management took great care to draft new position descriptions and identify human gaps in the new work flow. The Bank noted problems recruiting capable staff at higher levels, which leaves few options. One is to hire at lower levels and “train up” personnel that would work under close management supervision. This option won’t fill some important gaps at higher levels like credit analysts, many of whom were recruited from local banks for positions outside Jordan. Moreover, recruiting analysts and higher level staff means paying high salaries and incentives. Many times the Bank does not know “market” rates or how long these people, once hired, will remain at the Bank.

Public Outreach and Education

Management believes SME borrowers continue to need education. Despite the helpful initiatives by BDC and other groups, more must be done in this area if banks and SMEs are to communicate and work with each other on a broader scale.

Advisor Comments

Introduction:

The Bank was very cooperative in providing certain written and considerable amount of oral information. The Advisors responded orally to many issues raised by the Bank, some of which are written here. However, one should not interpret this section as a serious analysis of the Bank's written strategic plan to form a SME Loan Department because the Bank's written strategic plan was not shared with the Advisors. We hope that our discussions with Bank management as well as the following recommendations are helpful to the Bank.

Strategic Planning:

The formation of a SME Loan Department is a natural response to market and competitive forces but it introduces formidable challenges including the Bank's need to offer new loan products, develop a specialized credit process and integrate work flow among departments that, in the past, were not interactive. Moreover, the Bank will likely commit considerable resources to the new department and its success will impact the Bank's brand name and reputation in the marketplace.

Banks have overcome similar challenges and have successfully met strategic goals after creating and adhering to a well-conceived strategic plan. Clearly, the Bank has considered at least some of the important steps for strategic planning. Nonetheless, the following questions come to mind:

- how extensive was the Bank's strategic planning process,
- did it consider all critical areas, and
- did experienced professionals assist or review the plan.

The Advisors can not answer these questions but the Bank can. Table 1 is an abbreviated illustration of a Strategic Planning Process (Appendix C shows an Outline in full narrative form). This material was originally presented to senior management faced with making radical changes to an existing financial institution. However, the same material can be useful to managers planning strategy to service an important market segment, e.g. SME market. After reviewing this material, the Bank may elect to revisit its Strategic Plan. The general rule is it is never too late to change a plan or create new sections. If sections of the plan are now considered important, but were considered unimportant and left out during the planning stage, the Bank may interpret this as a clear sign that it needs help with strategic planning.

Recommendation:

At a minimum, review and compare a complete planning process like the one shown in Table 1 and Appendix C with the one the Bank used to develop its strategic plan for a new SME Loan Department. Consider paying a consultant or a consulting firm to review the Bank's strategic plan before major actions are taken or funds are invested.

Outline for Strategic Planning (See Appendix C for more details):

Table 1

Overview/ Introduction	Planning Process	Operating Plans	Managing the Plan
Introduction	Overview of Process		
Plan for the:	Step 1: Define strategic approach	→	Integrating Business Planning
→	Step 2: Situational analysis		
Business	Step 3: Competitive Advantage and Core Competencies {Three keys to competition}	Measurable goals (Performance Based)	
&		→	
→	Step 4: Vision	Approve Operating Plans	Managing Implementation of Business Plans
Competitive	Step 5: Mission Statement		
	Step 6: Values	→	
	Step 7: Strategic Options	Implement Operating Plans	
	Step 8: Goals		
Environment	Step 9: Yearly Targets		
	Step 10: Implement		
Mapping →	Pro-forma projections/targets	→	Strategic Plan - Annual Review & Revision Process
Results	Tracking projections vs. actual Adjustments		

Market and Portfolio

The Bank performed an extensive study of the market and its internal loan portfolio. Although time consuming, the Bank will not regret this action and likely retrieved solid data. Segmentation of the existing loan portfolio based on industry group will also provide good data for marketing and loan processing. On the other hand, we fail to see how loan size should be considered a fair barometer. Why? Because a Medium sized company (using the Bank's criteria) may only borrow small loan amounts and be placed in the Small category; or a Small sized company may have used relatively larger amounts of collateral to obtain larger loan amounts and be categorized Medium sized.

Recommendation: Relationship Managers should confirm categories as sales calls are placed with existing borrowers. Management may want to reconsider loan size as a measure unless a verification step is used.

SME Loan Process

The Advisors were not shown a work flow chart so our comments will center on efficiency. We understand that the Bank wants to develop cost efficient loan products. In our Bank Report we recommended that credit scoring and the refinement of credit scoring models are important cost efficient tools for volume based SME lending operations. The Bank Report also noted obstacles to credit scoring in Jordan, such as the absence of a credit bureau, and provided recommendations to address these obstacles.

We understand that the Bank may use credit scoring for Micro size loans with approval at the Regional Level, without further processing through Risk Management. Depending on the credit scoring model, this may be a good way to introduce scoring at least on a pilot basis. The Bank Report describes the pilot approach.

Recommendation: Consider using a validated credit scoring model **on a pilot basis** for Micro loans until a comfort level is reached and an appropriate credit history is developed. Given the relative absence of critical scoring tools, e.g. no Credit Bureau, a modest expansion may be considered after successful use of scoring on a pilot basis.

Loan Products

The Bank wants to expand Accounts Receivable (A/R) financing for borrowers with credit amounts due from their private sector customers or obligors. The Advisors did not review and offer no opinion on the A/R collateral filing/notice process in Jordan.

It does make sense to explore this particular product, particularly if the Bank has had success financing similar loans involving the public sector. Again, we understand how a Credit Bureau would enhance the information and efficiency involved with this new product (see Bank Report on Credit Information). Lastly, similar products in other markets have more maintenance expense such as an auditor checking the borrower's records once a quarter. Such expenses are normally passed on the borrower.

Recommendation: Explore and test a broader A/R loan product using risk mitigation measures and quarterly auditing.

Competitive Loan Products

HSBC is a leading international bank with a presence in Jordan and has introduced recently a new SME loan product. This bank reportedly uses a credit scoring model that was developed in Dubai to analyze SME lending applications in Jordan. We were told by a salesperson in the Business Banking Unit (SME Facilities) that the model is “working well” and applications are processed quickly. Since product launch, 25 – 50 facilities were reportedly scored and approved.. No other details were provided regarding efficiency. The product details are public information:

- loan amount up to JD 100,000 (max direct/indirect exposure is JD 60,000/40,000)
- no collateral required
- principal owners or partners must guarantee the loan

It’s worth noting that HSBC offers other SME products including general credit facilities up to JD 700,000 (no details provided), pre-approved corporate credit cards and a full array of deposit services.

The Bank and other local banks in Jordan face a dilemma. One option is to match HSBC with a similar product though it lacks a credit scoring model to analyze loan applications. This option presents obvious risks such as poor service and the prospects for increased non-performing unsecured loans. A second option is to match some of the terms of the competitive product and assume some measure of additional risk. A third option is do nothing and wait until credit scoring allows the Bank to compete on a more level playing field.

There is a fourth option that banks generally detest but the Bank may wish to consider. The Bank could approach HSBC on a cooperative basis. HSBC would provide its scoring model, after inspection and satisfaction by the Bank, to score loan applications. The Bank would use its name and extensive branch network to generate loan applications. Loan amounts, fees and interest income would be shared as well as risk of loss. The main benefit for the Bank is a look inside at a scoring model that was tested and deemed acceptable by one of the world’s largest banks. Perhaps it would bring the Bank one step closer to developing its own model in the future. For this reason, any cooperative agreement between the Bank and HSBC would need to be short term and renewable by both parties, and the terms fairly broad regarding the Bank’s ability to make similar loans in the future using its own scoring model.

Strategic planning for product development can be found in Appendix C under Strategic Planning Process - C. Step 2: Situational Analysis, External and Internal and D. Step 3: Competitive Advantage and Core Competencies.

Recommendation: Pursue aggressively the development of a valid and usable credit scoring model. Collaborate with other banks, perhaps through the ABJ, to overcome obstacles to

developing scoring models. Consider a collaborative effort with HSBC that would allow use of its scoring model for SME loan applications generated by the Bank in return for a share of loan related fees and income. If the Bank and HSBC elect to proceed, a time restrictive agreement that would allow future unilateral based scoring is in the Bank's best interest.

Lower Cost/Time Burden on SME Application Process

The previous section of this Report addressed credit scoring. After completing the pilot phase and absorbing implementation costs, lower cost/time burdens are realized by banks that adopt credit scoring to process a high volume of loan applications.

Other efficiencies may be realized if a bank undergoes a time study to analyze the loan application process. A time study will track the time and costs to process a loan application from inception until denial or approval. Normally, an approved application is not considered complete until after the loan is documented and disbursed. The time study provides a base line and, hopefully, allows a manager to find ways to speed the process and decrease costs. Software is available to run time studies and analyze results, which may eliminate or reduce the need for outside consultants.

A time study and analysis was completed on the Case Study noted in the Bank Report (summarized in Appendix B). A significant cost area that emerged from the study was prolonged processing of incomplete loan applications and the extra time it took analysts communicating with relationship officers and branch personnel before a "complete" loan application was finally received. The bank used targeted training of branch personnel, incentives and manager intervention to improve processing results and use analyst time to complete the application process.

Recommendation: Obtain software to perform a time study of the loan application process. Look for ways to speed the process while lowering cost areas.

Pricing SME loans

SME Pricing and Risk Adjustment

This section demonstrates how a pricing model for corporate loans can be converted to price SME loans. For the purposes of this section, we assume credit scoring is used to make SME loan decisions.

1. The total pricing or interest rate range for a given SME loan is calculated as follows:

Base Rate Profitability Components plus the net total of all Risk Adjustment Components (See chart in See Appendix ____).

2. Base Rate Lending Cost Components are shown in Table 2:

Table 2.

Base Rate Components	Rationale/Comments	Estimated Cost	Participants
Marginal Cost of Funds	<ul style="list-style-type: none"> - Cost of funding a new loan is, to a large extent, the cost of deposits generated to fund the loan³ - Many banks consider the cost of variable deposits as the marginal funding cost⁴ - Accuracy suggests that actual costs be based on most liquid portion of variable deposits - Ideally, the cost should be varied to match loan maturity 	<p>10% (Assumed as present cost of one-year fixed deposit)</p> <p>Do not change if variable deposit rates are less than 10%; increase to variable rates if more than 10%</p>	Treasury, Asset Liability Committee or other members of Management.
Reserve Adjustment	<ul style="list-style-type: none"> - Assume reserves required for all deposits - Assume no interest received on reserves - Actual adjustment is more than actual requirement to reflect management costs - Formula is: deposit cost times % reserves required 	2.5% (Assumed)	Same
Loan and Deposit Servicing Cost	<ul style="list-style-type: none"> - The average cost of servicing fixed deposits and loans - Determining exact calculations is a complex cost accounting/allocation exercise 	2% (Assumed)	Accounting. Outside accounting firm may assist.
Subtotal		14.5%	
Taxes	- Assumes taxes are paid before any profits available for retention or distribution	Other margins to be adjusted	Treasury and Accounting
Fund Growth	- Assumes bank must retain sufficient earnings to support new growth, e.g. at minimum, assume Tier 1	.40% - .60 % (for growth of 10 – 15%)	Various

³ SME departments may elect to use SME customer deposits as a cost reference

⁴ Until SME departments can measure or accumulate SME generated demand & savings deposits, general variable deposit costs may be the best measure

	capital to risk-weighted assets must be 4%		
Additional Profits	<ul style="list-style-type: none"> - Additional profits to meet shareholders' objectives above capital appreciation from retained profits - Should depend on risk-free adjusted for a reasonable risk margin; initially, the bank attempts to meet first 3 objectives 	Assume .6 - 1% (after tax) Assume .8 – 1.35% (before tax)	Same
Subtotal		1 – 1.6%	
Total		15.5% - 16.1%	

2. Risk Adjustments (See Appendix ____)

- Adjust for Profit Margin – assume all SME loans must earn a minimum profit margin of 2%
- Adjust for Industry Risk – a lender may elect to assign the highest Industry Risk Premium (IRP) to loans classified under “agricultural – livestock”. This would mean that approved “agricultural – livestock” loans would receive a higher IRP than loans classified under other industries. Assume IRP is .50%
- Adjust for Company Risk Premium – this premium is based on a company’s credit score. Assume this is .25%
- Adjust for Collateral Coverage – most SME loans are analyzed based on cash flow but few are approved without collateral. Exceptions may include small loan products to existing SMEs clients with a solid credit history or to new applicants that receive high credit scores. Thus, medium to large loan requests from SMEs must show acceptable cash flow and offer reasonable collateral. Banks will often set minimum loan to collateral value (LTV) ratio requirements as a matter of policy, depending on the type of collateral. The Security Coverage adjustment may depend on if and how much the collateral offered falls within bank policy.

Table 3 below shows how the Base Rate Component and Risk Adjustments are used to arrive at an interest rate range for this SME borrower.

Table 3

Base Rate Component	15.5 – 16.1 %
Risk Adjustments:	
Profit Margin	2.0 %
Industry Risk	.50 %
Company Risk	.25 %
Collateral Coverage	.0 % (LTV = policy guidelines)
TOTAL RATE RANGE: SME Loan (does not include cost to monitor loan)	18.25 – 18.85 %

Recommendation: Consider converting corporate pricing models or developing a new SME loan pricing model using Base Rate Components adjusted for profit margin, collateral coverage (using policy guidelines), industry risk (using credit score) and company risk (using credit score). Costs to monitor asset-based facilities should include cost of audit and other related costs.

Service Capability and Related Issues

Our conversations with Mr. Mohammad A. Hamdan and Mr. Abdel Hameed Al-Saeed revealed increasing complaints among SME customers. Such a reaction is normal when a service area within a bank undergoes a major transition. A few points are noted here.

First, the bank staff must understand and be “sold” that a major change is underway that will result in better service. Communication and education must be “on-going”, even if the Bank is still working out details of its strategic plan. Some banks create focus groups within branches that report vital client information. Focus groups often improve morale by making branch staff feel part of the process.

Second, once branch and other bank staff are sold and made “change agents”, a similar process is required to “sell” customers. This should be viewed as a strong marketing opportunity for the Bank and not as an onerous exercise. Letters, postings on the Bank’s web site, public notices in branches are only some of the ways to communicate the Bank’s message. Many banks start a “hot line” to field phone calls inquires or e-mails from bank staff and customers. Another possibility is establishing an advisory group of successful SMEs. Again, this group may provide good feedback and new ideas.

Recommendation: Consider increasing communication with bank staff, establishing focus groups and an outside advisor group consisting of SMEs.

Staffing Shortage

Similar issues were raised by other banks as stated in the Bank Report. Unfortunately, we are not in a position to address the Bank's staffing shortages or management's lack of good information to establish market prices for higher level positions, e.g. credit analysts.

A mechanism is needed to gather this information and an agreement among the banks to share this information. Jordan may not be the best location for a salary survey because of the sensitive nature of the information and the country's seemingly non-transparent corporate culture. However, we see little downside for a general discussion of this issue among the banks. A simple cost/benefit analysis may show that the cost of hiring a professional to perform a salary survey (on a confidential basis) would bring higher benefits to the users of the survey information.

Recommendation: Consider a collaborative effort among the banks to conduct a confidential survey of salary information for specified positions. Banks that shared the cost of the survey would pay no fee for the results, while the other banks would pay a set fee.

Keys to Success

The Advisors believe the keys for success in the SME market are:

- Banks that provide reliable and quality service to SMEs will stand out in a highly competitive banking environment
- While competitive pricing and low fees are important, reliable and quality service are more important
- Most SMEs consider reliable and quality service as meeting credit needs by reacting promptly to loan applications. These businesses prefer a fast "no" to a slow "yes"
- Training branch and relationship officers to communicate effectively with SMEs will help keep existing clients in the bank and bring new ones into the bank
- The SME loan business is not profitable for banks unless it is run on a high volume basis at a comparatively low cost per application
- Banks still need to demonstrate "tailored solutions" or may be seen by SMEs as insensitive mass production facilities
- Credit scoring is essential. Decisions on a majority of SME loan applications can not involve lengthy analysis or cost factors will overtake loan margins
- Though costly, automated file transfer, storage and capture are favored by banks and cost effective (assuming it supports a volume loan operation)
- Banks do not need to be "pioneers" in credit scoring. The market is huge and ample time exists to develop scoring models after critical path tools are created, e.g. credit bureau

- It's highly likely that the better performing SMEs will be pulled in the direction of banks best prepared to service the market. This means banks with SME loan departments that understand the smaller, less glorified and non-corporate businesses

A bank depending on income from SMEs can not afford to be in the last group of banks to develop a SME loan department and efficient loan processing.

APPENDIX A

September 16, 2007

Bank of Jordan
Mr. Abdel Hameed Al-Saeed, Executive Manager

Subject: Non-Disclosure Statement and Reports

Dear Sir,

USAID through the Sustainable Achievement of Business Expansion and Quality program (SABEQ) is undertaking a broad economic development initiative including recommendations to enhance access to finance by small to medium size enterprises (SMEs). Two advisors from SABEQ are now in Jordan and part of their assignment is to research bank strategies and provide recommendations to target and service SMEs.

Kevin O'Brien and Ms. Eman Malkawi from SABEQ have begun their work with you and your colleagues. We want to thank you for your cooperation and assure you that any information received by SABEQ or its advisors during this assignment will be held in strictest confidence.

In about two weeks we will complete two reports:

- The first report will state *specific* findings on your strategy for SMEs and address some questions you raised for our consideration.
- The second report will state *general* findings on strategies for approximately 9 banks operating in Jordan. This will describe the overall approach to the SME market and offer recommendations that would enhance access to bank finance.

Please understand that the first report will be shared only with you and USAID (but with the name of the bank and other key identifying information removed from the USAID copy) and the second report will go to the Association of Banks in Jordan for distribution to the banks.

If you have any questions, please call me at 06/550-3050 ext. 162 or email me at glenn.tasky@bearingpoint.com. Thank you again for your cooperation.

Sincerely,

Glenn Tasky
Component Leader
Financial Services Component
SABEQ

APPENDIX B

Summary of Case Study

One US based regional bank underwent a conversion to a SME loan department with credit scoring during the mid 1990s. Some aspects of this case are presented as an illustration. This case is not presented to suggest recommendations or to provide specific advice.

Lessons learned based on this case:

- Management was highly satisfied with the SME loan manager hired from another bank and the scoring model. However, the bank asked its outside accounting firm to assign its consulting affiliate to recommend cost cutting options
- Given conversion costs and branding issues, there was little choice in hiring a well-known service provider for Credit Scoring
- Used best efforts to estimate all costs and revenue and presented projections based on different scenarios. Should have considered using an outside consulting firm
- Unrealistic to expect all cost recovery in the near term. Rather, should have viewed full cost recovery in the medium term
- Should have planned for a longer conversion period
- Competitor based pricing was necessary at the outset but costly.

APPENDIX C

I. Overview for Strategic Planning

- A. Introduction
- B. Model for Business Planning
- C. Competitive business concepts
- D. Starting the planning process

II. Strategic Planning Process

- A. Overview of the process
- B. Step 1: Define strategic plan approach
 - 1. Roles and responsibilities
 - 2. Senior management support
 - 3. Time line for planning
- C. Step 2: Situational analysis
 - 1. Components of situational analysis
 - 2. External analysis
 - a. Regulatory environment
 - b. Economy
 - c. Competition
 - d. Technology and automation
 - New markets and products
 - Service delivery
 - Barriers to entry
 - Outsourcing
 - Social, political and cultural issues
 - e. Market area analysis
 - Comparison to the competition
 - Customer profile
 - Market growth and profit potential
 - Socio-economic analysis

- f. Sources of information
- 3. Internal analysis
 - a. Components of internal analysis
 - b. Strengths, weaknesses, opportunities and threats (SWOT)
 - c. Organizational structure
 - Specific characteristics
 - Communication
 - d. Human resources
 - e. Bank-wide policies
 - Loan policies
 - Investments
 - Asset/liability management
 - Accounting treatment
 - Human resources policies
 - Security program
 - Other
 - f. Financial condition and performance
 - Methodology of performance analysis
 - Capital adequacy
 - Asset quality
 - Management
 - Earnings
 - Liquidity
 - Ratio analysis *{may be product specific}*
 - g. Planning based on financial analysis
 - h. IT and Management systems
 - i. Operations
 - j. Products and services
 - Sample of products and services *{SME Market}*
 - k. Service delivery *{SME Market}*
 - Branch network
 - Hours of operation
 - Effects of Technology on product and service offerings
 - l. Technology *{SME Market}*
 - m. Marketing *{SME Market}*

- n. Bank image {SME Market}
 - o. Strengths, weaknesses, opportunities and threats {SME Market}
 - Strengths and weaknesses
 - Opportunities and threats
 - p. Summary of situational analysis {SME Market}
- D. Step 3: Competitive Advantage and Core Competencies
 - 1. Three keys to competition {SME Market}
 - a. Cost position
 - b. Product differentiation
 - c. Market focus
- E. Step 4: Vision {SME Market}
 - 1. Vision sets context for planning
 - 2. Formulating the vision statement
 - 3. Communicating vision
- F. Step 5: Mission statement {SME Market}
 - 1. Purpose
 - 2. Geographic areas to be served
 - 3. Markets to be served
- G. Step 6: Values {SME Market}
 - 1. Drafting value statements
 - 2. Communicating values
- H. Step 7: Strategic options and choices {SME Market}
 - 1. Assessment and selection of strategic alternatives
 - 2. Strategy formulation
- I. Step 8: Strategic goals {SME Market}
 - 1. Writing goals
 - a. Specific and measurable
 - b. Achievable
 - c. Relevant
- J. Step 9: Yearly targets {SME Market}
- K. Step 10: First year implementation {SME Market}
- L. Other considerations for strategic plans{SME Market}
 - 1. Pro-forma projections

III. Operating Plans

A. Measurable goals (Performance Based Management) {SME Market}

1. Specific and measurable: Quality, quantity, time
2. Achievable
3. Relevant
4. Monitoring system

B. Implementation of operating plans {SME Market}

1. Roles, responsibilities and accountabilities
2. Target dates
3. Planning resource requirements
4. Staff planning process
 - a. Evaluate current staff and departmental workload
 - b. Measure employee skills against job requirements
 - c. Implement formal programs to support staff plans
5. Budget planning process

C. Approval of operating plans

IV. Management of the Strategic Plan

A. Integrating the business planning process {SME Market}

1. Approving operating plans
2. Coordination of functional departments

B. Managing the implementation of plans

1. Methods to monitor the results
2. Accountability for implementation
3. Leading for progress

C. Annual review and revision of the strategic plan

D. Summary

APPENDIX D

Pricing loans with Risk Adjustments

Security Coverage
(0 or {+ or -})

Company Risk
Premium (+ or -)

Industry Risk
Premium (+)

Profit Margin

Base Rate
(without profit margin)

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