



“My Chat with a Bank CEO”



Abdalla Abdulkhalik, CEO Gulf African Bank

TOPIC | Trade

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Maurice Ndege: what measures can be put in place to help SMEs access credit formally?

Abdalla Abdulkhalik: I have seen questions around SME businesses...SMEs form an important part of any economy. From the very jua kali businesses to the high end SMEs. Of late there has been a lot of focus on SME business in Kenya. Some of which is also supported by other organisations such as the World Bank and other NGOs.

To access credit on SME you need to have a business idea, premises you will operate from, and projected cash flows for the business. This will allow your bank to make proper assessment of your business and extend credit to you.

As much as possible SMEs should try to formalise their business by attempting to keep formal records (accounts) which helps a great deal in enabling banks to assess their credit worthiness.

Abdalla Abdulkhalik

Wanja Ngunjiri: if you are new in international trade, you have done your survey you have the product and the customer but you don't have enough money to buy the product, how can the banks help this young entrepreneur?

Abdalla Abdulkhalik: Welcome Wanja...thank you for your question about accessing credit facilities to purchase a product when you have identified your market.

I would say the best approach would be to approach your bank with your idea and projected cash flows to discuss financing options. The bank would analyse your proposal and see if it is a viable business proposition and based on that you can access credit.

Usually, many banks would shy away from offering credit facilities to what we call "green field business" which means the applicant has not done that business in the past or has no experience in the business...it would be therefore important that you partner with someone or a company that has done similar business before for the comfort of the bank to ensure that there is enough experience in it.

Maurice Ndege: Access to formal and affordable credit will create conducive environment for trade especially on the sme sector that.

Abdalla Abdulkhalik: Maurice, I would say that in general banks are in the business of lending...so when a client approaches us for lending purposes they are actually the ones supporting our business. Banks need to take proper due diligence in assessing the viability of the business proposed by entrepreneurs. Remember Kenya also has one of the largest non-performing loans portfolios in the region, largely because banks are willing to take a bigger risk and therefore lend to businesses due to the competition pressure in the market.

ABDALLAH ABDALLAH: How does GAB carry out Trade financing? Does it have a predetermined profit rate that it charges or it works with the performance of the business of the client? i.e. risk/return sharing.

Abdalla Abdulkhalik: Good morning Abdallah, trade finance business, particularly letters of credit, are naturally sharia compliant because it is a trade transaction. The fees and commission charged is market driven and standard.

JOHN NJOKI: How has KBRR helped in bringing down the cost of credit in Kenya? The cost of credit is still high and this is discouraging many would be traders.

Abdalla Abdulkhalik: John Njoki karibu...thank you for joining us...before the introduction of the Kenya Banks Reference Rate or KBRR, the market was using base lending rates which was determined by the individual banks and therefore no particular formula to arrive to that rate. KBRR is now determined by the Central Bank which is independent and therefore not influenced by the lending bank. This has brought in transparency in how lending rates are derived.

Wanja Ngure: Thanks Abdalla the challenge is that the banks will forever ask for bank statement and as a young entrepreneur chances are slim that you will have an impressive statement and hence this act as a setback because you are not even given a chance to present your business proposal and its projections.
Advice

KENNETH NJERU

Sir about wanja's question I would like to know why the process is that rigorous yet as a new Enterprise I have no idea of the market dynamics

Abdalla Abdulkhalik: Wanja and Kenneth, I agree it can be a challenge for young or new entrepreneurs to access financing from banks.

....I would say in the beginning you need to partner with someone who has sufficient experience in the business you are in to give comfort to the financier who is not just banks but also equity funds, private investors, etc. Remember that banks use deposits from other customers and also capital from shareholders to lend, therefore they have a duty to ensure that those resources are prudently managed.

Lewis Ndichu: My question is, we have been hearing that central bank is regulating interests on which banks should charge, in order to help SMES, I have a real estate agency even with good savings and banking I am afraid of borrowing a loan to transform my start up, is the negotiations of interest charges on going in order to help startups?

Abdalla Abdulkhalik: Lewis Ndichu, thank you, interest rates are determined by many factors. One of which is the risk that the lender is taking on the customer. For startups, as you can imagine, that risk is much higher and therefore you would expect the rate of interest to commiserate with the risk. In other countries, Governments have subsidised such loans so that they are more accessible to new entrepreneurs. In Kenya we have similar arrangements such as the Uwezo Fund which is accessible to groups...this also brings the point we raised earlier that entrepreneurs need to form groups or partner with people who have experience in the field so as to increase your chances of success.

George Olaka: Devolution is still quite chaotic for any meaningful investments to take place. Most counties still lack the basics to support most businesses. County governments need to concentrate on putting in place structures that will invite worthwhile investors.

Charles Mabeya: Thanks George, how can the central government help in bridging the gap if counties do not have the capacity, or is this a long-term structural reform that counties need to pursue

Abdalla Abdulkhalik: I see the discussion about Counties and investment opportunities.

In my view one of the major problems we have in counties, other than Nairobi, is unemployment. I think counties need to invest in capacity building for their people such as setting up technical training schools for people to learn specialised skills which enable them to become self dependent.

Once you have the basic skills it will take care of so many issues and vices that happen around us because of unemployment. And also provide a base to build the economy at the local level.

Muema Wambua: How can banks exploit available trade and investment opportunities that have been occasioned by devolution?

Abdalla Abdulkhalik: Muema...good question...banks have an opportunity in the devolved government system which has created opportunities at the county level that previously didn't exist because of a centralised system. Banks are seeking to support the thriving of businesses at that level through their branch network expansion and in the process help those investments thrive.

Lewis Ndichu: Just an opinion, the biggest issue here is borrowing I think government should work in hand with banks in order to regulate and redo the regulations. The worst of all things doing business in Kenya is taxes, government regulations to which as a startup we cannot afford, so we end up using our loans to pay them. In US a startup pays for licence when the start up is stable, all what they do is following on small businesses. Since I started my company the most money haven't been on production but on paying government.

Abdalla Abdulkhalik: Lewis, there is no doubt that SME is a very large component of any economy. A country like China has a SME contribution to the GDP of more than 60 percent. This also brings to the point where we need to first define, who is SME? Just here in Kenya we have different definitions of SME but the most standard one is a company that has annual turnover of less than Ksh 100 million or borrows less than 1 million USD at any given time.

Lewis Ndichu: About interests. But it's very difficult to access those funds in most counties we have tried it, I did in fact moving to another county were I thought its accessible, my idea is regulations of interests in away we can borrow and pay without much hustle. Go to Rwanda today doing business is much easier than in Kenya why? Because they know that SMES are biggest employers and this solves the problem of unemployment.

Abdalla Abdulkhalik: Regarding comparing Kenya with Rwanda in terms of ease of access to credit for SMEs, I would say the process of setting up a business in Rwanda may be faster than here in Kenya, but that does not necessarily translate into ease of access to credit/funding. Here in Kenya we have our minimum acceptable requirements for lending to SMEs, a sector which is very difficult to assess due to lack of proper accounting information. Nevertheless, despite the fact that there are these challenges, in this region, Kenya still leads in terms of the total value of credit that is directed to SMEs.

Simon Maina: Do the high interest rate spreads have something to do with high operating costs as well, which could be solved by technological innovations? Because in some instances, you reconsider borrowing when you think that the business is not going to generate revenue that is above the high interest rates.

Abdalla Abdulkhalik: Simon, when you talk about spreads, yes, it definitely has to do with the high cost of operations in Kenya. There is an assumption that the cost of funds for banks is only the rate of deposit that is paid, for example 3 per cent, however, cost of operations including security, insurance, infrastructure (electricity, operational systems,) are all included in the calculated in the cost of funds. Added to that is the cost of risk and inflation. All these plus the deposit rate then give you the market interest rate.

Simon Lee: For a new/startup business a bank loan is not always the best option as you need to prove your business plan before you can truly understand the amount you require to make a positive difference. However there are 3 key issues that I have experienced: 1) That of risk appetite for banks when it comes to other forms of financial assistance such as overdrafts. 2)The level of understanding of non-traditional industries to bank managers at branch level is lacking and therefore presenting a business plan that they understand, can buy into and defend at bank level is not there. 3) At branch level there is often a lack of complete knowledge of products and services the banks offer that could provide financial relief/assistance to the company. This includes access to forums such as this Chat session, workshops and industry sector associations and the like.

Abdalla Abdulkhalik: I see Simon Lee's point raised earlier about whether or not banks have the capacity to finance nontraditional SMEs or assess certain business proposals...I would say that banks identify sectors that they have an expertise in, for example, agribusiness, aviation, tourism, manufacturing, etc., so depending on where the bank feels they have sufficient expertise to assess credit risk in that sector, then it becomes easier to make a decision.

Lewis Ndichu: We cannot class SMES on such high category here in Kenya, I think an SMES in Kenya is start up that is about to hire/employ about 5 to 10 and a working capital of 250K and keeping a profit of 3/4 of stake. So to me SMES have classes and that class is taking of consist of many ventures and those are the businesses the government and financial institutions should be looking up to for growth. I have been Rwanda what am saying about the country am very sure of, plus instead of funds like those of Uwezo Rwanda government is more concerned of a promising young entrepreneur.

Abdalla Abdulkhalik: Lewis, thank you for your point, the classification of SME is -- small and medium sized business -- the classification you cite, i.e. working capital of 250K is actually a micro business...within Kenya there are institutions such as micro finance banks which are adequately positioned to support and finance the micro business segment.

JOHN NJOKI: The banks should also come up with education programs to enlighten the SMEs owners. The success of SMEs is not only a benefit to the country but also to the commercial banks themselves in terms of interest income.

Abdalla Abdulkhalik: John Njoki yes, capacity building is key and many banks offer this to their customers.

DAVID MURIITHI: Financial institutions specifically the commercial banks have been actively involved in trade financing. In your view what are the prospects of trade financing;- are the opportunities in trade financing at the disposal of commercial banks fully exploited?

Abdalla Abdulkhalik: David Muriithi, trade finance products are being used quite widely. In fact banks prefer to use such products because they are less risky and contribute a lot to the non-funded income of banks.

Charles Mabeya: The clear point coming out of today's chat is that for any SME to access funding,it needs to demonstrate scale and expertise in its industry which is not a common thing for start-ups especially scale.

Abdalla Abdulkhalik: Charles Mabeya...I fully agree with your summary...As SMEs demonstrate scale and expertise, this is an opportunity for banks to leverage.

Muema Wambua: Again, what mechanisms are financial institutions putting in place to counter the threats exposed by trade-based illegal transfer of capital that compound the problem of capital flight from the country/region?

Abdalla Abdulkhalik: To Muema's question about capital flight...capital flight is not illegal. Usually this would be from foreign investors who invested in Kenya for a particular period of time and at some point they decided to exit the market. It happens regularly in any capital market. We do have measures to counter illicit trade through anti money laundering policy which is regulated by the Central Bank of Kenya.

Joan Wairimu: Good morning sir.... let's talk county policy and investment opportunities towards diversifying trade...there has been hue and cry about numerous conflicting tax regimes from the county governments that make it more costly to trade....what would be the most practical way to address this?

Abdalla Abdulkhalik: Joan thank you for joining us and for your point about county tax policies...my understanding on taxation is that it is centrally controlled. I am not sure if county governments can impose new taxes on their own. However, they do have discretion to raise revenue through levies (parking fees, business license, etc) which in my view they need to exercise cautiously -- otherwise they will make their county noncompetitive.

Abdalla Abdulkhalik: Trade is a very important element of our economy. I think we need to encourage and support businesses so that they can contribute to this line of income to the general economy. Today, our trade balance is quite negative, meaning that we as a country import a lot more goods and services than we export to other countries. This creates imbalance or trade deficits which will need be addressed. Therefore, it takes both the market as well as government through its role as the enabler of a conducive business environment to ensure that measures and policies are put in place to address the imbalance.

Unanswered Questions

Mugisha Franck: When can you apply for a home loan?

George Olaka: Banks are in the process of making money and hence have no time for startup with no business records, is time that we set up special departments in our banks to offer venture capital? I hope you are aware of what seasoned bankers like Tony Elumelu from Nigeria is doing through his foundations.

Charles Mabeya: What are the other financing alternatives if accessing finance is not an easy task for an entrepreneur?

Maurice Ndege: Sir kindly help us understand the benefit CREDIT RATING can bring in to the borrowers in regards to KBRR.

George Olaka: Maurice, it is simple, good credit rating leads to lower interest payments. Added to the KBRR are things like a borrower's credit rating. For example (hypothetical) a AAA rated business could even borrow below the KBRR.

Simon Maina: Are there incentives for Banks in place for investments in technology or other cost cutting measures? Like in most Asian countries where they get to expense investments and get subsidies.

Anthony Kariuki: What about the venture capital companies around, do they help in provision of capital to prospective start up in need of finance?

Emma Wacira: Yes the Venture capital companies do assist in capital injection and expertise. Just ensure the contract protects the interests of all parties especially you who has sought them.

Muema Wambua: What role can financial institutions play in advancing technical capacity for trade negotiations for internal trade?

DAVID MURIITHI: Therefore sir, given the preference for trade financing by banks, do you see this as having impacted negatively on banks; lending to SMES by crowding out SMES from borrower's pool?

Other Comments

George Olaka: We also have to appreciate that the Kenyan borrowing culture also need to change to one that will take all reasonable effort to repay back loans. This will enable the banks to lend more and be less demanding. Let us look at countries like Bangladesh where repayment rates are in the 90% region.

Mbatia James: I think the best way to finance your project (startup) you should start by approaching the people who know you favorably and a few friends and family members convince them about your project. Then after you get some seed funds work hard to earn a credit reputation so that you can approach the banks.

Jonathan Gitiya: If I may contribute regarding the issue of funding startups, I believe financial institutions should find a way to QUANTIFY risk, that way you can measure the amount of risk you are getting in to which is relevant to the risk strategy of the financial institution, without this we shall lock out a great deal of potentially lucrative projects that do not have the advantage of a history of operations in the market.

George Olaka: Charles, Kenya will need to actively look at PE and venture capitalists

George Olaka: Hello Charles, one of the options is for The Central bank to setup intervention funds or something of the sort to bridge the gap. if properly managed, the funds should go a long way in supporting start-ups and informal sectors with no access to formal bank products.

Lewis Ndichu: Just an opinion, the biggest issue here is borrowing I think government should work in hand with banks in order to regulate and redo the regulations. The worst of all things doing business in Kenya is taxes, government regulations to which as a startup we cannot afford, so we end up using our loans to pay them. In US a startup pays for license when the startup is stable, all what they do is following on small businesses. Since I started my company the most money hasn't been on production but on paying government.

Anthony Kariuki: Government needs to formulate policy of tax holidays for start business especially businesses by the youth who don't have so much capital.

Mbatia James: The biggest problem with our system of education we are learn to be individualistic, groups affairs like Uwezo fund require team work which our youth are very poor at.

Emma Wacira: There are a lot of opportunities in the Counties, but the younger entrepreneurs do not know how to tap into it.

George Olaka: On taxation, in as much as I agree that the government should do something, my opinion is that any business worth its salt and is socially responsible needs to pay taxes, it is a discipline in itself. Tax holidays are fine, but does start-up have the ethics to keep proper records to show that at some point they have become liable to taxation?

Joan Wairimu: Discussion taken over by issues around interest rates much...clearly we need more chats on interest rates Dear ADMIN...

Charles Mabeya: Absolutely Abdalla, skilled workforce at the county level can go a long-way in boosting the case for startup funding, in addition to Anthony's view above, government funds can also take a long-term view on funds advanced, private equity style, and exit when the startups have stabilized and making profits.

Anthony Kariuki: @George Olaka yes I agree with you that every business should pay tax but most starts up fail because of the high tax rate in the country. This usually leads to them trying to evade tax by not keeping reliable records for audit purposes.

Anthony Kariuki: Yes the ease of access to credit is there but I think financial institution should try to lower the cost of credit, which is quite expensive compared to the other developed economies of which most SMEs are in direct competition with.

Emma Wacira: Also setting up a business has been very much simplified nowadays, especially through the "Huduma" outlets. But many factors count before one can access credit from the financial institutions. Many also give up because they envision such a burden in the compliance requirements and costs. Most give up very early.

Lewis Ndichu: As we end today's chat, my advice to Banks and other financial institutions the only one who will make the biggest impact in terms of services and sales is the institution which will drive its money and services to start ups and offer good interest while creating a good relations with its customers.

Emma Wacira: Customers should be looking for these banks that offer business support, advice on payment plans, as opposed to just financial redemption... customers sometimes feel that the bank is just waiting to snap on your first default instead of options and advise on what could be wrong with your business style.