



VITAL ECONOMIC OPERATIONS MANAGEMENT (VEOM)

PLANNING AND DEVELOPMENT DEPARTMENT, GOVERNMENT OF KHYBER PAKHTUNKHWA

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SALARY REFINANCE SCHEME

PRINCIPAL DEFERMENT SCHEME OF THE STATE BANK OF PAKISTAN AND ITS IMPACT ON SMALL AND MEDIUM ENTERPRISES IN KHYBER PAKHTUNKHWA

SME FINANCING

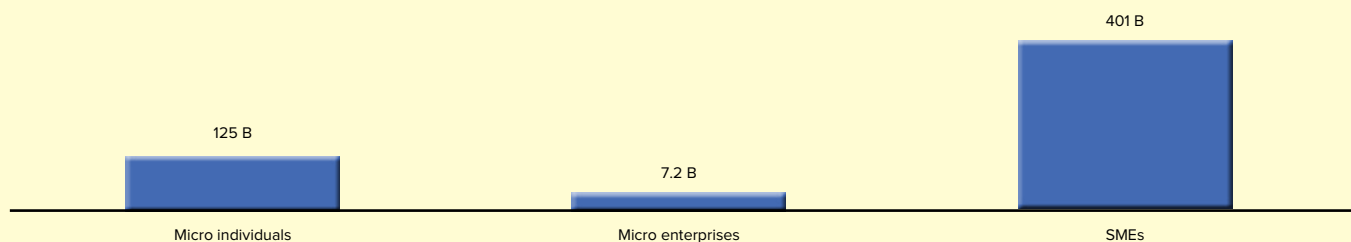
Globally, Small and Medium Enterprises (SMEs) constitute 90% of all private enterprises, provide 50% of all employment and contribute 40% to the GDP¹. In Pakistan, SMEs constitute 98% of all enterprises, contribute 40% to the GDP, 25% of the export receipt and employ 80% of the non-agriculture labour force². The following table shows the employment generated in the Micro, Small and Medium Enterprises (MSME) sector in Khyber Pakhtunkhwa and estimated impacts on employment under various scenarios of restrictions.

VULNERABLE CATEGORIES OF EMPLOYED	EMPLOYMENT (IN MILLIONS)	IMMEDIATE EFFECT	MODERATE RESTRICTIONS	STRINGENT RESTRICTIONS
		(LOSS OF EMPLOYMENT IN MILLIONS)		
Daily wage workers	3.04	0.30	1.52	1.82
Paid worker by piece rate or work performed	1.40	0.14	0.70	0.84
Paid non-family apprentice	0.07	0.01	0.04	0.05
Street vendors	0.15	0.02	0.07	0.09
Equipment procurement	1.4	1.4	1.4	1.4
Total	6.06	0.4665	2.3325	2.7975

Source: Coping Strategy; Mitigating the adverse impact of COVID-19 on the economy and employment in Khyber Pakhtunkhwa, Planning and Development Department, Government of Khyber Pakhtunkhwa

Despite their significant role in the economy, the share of SMEs in Pakistan in the Gross Loan Portfolio (GLP) is only 17%.³

GROSS LOAD PORTFOLIO



Therefore, we can conclude that the SMEs sector is massively underserved by the financial sector in Pakistan.⁴

¹ <https://www.worldbank.org/en/topic/sme/finance>

² p-12, Defining micro, very small and small enterprises: moving towards a standard definition continuum, Pakistan Microfinance network, 2018

³ Infrastructure, housing and SME financing department, SBP

⁴ DATA collection survey on SME finance in Pakistan, JICA, 2018



The decline in economic activity due to COVID-19 has hit the SMEs hard and with little recourse to formal financial services, the SMEs are finding it hard to survive.⁵ There are few studies on how SMEs in less developed countries like Pakistan fair during or after crises, but available data has shown that without a continuity plan, 75% fail within 3 years after a disaster or crisis.⁶ SMEs are more vulnerable to shocks compared to larger firms due to lower levels of preparedness, high dependence on government or local agencies, and the greater psychological and financial impact on owners/managers.

SMEs often lack working capital under normal circumstances and during the crisis they still have large volumes of non-payroll expenses including rent, taxes, insurance, debt payments, and utilities which they struggle to pay,⁷ and given a lack of liquidity they are particularly vulnerable to declines in demand.⁸ In particular, those enterprises most reliant on domestic demand and those carrying higher debt burdens (as measured by the ratio of debt to turnover), experience significant negative effects during crises.⁹ An online survey conducted in April 2020 by Small and Medium Enterprise Development Authority (SMEDA) found that 95% of the SMEs reported a reduction in business, 92% reported disruption in supply chains and 25% reported a total loss of exports.¹⁰

International evidence from previous crises also shows that firms dealing with weak banks struggle to access credit (especially if they lack collateral as many SMEs in Khyber Pakhtunkhwa do) and thus were more likely to shut down or reduce employment levels.¹¹ Significantly, from the perspective of the service sector's value chain, which has been particularly hard hit by COVID-19, a decline in demand at the final goods and services end will also negatively impact activity volumes in various other sectors operating on that value chain.¹²

Most countries recognise the importance of supporting SMEs during and in the post COVID-19 crisis.¹³ There is an agreement that the economic crisis triggered by COVID-19 differs from past economic crisis that originated in the financial sector¹⁴ or environmental disasters such as earthquakes or floods¹⁵, and thus requires a more robust and creative response. Economies are facing simultaneous supply shocks (disrupted supply chains, halted labour and production, etc.) as well as demand shocks (households and firms unable or unwilling to purchase certain goods and services). If enough SMEs do not survive it could have long-term cumulative effects where the breakdown of key relationships between firms and their stakeholders (including workers, suppliers, customers, etc.) makes economic recovery slower and more difficult.¹⁶

Several developed countries especially in Europe have opted for "furlough schemes" under which, up to 75% of the salary of the staff of the qualified SMEs (selected on the basis of adverse impact) is paid by the state.¹⁷ Such schemes have been credited with preventing huge job losses, however; these schemes are costly and may cost approximately 3% of the GDP. Developing countries like Pakistan, India and Bangladesh have opted

⁵ <https://blogs.worldbank.org/endpovertyinsouthasia/covid-19-delays-activities-pakistans-domestic-tourism-industry>

⁶ Fabeil, N. F., Pazim, K. H., & Langgat, J. (2020). The Impact of Covid-19 Pandemic Crisis on Micro-Enterprises: Entrepreneurs' Perspective on Business Continuity and Recovery Strategy. *Journal of Economics and Business*, 3(2)

⁷ Lu, Y., Wu, J., Peng, J., & Lu, L. (2020). The perceived impact of the Covid-19 epidemic: evidence from a sample of 4807 SMEs in Sichuan Province, China. *Environmental Hazards*, 1-18

⁸ McGeever, N., McQuinn, J., & Myers, S. (2020). SME liquidity needs during the COVID-19 shock (No. 2/FS/20). Central Bank of Ireland

⁹ Lawless, M., O'Connell, B., & O'Toole, C. (2015). SME recovery following a financial crisis: Does debt overhang matter?. *Journal of Financial Stability*, 19, 45-59

¹⁰ <https://dailylimes.com.pk/601403/impact-of-covid-19-on-smes/>

¹¹ McGeever, N., et al.

¹² Özatay, F., & Sak, G. (2020). What Can We Do to Manage the Economic Consequences of COVID-19? Economic Policy Research Foundation of Turkey (TEPAV), Policy Note N, 202006

¹³ <https://www.brecorder.com/2020/04/16/589898/sustaining-smes-covid-19-crisis-and-beyond/>

¹⁴ Didier, T., Huneus, F., Larrain, M., & Schmukler, S. L. (2020). Financing Firms in Hibernation during the COVID-19 Pandemic. Research and Policy Briefs. World Bank Chile Center and Malaysia Hub

¹⁵ Lu, Y., et al.

¹⁶ Didier, T., Huneus, F., Larrain, M., & Schmukler, S. L. (2020). Financing Firms in Hibernation during the COVID-19 Pandemic. Research and Policy Briefs. World Bank Chile Center and Malaysia Hub.

¹⁷ <https://www.economist.com/business/2020/06/20/waging-war-on-recessions>

¹⁸ https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=49844

¹⁹ <https://home.kpmg/xx/en/home/insights/2020/04/malaysia-government-and-institution-measures-in-response-to-covid.html>



for involvement of commercial banking in easing the operational challenges faced by enterprises. In the case of India for example, the Reserve Bank of India announced two important schemes in May 2020, (1) moratorium on term loan installments and (2) deferment of interest on work capital facilities¹⁸. Malaysia announced a strategy which provided relief to enterprises across three avenues (1) across the board immediate tax relief, (2) direct monthly payments to lowest tier of private sector employees and (3) new loans and a moratorium on debt repayment¹⁹. The two major schemes for enterprises launched by the State Bank of Pakistan (SBP) are (1) salary refinance scheme and (2) deferment of principal.

SALARY REFINANCE SCHEME²⁰

On 10th April 2020, the SBP launched the “refinance scheme for payment of wages and salaries to workers and employees of business concerns”. The major objective of the scheme is to protect private sector jobs by providing financing equivalent to three months of total salaries and wages. The commercial banks are providing the facility to client enterprises at 3% in case they are tax filers and at 5% in case of the enterprise being a non-tax filer²¹. The loan repayment is scheduled to start from 1st January 2020 and is to be repaid in 8 equal installments along with the accrued mark-up.

REGULATORY RELIEF - DEFERMENT OF PRINCIPAL AMOUNT²²

The SBP on 26th March 2020 announced regulatory relief for borrowers through the refinance scheme. The scheme provides for deferment of the principal amount of an outstanding loan for a maximum period of 1 year. During this period however, the borrowers are required to keep paying the interest payments. Furthermore, under the scheme, borrowers who are unable to pay the principal amount can apply for re-scheduling and if the re-scheduling is done with 180 days of the loan being past due; then such a facility will be considered regular.

KEY NUMBERS (15TH MAY 2020)

1700 Salary refinance scheme applications²³

PKR 120 Billion Expected Value of requested finance under Salary refinance scheme

1.1 Million Employees covered

600,000 Regulatory relief applications

PKR 423 Billion Expected value of requested finance under Regulatory Refinance Scheme

IMPLEMENTATION OF THE SCHEME

- SBP has created a helpdesk for enterprises facing problems in accessing the facility after getting the feedback that most of the allocated funds for salary refinance have been sucked up by the large-scale enterprises who have had established relationships with the commercial banks.
- Commercial banks on the other hand argued that SBP is not offering any risk sharing mechanism and in case of default they are the ones who might end up losing money and therefore they are inclined to offer the facility to clients with a proven track record of repayment or have high quality collateral to offer to them.

²⁰ <http://www.sbp.org.pk/smeffd/circulars/2020/C6.htm>

²¹ <https://www.brecorder.com/2020/04/23/591689/salary-refinance-scheme-sbp-announces-more-incentives-for-business-concerns/>

²² www.sbp.org.pk/bprd/2020/CL14.htm

²³ <https://www.dawn.com/news/1558667>



- On 7th May 2020, the Ministry of Finance and SBP announced that Government of Pakistan would bear 40% of the first loss of principal portion on the disbursed portfolio of a bank.²⁴ The government has set aside a fund of PKR 30 billion for a credit risk sharing facility. The facility would encourage banks to lend to collateral deficient SME with sales under PKR 2.0 billion / year²⁵.

The following table summarises the number of applications received, approved and the value disbursed as on 12th June 2020. With less than 1,000 SMEs served across Pakistan, it is evident that the SME sector in Khyber Pakhtunkhwa (like in other provinces) has not benefited from the SBP schemes in a meaningful way.²⁶

**BANK WISE PERFORMANCE UNDER RISK SHARING FACILITY OF SBP ROZGAR REFINANCE SCHEME
(WITH ANNUAL SALE ≤ RS. 2 BILLION)**

BANK WISE POSITION AS ON 12 JUNE 2020					
BANK NAME	NO. OF APPLICATION APPROVED	TOTAL RUPEE AMOUNT OF APPLICATIONS APPROVED	TOTAL NO. OF EMPLOYEES COVERED IN THE NO. OF APPLICATIONS APPROVED	NO. OF APPLICATIONS APPROVED / APPLICATION RECEIVED (%)	RUPEE AMOUNT OF APPLICATIONS APPROVED / APPLICATIONS RECEIVED (%)
JS Bank Limited	140	3,783,593	32,550	83%	83%
Habib Bank Limited	102	3,624,596	29,840	77%	83%
Bank Al Habib Limited	179	3,093,852	30,593	72%	78%
Bank Alfalah Limited	114	2,255,738	22,012	70%	65%
Askari Bank Limited	98	1,986,796	17,220	73%	67%
Habib Metropolitan Bank Limited	77	1,594,313	16,793	52%	53%
Meezan Bank Limited	29	1,189,800	10,857	38%	46%
Dubai Islamic Bank Pakistan Limited	33	1,172,906	8,279	70%	66%
Faysal Bank Limited	40	1,149,326	11,041	61%	67%
The Bank of Punjab	26	946,966	8,853	62%	82%
Soneri Bank Limited	19	395,545	3,474	61%	45%
SAMBA Bank Limited	26	365,821	2,528	93%	96%
MCB Islamic Bank	10	343,108	1,624	42%	40%
Allied Bank Limited	12	328,823	2,729	30%	26%
United Bank Limited	30	328,001	3,163	43%	24%
Bank Islami Pakistan Limited	6	258,609	2,043	60%	94%
Al Baraka Bank (Pakistan) Limited	11	254,727	2,384	42%	39%
Standard Chartered Bank (Pakistan) Limited	4	243,000	941	9%	18%
MCB Bank Limited	15	220,147	1,886	34%	21%
First Women Bank Limited	5	181,934	2,212	42%	44%
National Bank of Pakistan	12	114,974	1,229	33%	24%
The Bank of Khyber	3	8,398	76	30%	6%

²⁴ <https://tribune.com.pk/story/2215784/2-sbp-finance-ministry-unveil-risk-sharing-mechanism/>

²⁵ SDP, UNDP and KPEZDMC organized a round table with about a half a dozen representative from enterprises including women led enterprises on 18th June 2020. The major concern of the enterprises was the slow response of financial institutions.

²⁶ EDR/M&PRD/PR/01/2020-62. External relations department, SBP.



IMPLICATIONS FOR THE GOVERNMENT OF KHYBER PAKHTUNKHWA

- A large number of SMEs in Khyber Pakhtunkhwa (or in other parts of the country) are not likely to benefit from the SBP schemes as is evident from the number of enterprises that have benefited till 15th May 2020 as reported by the SBP. SMEs in the manufacturing sector are likely to be hit the hardest.
- Unemployment due to slowdown or closure of businesses could affect millions of jobs in Khyber Pakhtunkhwa. It is estimated that 32% of the salaried labour force became unemployed in the wake of the lockdown²⁷. With opening of major sectors, the unemployment number must have reduced and a follow up survey by the Khyber Pakhtunkhwa Bureau of Statistics is warranted to assess the latest unemployment numbers.

RECOMMENDATIONS TO BOOST THE SME SECTOR IN KHYBER PAKHTUNKHWA

- Establishing a Credit Guarantee Company, which can provide collateral on behalf of collateral deficient SMEs especially those who have been profitable and have paid taxes.
- The Government of Khyber Pakhtunkhwa can also engage Pakistan Credit Guarantee Company (DFID and SBP sponsored company), which specialises in defining criteria for selecting sectors and enterprises, which ought to be supported in the long-term.
- Ease of doing business fostered through digital platforms and communication technologies for correspondence between government and enterprises.
- Launching of a two-year interest free scheme for micro enterprises in Khyber Pakhtunkhwa, which also covers the Merged Areas of the province.

²⁷ VEOM estimation based on BoS, KP survey conducted in April & May 2020.