MANAGING CASH FLOWS TOGETHER

Banks are acting in partnership with financial intermediaries such as fintechs to offload the heightened financial risk when dealing with SMEs BY KOH JIA RONG

THE lifeblood of any company, liquidity comes as both challenge and opportunity to small and medium-sized enterprises (SMEs). At the minimum, businesses require a healthy cash flow to maintain a sufficient level of working capital for operating expenses. Beyond surviving month to month, SMEs looking to capitalise on their flexibility and remain competitive will seek new equipment; upgrade processes or hiring talent – all of which require cash.

"Typically SMEs require three kinds of financing: Firstly for capital investment, then secondly operation costs to cover salaries and rent," says Dheeraj Chowdhry, chief executive officer and country manager of Funding Societies Singapore. "The third piece is the managing of receivables which are bridge financing short-term loans which are required to bridge gaps between funding cycles."

A tight cash cycle allows for better financial forecasting, which aids in making better business decisions. But with as much as 40 per cent of payments arriving late, including 2.4 per cent that are late up to the point of bad debt, knowing when the next dollar might come in becomes difficult.

Typically near the end of the supply chain and trading on credit, SMEs find themselves especially vulnerable to late payments. For 2019, Singaporean businesses reported a Days Sales Outstanding (DSO) figure of 42 days, despite the commonly given net 30-day payment term.

Bigger businesses may be able to tide over when payments come through late, but SMEs do not have the luxury of deep pockets. On top of that, small business owners (SBOs) often wear many hats, and can spare little time and attention to chasing payments. According to UK payment processing service provider Sage Pay, as much as 20 days of a year are spent chasing after what is owed.

Consultancy firm Steward Redqueen reports that SMEs in Singapore face a financing gap of S$20 billion, affecting up to 40 per cent of SMEs that do not have access to the right financing solution. Banks may offer lines of credit, but 43 per cent of SMEs report that interest rates offered by their banking partners are too high.

Several other dissatisfactions were raised in the report by the Singapore FinTech Association (SFA) and professional services firm Ernst and Young (EY) include slow and poor quality of service.

FRAGMENTED MARKET, HIGH RISK AND LOW MARGINS

From the banks' point of view, SMEs are a challenging market when it comes to determining credit worthiness and disbursing right loan amounts. Also, SMEs require three years to mature and develop a satisfactory credit history, according to the SFA-EY report. Only half of the companies that have been in operation for less than three years obtain approval for their loans. This jumps to 72 per cent after they break the three-year mark.

Banks feel that transaction and servicing costs do not tally with the increased default risk, lack of guarantors and a lower loan margin. The unique business models of individual

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SMEs results in a longer time spent assessing these high risk businesses – time which would be better spent servicing safer, larger corporations and multinational corporations (MNCs) with proven track records and financial stability.

"Firstly, there is a lack of transparency and sufficient business information disclosure in Singapore for assessing risks of the micro SMEs (MSMEs). In other markets, there is a centralised official channel where banks are able to access standardised credit files," says Victor Lee, deputy CEO of CIMB Bank Berhad, Singapore Branch, and CEO of CIMB Group Commercial Banking. "Secondly, the MSMEs have very widely dispersed profiles, ranging from the 'mom & pop' shops to pre-IPO (initial public offering) type of businesses," he adds.

DEFENDING THEIR TURF

Despite the uncomfortable ground, bank loans still account for 70 per cent of SME funding, with the average loan request falling below S$3 million. Banks still hold the lion's share of the market, but they also recognise the need to improve accessibility to financing and offer bespoke services to match unique business models.

"We focus on the life cycle of the business. What that means is supporting businesses as they grow from startups, into middle market and then established SMEs," says Tan Chor Sen, head of International, Global Commercial Banking at OCBC Bank. "Within this framework, we also understand the unique needs of different segments; fast-growth entities and new segments like serial entrepreneurs manage their businesses differently – and we have a dedicated team to support them."

Banks have also chosen to act in partnership with financial intermediaries such as fintechs to offload the heightened financial risk when dealing with SMEs.

"CIMB continues to build and to leverage on new additional sales channels such as strategic collaborations with chambers of commerce and associations, peer-to-peer (P2P) lenders and established fintech players to enhance the Bank's offerings," says Mr Lee. "This includes alternative credit underwriting models and scorecards, investing in digital capabilities such as online account openings and online loan application platforms," he adds. "We will also look into introducing ecosystems and value chain financing."

CIMB has partnered with SESAMi-Capital Match to finance the E-supply chain's invoices, integrating with their automated invoice workflow which enables suppliers to receive immediate payments on invoices. Last June, a CIMB-CapBridge collaboration gave SMEs banking with CIMB access to raise private capital and liquidity through the CapBridge private capital eco-system.

No man is an island, and doubly so for SBOs as business mistakes can prove disastrous for small businesses. Banks offer their trove of experience, advisory services and networking capability as part of the package when SMEs choose to take up their services.

"Digitalisation is a pillar of focus, as we believe that businesses need to be digitally effective to run a successful business. We have made a concerted effort to provide beyond banking digital solutions, on top of digital solutions in the banking realm," adds Mr Tan, summarising OCBC's strategy when it comes to capturing SME market share.

"These solutions help businesses better manage costs and can spur innovation, which is especially important these days against an uncertain, ever-changing landscape," he explains. "Businesses can't be content to just remain in their home markets – it's a must for them to venture overseas – and so the network support that we provide continues to be key."

OCBC offers a Business First Loan that requires SMEs to be in operation for six months, but allows for a loan of up to S$100,000 at a rough 8.75 per cent interest rate per annum. There is a facility fee of 2 per cent on the quantum of the loan.

ON THE ALTERNATIVE LENDING FRONT

Having identified an underserved SME loan market, fintech firms are quick to leverage on their technology and agility to service SMEs. They tackle the two challenges: connecting investors with borrowers, and accessing credit worthiness based on limited financial documentation.

"If you were to look at SMEs from the lens that is used for assessing large corporates, then there is a mismatch, but what we have managed to do is create a lens which is especially for SMEs," says Funding Societies' Mr Chowdhry. "We do a lot more cash flow-based lending – we look at their cash flows more, rather than only the financials."

For assessing the credit worthiness of SMEs, these alternative lending companies develop proprietary risk algorithms that are fed with what limited financials that the SMEs can provide. Much of the evaluation follows the traditional approach of analysing an applicant's basic financial statements to reach an approval decision, but include additional unorthodox criteria and artificial intelligence-driven fraud and credit assessments.

As these alternative lenders rely on their in-house model to woo investors, the exact weighting and composition of the models are tightly held and regularly optimised to improve their predictive capabilities.

Funding Societies has a proven track record of a 1.34 per cent default rate across a total of 1.25 million financing requests, and has connected SMEs with S$1.04 billion in loans since operating from 2015. Speedy disbursements are also a forte for Funding Societies, as they tout Bolt as being a market first. Bolt is a product that allows a borrower to apply and receive loans within 24 hours, with the entire process done online.

Validus Capital is another such fintech built on an online aggregator platform, where investors place funds in an escrow account. Funds are then disbursed according to their preferences, and earn a return based on the interest paid by the borrowers. An online checklist may be completed to determine what types of loans and the diversification criterion, which is the maximum percentage of asset under management (AUM) to place with a single SME, and an "auto-invest" feature spreads out the capital to SMEs.

"If an SME requires, say S$25,000, that deal is uploaded on our platform and then an algorithm conducts checks across all the investors to see who is eligible for that deal. Bite size amounts of capital, according to the diversification criterion set by investors, are taken out to service the loan," explains Vikas Nahata, co-founder and executive chairman of Validus. "We distribute the loan nicely across investors, and that's, technologically speaking, what crowd funding is."

Validus offers three types of business loans with different loan durations and purposes. They range from a repayment period of 30 days for their Invoice Financing loans to a One Year Working Capital Loan, interest rates start are 0.67 to 2.5 per cent, per month based on the credit risk.

GROWING WITH DEBT

There are some 260,000 SMEs in Singapore, employing 70 per cent of the workforce. They contribute just under half of Singapore's gross domestic product, but struggle to attain financing as their kaleidoscopic nature makes it hard for banks to effectively risk rate and serve loans.

And then there is also the cultural factor – SBOs at the helm of a company may be reluctant to seek growth financing, as they view indebtedness as inherently bad, despite promising growth opportunities. "Many businesses continue to hold the belief that having debt on their balance sheet is detrimental. Our studies show that debt can be a growth-enabler when prudent capital management is exercised," says Mr Nahata.

Sum these up with strong headwinds expected in 2020, and SMEs face a tough outlook. Being small and agile extends flexibility but when facing a storm, stability becomes paramount to survival. Banks can extend this stability to the SMEs, but will require fintechs to bridge the gap. Not all banks view fintechs as encroaching on their businesses; some see them as partners in fostering small businesses into larger players, when they will be able to effectively take up bank loans.

"Fintech firms attract a specific attract a specific group of borrowers, as their funding costs can be high," says Mr Lee, on CIMB's relationship with fintechs, "We look upon them more as potential partners instead of competitors. This is because as businesses grow, they will to want to look for more cost-efficient sources of funding, hence for borrowers who have outgrown their needs from fintech companies; they will turn to banks for funding. This allows us to collaborate with fintech companies to offer a more extensive suite of solutions for their customers as well."

Such a collaborative environment bodes well for SMEs in their ever growing need for financing. ■