A GUIDE TO IMPLEMENTING SEGMENTATION FOR SME BANKING

INTRODUCTION

The goal of a segmentation strategy is presumed to be both the provision of services to all segments served so that the bank has the biggest and the most profitable wallet capture possible, and priority service to particular market segments, depending on the bank’s interests. The topics discussed below cover different aspects of implementing a new segmentation policy, and should also benefit the SME banking line of business more generally by offering a review of how business is done. The specific topics are set out as a series of separate steps, and include:

- Portfolio analysis and data mining individual customer relationships
- Calculation of profitability
- Credit evaluation
- Staffing – organisation and competency assessment
- Product bundles for segments
- Delivery and marketing channels
- Non-financial services

Mary M. Miller is an international expert to GrowthCap

Abstract

This Technical Guide provides detailed information on implementing a segmentation strategy as a series of steps, and covers portfolio analysis and data mining, credit evaluation, staffing, segment product bundles, and delivery and marketing channels. The prerequisite documents, the implementation process, and the benefits of each step are described.
It is important to remember that change management may be the most difficult part of implementation.

Each of these topics includes the following:

- **Advance information** — what does the bank need to have on hand to start this step;
- **Actions** — what will the bank be doing as a part of the step; and
- **Benefits** — why should the work be undertaken, what will the bank get out of it.

There is a lot of information readily available in the market for review, and selected publications that may be useful are listed in the bibliography.

It is also important to remember that change management may be the most difficult part of implementation — ways of doing things will change, and more important, responsibilities will change, and staff need to buy into the benefits both to the bank and to them personally of making the changes work.

---

**PORTFOLIO ANALYSIS AND DATA MINING INDIVIDUAL CUSTOMER RELATIONSHIPS**

As a part of a segmentation strategy, the bank should get a good understanding of its current portfolio characteristics and of its individual SME customers. Even if the segmentation strategy will be targeted at new customer segments, a deep understanding of the portfolio is valuable, and it is easier and cheaper to cross-sell to current customers than to only go after new clients. Portfolio analysis is the process of reviewing account data to better understand the customers and accounts that make up the portfolio. The types of portfolio analysis that can be done are described below. Ideally portfolio analysis will have been done as a part of making segmentation choices, but should be accomplished regardless.

**Portfolio analysis**

**Advance information:** Access to deposit and loan portfolio data in sortable form.

Depending on the size of the portfolio, it may be possible to export data to an Excel spreadsheet, and by using filters and pivot tables the information can be sorted. The analytical capabilities of the core loan and deposit systems may also be able to do data sorts. More sophisticated customer relationship management (CRM) systems will have these analytical capabilities built in.

**Actions:** Sorting current data indicates concentrations by sector, legal form, and geographical information. Calculations can determine values of concentrations, numbers of accounts, averages, and means. This quantifies the current portfolio and confirms or clarifies expectations about account sizes.

The following types of questions about the bank’s SME term loans might be addressed with portfolio analysis:

- What is the average original term loan size;
- What is the average outstanding balance of term loans;
- What are the mean or median values (the “middle” value, which may be different than the average);
- How many loans are equal to or above the bank’s stated cap for SME loans;
- How many loans (original value) are underneath the stated floor value;
- What are the typical ranges for the loans.

This type of portfolio analysis is covered in greater depth in the GrowthCap Technical Note ‘Effective data mining and analysis for SME banking’.
For overdrafts the bank would want to look both at original commitments and outstanding amounts, to get an idea of how many of the overdraft lines are used and average usage compared to available amounts. For deposits, it would be preferable to compare primary current accounts rather than all accounts, as many secondary accounts are used for transfers and the like, and are swept or otherwise have low or zero balances. Other useful information would be number of fee-based transactions and the number of products per customer.

Depending on information fields that are available in the systems, the sorting can also provide information about operating sectors, geography, and legal status, and can be an impetus to accurately select codes for these fields.

**Benefits:** Doing this type of portfolio analysis has two specific benefits. First, it gives the bank a realistic idea of its current portfolio, and can help the bank tailor services appropriately. Second it informs future planning, helping to select targets for performance, for example the bank would like to move the average account size up, and so overall the bank would focus on clients that are larger than its current portfolio.

**Data mining individual customer relationships**

**Advance information:** Information on IT/MIS systems in use at the bank, including background on modules in use (what information do they collect or produce) and modules that could be implemented to do data analysis.

**Actions:** This will be the centralisation of information on a customer to evaluate their total financial wallet, including both the part of the wallet captured by the bank and the part captured by competitors. This will be the basis of planning marketing calls.

---

**Using gamification techniques**

Gamification can be defined as the use of game elements and game-design techniques in non-game contexts. Gamification is used internally to address business problems, to improve productivity, and to enhance teamwork; externally to improve the relationship between the business and its customers; and to encourage behaviour change of employees or customers. A well-designed games approach may offer both intrinsic and extrinsic rewards.

What does this have to do with implementation of a segmentation strategy? Gamification is being used increasingly to achieve organisational objectives, and can apply to many of the changes and work that is being asked from relationship managers in realising the strategy. For instance, addition of customer information to a common database may be a part of the strategy, so that information can be accessed and analysed. While relationship managers can simply be assigned to complete information sheets, using gamification techniques could turn the process into a game of sorts, with rewards ranging from the intrinsic (my bank employer and my customers are better off because I am documenting the file so that the customer can be served if I am not around) to the extrinsic (cash prizes for timely completions) and somewhere in between (I have bragging rights for the best customer write-ups; our team gets ice cream on Friday because we documented the most this week).

Gamification can also be used to change behavior, for instance, in encouraging customers to use lower cost information channels. For example, web-based information may be the most cost-effective and complete information source for customers, but what can be done to encourage customers to check the website on a daily basis? This might be best addressed as a gamification challenge — and there could be a gamification approach to developing the game, by sourcing innovative ideas from employees.

Gamification should not be a tool to covertly get more work out of employees or get more sales out of customers — in all cases participation should be considered voluntary, and the activity should be fun.

For more information on gamification consult Kevin Werbach and Dan Hunter’s *For the Win*, details in the Bibliography Annex.
This data mining is a complementary activity to portfolio analysis and is the collection of information on a single customer. A good CRM system, faithfully followed, will provide this information, but commonly banks are just implementing a comprehensive CRM system or relationship managers have not been diligent in reporting information.

Data mining to document individual customer relationships is also covered in greater depth in the GrowthCap Technical Note ‘Effective data mining and analysis for SME banking’.

Good data mining of this type is going to be a tedious and mundane task (which is why CRM systems may not always be updated and as accurate as they should be). A bank that is serious about its marketing and cross-selling a full financial wallet, however, will recognise the need to go through this process.

**Benefits:** The main benefit of this work is to be well-prepared for customer marketing calls and to be able to anticipate customer needs, rather than just reacting to customer requests. This can enable relationship managers to plan their calls with results in mind — for example, collect information for expected request for new equipment financing; introduce bank’s payroll product to support service to customer’s growing employee base. Doing this type of research on all accounts may also identify customers where the relationship can be revived and expanded. A secondary benefit is that it gives information on which financial institutions are competitors. Banks generally know who their competition is, but collection of this information is more precise — who is dominant in payroll services? who is providing equipment finance in a particular sector?

---

**CALCULATION OF PROFITABILITY**

**Advance documents:** Information from bank on how customer performance or profitability is ranked or rated, and on how segment performance is ranked or rated.

**Actions:** This step is calculation of individual SME customer profitability, which can be used to evaluate the collective profitability of segments, and to evaluate the level of bank resources that should be devoted to marketing to that customer, also to determine the level of bank services that should be available to the customer. Calculation of profitability of a full segment should be a step in the segmentation selection process. Ideally the bank is doing a profitability evaluation of each customer on both an actual and potential basis, and in some sense this would be another step in the data mining with respect to individual customer relationships. The bank wants to know how much it is making on customers, and also wants to be able to evaluate potential of relationships if it is able to capture the full relationship or wallet.

Calculation of profitability is discussed in greater depth in the GrowthCap Technical Note ‘Profitability of SME products and services.’

**Benefits:** Calculating profitability by customer is beneficial for deciding service levels to provide to customers, and for prioritising marketing targets. Another benefit is that it can be helpful in moving relationship managers from only looking for loan prospects to looking for profitable SME customers. While credit is often the hurdle product that must be provided to bring an SME customer into the bank, the loan itself may only be marginally profitable at best. The profitability calculator shows where profit is coming from, and also moves relationship manager attitude from providing lending services to providing banking services.

---

**CREDIT EVALUATION**

**Advance documents:** Credit policy and procedures manual, flow charts of credit approval.

**Actions:** This will be a review of the bank’s credit approval process as applied to the SME segments, with an eye to simplifying the process and making it more efficient, thereby reducing the cost of credit delivery.

This section is not a comprehensive review of credit evaluation, which is a long and complicated subject in its own right. However, adoption of a new segmentation
Simplifying the SME credit process can be a matter of asking and answering better questions that get to the core inquiries – is the customer able to repay the credit, is the customer willing to repay the credit. The questions can be considered in two stages – Minimum Acceptance Risk Criteria (MARC) and analytical questions. MARCs are hurdle questions, and if a customer or credit does not meet these requirements, the credit should be rejected immediately. The analytical questions will get to an understanding of the customer and the credit, and if thoughtfully answered, should be telling a story about the credit – how will the funds be used, how will the business benefit, what are the particular characteristics of the business. Examples of MARC and analytical questions are shown in the Credit Evaluation Annex.

If the bank is developing new credit products for a targeted segment it may need to develop a separate credit process for that product. For instance, the bank may have decided to focus on manufacturing in certain sectors for export, and the key credit product needed for the sector is purchase order finance. This is not a conventional loan that can be analysed by extensive review of financial statements; it requires investigation of the purchase order contract and the purchaser. If this is a new product for the bank the process would need to be carefully thought out and documented.

Simplifying the SME credit process can be a matter of asking and answering better questions that get to the core inquiries – is the customer able to repay the credit, is the customer willing to repay the credit. The questions can be considered in two stages – Minimum Acceptance Risk Criteria (MARC) and analytical questions. MARCs are hurdle questions, and if a customer or credit does not meet these requirements, the credit should be rejected immediately. The analytical questions will get to an understanding of the customer and the credit, and if thoughtfully answered, should be telling a story about the credit – how will the funds be used, how will the business benefit, what are the particular characteristics of the business. Examples of MARC and analytical questions are shown in the Credit Evaluation Annex.

If the bank is developing new credit products for a targeted segment it may need to develop a separate credit process for that product. For instance, the bank may have decided to focus on manufacturing in certain sectors for export, and the key credit product needed for the sector is purchase order finance. This is not a conventional loan that can be analysed by extensive review of financial statements; it requires investigation of the purchase order contract and the purchaser. If this is a new product for the bank the process would need to be carefully thought out and documented.

Other parameters in SME lending are that the turnaround time (TAT) should be quick. TAT is a major competitive element for SME banking business, thus as few reviewers and approvers as possible should “touch” the credit. Multiple reviews bears on TAT, but it is also important to remember that additional approvers are unlikely to bring any additional knowledge or expertise to the credit decision, since the analysis will typically be based on soft information rather than reliable financial statements.

Following are guidelines to consider in reviewing the credit approval process:

- Are financial statements useful — smaller businesses in particular rarely have good financial statements, and for smaller credits surrogate information may be more informative.
- What is the role of each approver or reviewer — there is a tendency in banks for the approval procedure to include signoffs by more senior staff that do not also include any responsibility for credit quality — apparently being done because of an unwillingness to delegate authority. These should be eliminated.
- Is there a credit committee, and is it enhancing the credit approval process — while there is some value to credit committees as an on-the-job training mechanism, they are frequently dominated by a single senior staff member. It would be more efficient to simply make this person the approver, with a dual signoff as necessary.
- If the bank is doing a lot of similar small loans it should consider adopting a credit scoring model. This is discussed in further depth in GrowthCap’s Technical Guide ‘Getting started with credit scoring’.
If segmentation is done by sector and sub-sector, the bank should be doing sectoral studies and collecting sectoral information, and make this available to all relationship managers. This would include following professional journals and joining appropriate trade associations: for instance, for food processing and other agricultural value chain stages the Ministry of Agriculture keeps statistics; extension agencies have literature on up-to-date processing techniques; and local and international agencies will have published value chain studies. If the bank already has several customers in the same sector, data on these customers can be accumulated and analyzed together to extract standards.

**Benefits:** Reviewing the credit evaluation process can be a significant step in making the SME credit process more cost-effective, both by approving better quality loans and by decreasing TAT. Too frequently the credit evaluation process for SMEs is the corporate process with lower approval limits, that is neither cost-appropriate nor an accurate gauge of credit quality. Simplifying the process will reduce costs and make SME banking more profitable.

**STAFFING – ORGANISATION AND COMPETENCY ASSESSMENT**

**Advance documents:** Job descriptions for relationship managers and other SME staff, bonus and incentive program descriptions.

**Actions:** Review accuracy of job descriptions, and review required competencies for SME banking delivery. Depending on the segmentation strategy, relationship managers may require a different skill set than traditional relationship managers. This needs to be understood, and the gaps in relationship manager knowledge should be identified and addressed.

The segmentation choices that a bank makes may indicate the skill set that its relationship managers need and the appropriate organisational structure. In general, the larger the average customer size and segment that the bank is targeting the more its organisation will look like a corporate division, and the greater knowledge of credit analysis that will be needed. Overall the preference is for the SME line of business to be run separately, rather than as part of the corporate division. The tendency in banks is to pay the most attention to, and to value, the larger customers more. SMEs usually are not prioritised if managed with corporate customers.

Since SME business for most segments will be focused on handling a high volume of smaller businesses and small transactions, the approach is closer to a retail operation, and relationship managers are more focused on sales of a range of products than on vetting credit.

A bank can deal with customer relationship retention organisationally by creating SME customer teams, rather than having a conventional reporting structure. In an SME team the team leader does not carry his/her own portfolio, but acts as a backup to all the relationship managers on the team, makes joint calls with them, and is responsible for the team meeting performance targets. While the relationship manager will be responsible for individual customer relationships, having this close backup means that the customer knows more staff at the bank and more know him/her, so the relationship does not have to be re-created if the relationship manager moves on. The SME team may also include assigned administrative staff who can handle routine work, which also creates more customer links.
Job description review at the start of a new segmentation strategy is a good idea, as job descriptions are often outdated, and may reflect a skill set that was needed as a corporate relationship manager. The job description should reflect how the person spends the majority of his or her time — is this a sales job; is it management; what level of credit skills are needed? Prerequisites should also be shown — what education is needed; how long should performance in lesser positions be?

GrowthCap has developed and tested a set of core competencies that relate to the role of an SME relationship manager. See GrowthCap Technical Note ‘Small business relationship management competencies’.

What are the bank’s overall requirements for SME relationship managers? A skills audit is a methodology for determining the key competencies expected in certain jobs, and in turn is used to determine the training topics and subjects that would enable a bank’s relationship managers to improve their job performance.

The bank should prioritise addressing the greatest skills gap. For instance, negotiation skills may be considered less important than selling skills, but if the gap is greater the bank will put more emphasis on development of negotiation skills. The bank should emphasise achievement of competency in the highest priority skills.

The skills audit will reflect the bank’s organisation, and will change over time. For instance, during an economic downturn, problem loan management will be emphasised. If credit approvals are done centrally, the need for credit analysis skills will diminish.

A skills audit of this type also helps the bank evaluate what skills it will hire for, and what skills it will train for. For instance, knowledge of bank policies and procedures will be an internal training topic; if the bank’s approach to SME credit is a break away from a "mini-corporate" approach it may prefer to hire relationship managers who do not have prior credit experience, and do all the training itself. For new hires from university, the bank may reasonably expect that staff will come with computer skills (although may expect to train long time employees).

The skills audit priorities may also be applied to assessment of individual relationship managers in creating training and development plans.

Another item for consideration as part of staffing is the use of incentive plans. As SME relationship manager performance is driven more by sales and less by credit, incentive plans increasingly become a more appropriate way to drive performance. Unlike a year end evaluation of performance with the opportunity for a bonus that may be dependent upon overall bank performance, an incentive plan provides payments for performance that is measured more directly — the bank is tangibly better off because the relationship manager sold the service, so the relationship manager shares the profits from the sale.

A well-designed incentive plan will address four points:

- **Performance measures** — the plan should link to the bank’s SME business strategy and to the bank’s overall business plan;
- **Mechanics** — how does the plan work; is it easily understood and calculable by relationship managers;
- **Frequency** — how frequently are payments made — typically this would be monthly or quarterly;
- **Hurdles** — what is the threshold that must be met for participation and to qualify for a full payout.

Designing a good incentive plan is not easy. Incentives should not be paid for ordinary work, and need to reflect bank needs. For instance, if the bank is building its SME portfolio it should not be providing incentives simply for generating deposits, or relationship managers will be seeking out the biggest depositors, without regard to SME status. A compromise might be to make awards for single deposit accounts for balances up to a certain amount, with no incentive for balance amounts that exceed this.

Finally, a discussion of staffing and competency assessment must note that the most difficult element of implementing a new SME policy is managing change. Old skills such as credit analysis may no longer be prioritised, and certain management staff may no longer directly maintain a portfolio, or be in the credit approval chain. These changes belie the “important” responsibilities that are traditionally identified with banking, and it may be hard for staff to understand and cope with these changes. Information sharing, which is increasingly easier as portfolio assessment and profitability analysis is more feasible, and involvement of staff in developing new policies, procedures, and structures are ways to address this.

Benefits: SME banking is different from other bank lines of business, and staff recruitment, training, and incentives should reflect these differences. A skills audit and evaluation of competencies is a way to quantify the needs and shortcomings of staff, and plan for training to address the gaps. The creation of SME banking teams allows for more specialisation and service by segment, and also ensures that the bank, not just the relationship manager, knows the customer.
PRODUCT BUNDLES FOR SEGMENTS

Advance documents: SME product descriptions; also consult bank website for information.

Actions: Create product bundles for particular SME segments. Product bundles are a way to cross-sell multiple products to a customer at a collective price discount, and the more products a customer takes from the bank, the less likely that the relationship will be moved.

Unless the bank is pursuing highly specialised segments, additional new products are not likely to be necessary, although products will be reviewed (and may be modified) regarding suitability for the segment. However, product bundles can be particularly effective in addressing segment needs.

In all cases for SME customers, the guidelines on product sales are that the customer wants a one-stop shop, and will benefit from a lower price of services, so a product bundle is an attractive offer from the customer's point of view. Product bundles may be created either by volume segment, or by sector segment. For a volume segment bundle, the offer is typically contingent on the customer maintaining a minimum average current account balance. For a sector bundle, products are chosen as needed by particular market segments, such as professional businesses or trade businesses. The two approaches can also be combined, and a bundle could include access to services for the business owner and the employees. In the Bibliography there are links to bank web pages with examples of product bundles.

The benefits of providing product bundles to certain customer segments include the following:

- Greater profitability for the bank because of greater cross-selling;
- Relationships are more stable if “sticky” products are included — products that are difficult to move because they are so central to the business operation such as the main current account and payroll services — these “lock-in” products can even be sold at breakeven or at a loss because of the benefits of relationship building;
- The greater the level of cross-sales the more likely that the bank is the principal bank for the customer — thus usually has the greatest relationship profitability, and tends to have credit relationships better maintained.

The starting point for a bank with newly-selected segments would be to review the products that are taken by customers in the segment (through Portfolio Analysis, described above), and to talk with the relationship managers who handle particular segments. The steps for development of products and product bundles are described in depth in GrowthCap's Technical Note 'SME product development'.

Benefits: The bank wants to build long term relationships with its segment clients, and product bundles are a good way to maintain the customer relationship on a profitable basis, since it is easier to serve and cross-sell an existing customer than to develop a new customer relationship. Product bundles are a way to semi-customise services based on segmentation.

Which business segments benefit from product bundles?

In addition to industry-based divisions, the segments that benefit the most from product bundles are smaller businesses and startups. Smaller businesses are looking for quality products at low costs, and are willing to accept standardised products with low or no flexibility. Product bundles can be particularly effective in reaching startup businesses because of the relatively low cost, and can be structured as a way to build business experience and credibility with the bank. In either case a product bundle gives the relationship manager a selling tool that can be offered to all customers. Product bundles are less used for larger businesses because of their greater need for customisation of services.

DELIVERY CHANNELS

Advance documents: Information on bank service delivery methodology.

Actions: Banks must choose delivery channels most appropriate for reaching particular SME customer segments. Different channels have different costs, and should be selected both for outreach- and cost-effectiveness.

Keys to success in SME banking are to deliver volume business of relatively standardised products, at low cost and to cross-sell a range of products with the target of capturing the customer's full financial wallet. The choice of delivery channels of services for different market segments touches both on the responsiveness to customer needs and to the control of costs. In general terms the preference is to encourage the customer to use the lowest cost mechanism possible.

A guide to implementing segmentation for SME banking
Below is a list of delivery or distribution channels that are available for SME banking, with the pros and cons of service delivery, and roughly shown from most expensive to least expensive. These may be used in tandem with each other:

- **Relationship manager** — one bank officer is responsible for cultivation of the customer relationship. The relationship manager will actively call on the customer and be available to answer inquiries and facilitate transactions. This is regarded as the most expensive delivery channel, but can be the most pro-active way to reach customers. For banks that segment based on business size, relationship managers are typically only assigned to larger SMEs that have the largest total financial wallet.

- **Branch** — customers are instructed to use the branch as needed for particular services. While the customers are still being personally served, the service is reactive. The trend in retail banking is to try to reserve branch services for higher potential customers (which may include SME segments) and otherwise push delivery to lower cost channels.

- **Call centers** — customers have access to information and other services 24/7 via telephone, and there may be dedicated lines available for SME customers. This has been an effective delivery method because it maintains the human touch, and can usually cover all but the most complicated transactions.

- **Internet- and web-based service** — information on accounts and transactions may be initiated via internet connections, 24/7. In markets such as the US this has become a standard delivery mechanism for larger banks, e.g., SMEs apply for loans on-line. In emerging markets internet banking has been promoted but experience shows that customers tend to use it more for information services, for example, balance inquiries, but it is rarer for customers to initiate transactions such as paying bills.

- **Mobile banking** — this is not a comprehensive delivery methodology for SMEs, but can be used for some payments, particularly for wages for employees.

To decide how SME segments will be served will be based on a review of the quality of services available in the bank, both absolutely and in comparison to competition. Banks that are already heavily technology-focused find it the easiest to build remote service capacity, but the key to customer acceptance will be to understand how the customer feels about using remote services. Banks have been successful with promotion of remote services to SME clients as long as the customer has been comfortable that he or she still has access to the relationship manager or the branch.

**Benefits**: Choice of delivery channels will be important for a bank that is fast-growing, because remote services are typically much lower cost than the traditional relationship-based relationship manager. This is a major decision for the bank to make however, because staff vs. technology choices are long-run commitments.
As NFS is an emerging type of service there are not yet standards on how success is measured, or how service cost is recovered or allocated. In general, services are both available to all SMEs and are part of marketing outreach; hence costs are part of the marketing budget or NFS services are only available to customers. For the latter the approach is to try to recover costs, or at least cost-share. This is done in large part because the services only tend to be appreciated if the SME customer has to pay for them.

Many banks are offering NFS to special market niche segments, including women-owned SMEs and “emerging micro” clients, and usually have partnered with NGOs or training firms to provide classes or services on business and financial management. However, as part of an SME segmentation implementation this should be reviewed, and NFS considered as a broader opportunity to reach out to particular market segments.

Development of NFS is described in depth in GrowthCap’s Technical Note Non-Financial services for SME banking.

**Benefits:** NFS are increasingly becoming a way to comprehensively serve SME segments, and to reach segments that are underserved. NFS is also valuable to the bank for branding as an SME bank.

**REFERENCES**


**PRODUCT BUNDLES**

Industry Specific: ICICI Bank India; PNC Bank US


Volume Driven: Bank of America, US; Raiffeisen Bank, Czech Republic

https://www.bankofamerica.com/smallbusiness/


**NON-FINANCIAL SERVICES**

Website-based Information: Wells Fargo Bank, US; ICICI Bank India

https://wellsfargobusinessinsights.com

http://india.smetoolkit.org/india/en

A guide to implementing segmentation for SME banking
Credit Evaluation Annex

There are two parts to credit evaluation questions:

- **Minimum Acceptance Risk Criteria — MARC** — which are hurdles that the SME must pass before real consideration of the loan request begins. If the applicant does not meet these criteria the application should be summarily rejected.

- **Analysis questions** — the account officer should think in terms of telling a story about the applicant, explaining condition, and describing both how the loan will be used and the effect the loan will have on the business.

MARC

MARC are hurdles, designed to be easy to apply and measure. They should be readily obvious from a quick reading of an application or business plan, or may come from outside sources.

If the owner and the SME business do not meet the MARC the application should be declined, and no further review should be done. These factors should be publicised and emphasised at informational meetings, and it should be readily obvious to owners whether or not they meet these criteria.

MARC should include the following:

- Clean credit report for owner and business from Credit Information Bureau
- Own equity adequate*
- No excluded businesses or activities (donor and government requirements; bank rules)
- Experience in sector — minimum 2-3 years*
- No bankruptcy
- No other negative information

Both the level of equity and the experience in the sector are considered to be *correctible items. For equity, if the application is just short of the amount of equity needed, it is reasonable to assume that the owner will be able to find a bit more money to invest. The bank does not want to do 100% financing of asset acquisition, so the business or owner should already have the cash in hand for a down payment.

The experience in the sector is a critical factor, and business owners should know that the bank will be looking for this. If the owner’s sectoral experience is not immediately obvious from the application, the application should be up front in addressing this gap, by showing a partner’s experience or the availability of committed senior staff. In this case, the owner personally should then be bringing more managerial or marketing experience to the venture.

Analysis Questions

**The IDEA** — what is the business going to do: what is the product, and what is the market? Is this already in the market, or is it new? How is the product or business approach different from what is available? What problem will the business solve?

**Use of loan** — what will loan proceeds be used for? How will the loan benefit the business? What benefit was seen from prior loans? (Note: it may be that a business is nominally asking for “working capital”, and the owner intends to take money out of the business for other use. If this is the case, it does not mean that the loan cannot be approved, but the loan will not benefit the business — so it will have to be repaid from existing resources and operations. Regardless, the real use of funds should be stated in the loan evaluation.)
Amount of own equity in the business – an owner who is truly committed to the business venture is willing to invest personal resources; the owner needs to have a commitment that he or she will lose if the business is not successful. An equity investment will keep the owner dedicated to operating the business, particularly if there are problems.

For existing businesses – is the business operating profitably, is it stable? Has there been a growth of sales from year to year?

For new businesses started by owners with other operations – does the existing business have adequate financial resources for its own operation? Will it be able to support the new venture or expansion? The stronger the existing business, the easier it is to support a new venture or expansion – it is realistic to expect that the existing business can provide financial support, and as necessary carry loans for an expansion business while it is in startup.

Note: a new venture by an existing business (different product or different market) should be considered like a new business – the advantage is that it has more operating and financial support than most new businesses.

Market assessment – what will the business be selling, to whom, for what price? This needs to be specific, and there also needs to be a realistic assessment of competition, including both direct and indirect competitors – who offer alternative ways to meet customer needs (for example, a food processing firm competes with peers, but also with bulk buyers for resale). What does this business do that is better/faster/cheaper/more targeted than its competitors? Is there a market niche that is not addressed?

Financial projections – if available – what will investment funds be used for? Where do cost estimates come from, is the cost of goods sold well-researched? Realistically an expanding business is likely to lose money for some months before it is profitable; does the owner have other sources of funding to draw on if necessary? If the product is truly new and innovative, does the promoter budgeted enough funding for promotion, to explain to the target market what the benefits of the product are?

Fixed asset costs – are these items that the business really needs, or are some of them indulgences for the owner?

Business premises – are these owned or leased? How close is the SME business to to suppliers and customers? How easy or hard is it to ship the borrower’s goods (access to transport)?

Supply side – where will the business get its inputs? Are supply sources stable, are there many or few suppliers? Is the cost of inputs stable, or are prices volatile?

What labour is needed – is training or prior education required? Are projected salary costs realistic?