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THE EVOLUTION OF SME FINANCING

The need for SME financing has not changed throughout the years, but the process and options available have now altered drastically

BY VIVIEN SHIAO

PEER-TO-PEER LENDING, OR CROWDFUNDING PLATFORMS, HAS BEEN GAINING TRACTION AMONG THE SME COMMUNITY DUE TO THE FEWER HOOPS THEY NEED TO JUMP THROUGH AND TIMELINESS OF SECURING LOANS.

IT IS often said that cashflow is the lifeblood of any company. Seasoned business owners are well aware that while turnover and profits matter a great deal in the long run, it is cashflow that will quickly make or break the company. That is the main reason why small and medium-sized enterprise (SME) financing is an evergreen concern for all small businesses. With less bargaining power due to their smaller size, SME owners often have to pay first for products or services from suppliers and other players in the value chain, and are usually last when it comes to payments by customers.

This gap in payments in certain industries can be up to several months, such as in the construction sector. When unexpected crises hit, such as late payments by customers or budget overruns during projects, businesses without adequate financing can be left high and dry.

With so much at stake, SMEs need to ask themselves if their current financing facilities are adequate for their needs and future expansion.

In the 2017 *SME Financing Survey* by then-Spring Singapore (now known as Enterprise Singapore), it was found that managing delays in customers' payment remains a key finance-related challenge. Findings revealed that 64 per cent of SMEs currently face some form of delay in receiving payments from customers. In fact, delayed payments was ranked as the top finance-related challenge they expect to face in 2018. Delayed payments can have a serious impact on an SME's cashflow and working capital management if not managed carefully.

While the *SME Financing Survey* suggests that SMEs do not have a serious problem with getting external debt financing as 90 per cent of SMEs were successful in securing loans in 2017, other SME surveys indicate that financing is still a top concern by this particular segment. In a separate *SME Development Survey 2017* by DP Info, 35 per cent of SMEs cited facing financing concerns – up from 22 per cent in 2016 and 14 per cent in 2015.

Regardless, the need for SME financing has not changed throughout the years, but the process and options available have now changed drastically. Banks and financial institutions may still make the bulk of SME financing loans, but financial technology (fintech) is fast changing the scene. Peer-to-peer lending, or crowdfunding platforms, has been gaining traction among the SME community due to the fewer hoops they need to jump through and timeliness of securing loans.

Despite the increased plethora of options, most industry watchers concur that financing remains a key issue for the SME community. "Financing has always been and always will be a challenge," emphasises Boh Wai Fong, professor and head of Information, Technology and Operations Management, Nanyang Business School.

Startups with less than three years of operations are "not within the banks' risk appetite", she noted. "Such SMEs will have to go to higher-risk appetite non-bank financial institutions and pay a high interest rate that eats into their cashflow." She adds that interest rates can go as high as 10 per cent per month for non-secured loans, while transaction-backed loans are typically about 2-3 per cent per month.

Even SMEs that are more than three years old still need to maintain "a good set of financials" before the banks will provide reasonably priced unsecured loans to them, says Prof Boh.

Duan Jin-Chuan, Jardine Cycle & Carriage Professor of Finance, NUS Business School says that SMEs all over the world face similar challenges with regard to financing. "Financing difficulty is obviously due to short history of individual operations, small scale, and in some cases, innovative and unproven business ideas or models," he says.

But Prof Duan notes that there are a number of government-assisted financing schemes in Singapore, which has alleviated some financing difficulties for SMEs. These include the SME Equipment Loan, which supports equipment financing for companies with higher risk profiles; the SME Micro Loan, which provides working capital financing for micro-enterprises; and the SME Enhanced Micro Loan, which provides working capital financing for young micro-enterprises less than three years old.

Bank loans have been consistently found to the most popular form of external financing across SMEs of different sizes, industries and stages of development in Singapore.

"Banks are still the most popular option for SMEs because they are able to provide the cheapest interest rate to the SMEs who are eligible to borrow from them. This is because of their cheaper cost of funds," says Prof Boh. "Banks have deep pockets that can help SMEs to create a financing and transactional solution that meets their needs and helps them grow, even across borders."

Many banks in Singapore have an SME presence, making the space an extremely competitive one. They have differing credit criteria, interest rates, and loan conditions, so it pays for SMEs to shop around to find one that can best meet their needs.

According to the *Asean SME Transformation Study* by UOB, EY and Dun & Bradstreet, the number one most important factor for small businesses when it comes to picking their financial partner is the competitiveness of the bank's pricing and fees.

Coming in a close second is the time taken for banks to process transactions. To help small firms access the funds that they need more quickly, UOB has developed a data analytics-powered credit underwriting engine to halve the time that it takes to process loan requests, says Mervyn Koh, managing director and Country Head of Business Banking Singapore, UOB.

And instead of seeing alternative lenders as competition, UOB tied up with equity crowdfunding firm OurCrowd and venture debt provider InnoVen Capital to offer customers other financing solutions, he adds.

DBS Bank, on the other hand, is embracing "digital and innovation-led" solutions to make banking simpler and faster for SMEs. Joyce Tee, global head of SME Banking, DBS Bank says: "Our customers tell us that digitalisation is a way to simplify day-to-day operations so that they can spend more time on business development rather than operational issues."

Some platforms offered to its SME clients include DBS TechMatch, an initiative started in 2016 to help SMEs embark on innovation projects to solve business problems and build capabilities. This year, to scale TechMatch, DBS is collaborating with the Infocomm Media Development Authority (IMDA) to expand the solution options to include their list of pre-approved technology solution providers, adds Ms Tee.

Another local bank with a strong SME presence is OCBC Bank. According to Christie Chu, its head of Emerging Business, Global Commercial Banking, one differentiating factor of the bank is that it is willing to lend to SMEs as young as six months old through its government-assisted Business First Loan.

"This is a stage where companies often struggle to get loans because banks typically require at least a two-year track record for credit assessment purposes," explains Ms Chu. "But we recognise that this is a stage where they might need cash the most to kick-start operations, so we simplify the credit assessment process."

NEXT PORT OF CALL

While banks are the most popular option favoured by SMEs here, it might not necessarily be the easiest means for financing. Prof Boh warns that it is "difficult" to qualify for bank loans: "Banks tend to be more strict and unforgiving when it comes to enforcing the default rights. Lending conditions tend to be more onerous for SMEs to upkeep," she says.

Aside from banks, financial institutions are usually the next port of call for SMEs looking for loans. In February 2017, the Monetary Authority

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of Singapore had announced that finance firms will be able to offer uncollateralised loans of up to 25 per cent of their capital funds, up from 10 per cent previously.

This easing in regulations have allowed the only three licensed finance firms – Hong Leong Finance, Sing Investments & Finance and Singapura Finance – to have more flexibility in their financing solutions for SMEs.

Ang Tang Chor, president of Hong Leong Finance, says that its ability to customise sets it apart from the rest. "Our partnership with government agencies such as IMDA and Enterprise Singapore enables our relationship managers to advise and customise financial solutions that work best for their business," he says.

Hong Leong Finance provides a slew of funding solutions such as Trade Advance and convenient online loan application to cater to the needs of SMEs. Mr Ang also emphasises the partnership aspect: "Some SMEs may not be aware that they can reach out directly to us for free financial consultation on their business needs. This could entail anything from financing to cash management advice."

THE RISE OF ALTERNATIVE LENDING

Peer-to-peer (P2P) lending is still in the nascent stage in Singapore, but it is steadily getting noticed by more SMEs due to the spotlight on fintech. As the name suggests, P2P lending pools together funds from investors. Crowdfunding platforms connect lenders to borrowers, disrupting the banks and financial institutions' traditional dominance in the SME financing scene.

Investors are attracted due to the relatively high interest rates that they can earn for short-term loans, while SMEs gain a quicker turnaround time and the fact that no collateral is needed.

Kelvin Teo, CEO and co-founder of crowdfunding platform Funding Societies, says that more SMEs now understand their financing needs better and know when to reach out for external funding. "The stigma of getting a loan is slowly fading away, although there still aren't many SMEs that wish to step out to share their stories," he says.

Having recently raised US$25 million in Series B funding led by a Softbank unit, Funding Societies is among the largest P2P lending platforms in South-east Asia. It has given out more than S$170 million across 4,000 business loans. Mr Teo says that the platform focuses on speed, technology and customisation to help SMEs based on what they need. "We try to be as tech-driven and automated as possible on the backend using data and artificial intelligence to provide world-class products and services, while our frontend sales team offers the personal touch to our clients," he explains.

He says that the platform is currently "a bit more conservative" in credit underwriting, and is comfortable with providing up to S$1.5 million for unsecured business loans. Interest rates vary from 9 per cent for secured loans to as high as 16 per cent for unsecured loans. It also offers invoice financing, of up to 80 per cent of the invoice value with a quantum of up to S$1 million.

Capital Match is another P2P lending and invoice financing platform headquartered in Singapore. It offers business loans and invoice financing of up to S$200,000, with interest of up to 20 per cent. Sharath Singh, Commercial director, Capital Match, concurs that speed, efficiency and clear communication are its key differentiators compared to other platforms.

"Most SMEs just want to hear a 'yes' or 'no' (answer) instead of having to go through multiple layers of assessment without clear guidelines," he says. "We are assisting a lot of SMEs who have quality receivables but are unable to get financing due to stringent bank criteria which focus more on the SME's quality rather than on receivable quality."

MoolahSense is another alternative lending and invoice financing avenue that SMEs can turn to. It has been accorded a full Capital Market Services (CMS) licence by the Monetary Authority of Singapore, enabling more investors to better access SME loans, while more SMEs can get additional financing support. To date, it has helped SMEs raise more than S$60 million over 600 campaigns on their platform.

Lawrence Yong, CEO of MoolahSense, says that its platform offers a variety of flexible business financing solutions to cater to the diverse needs of small businesses. "SMEs can choose to either repay their loans in monthly equal instalments, monthly interest repayments or quarterly interest repayments . . . With our wide range of financing products, SMEs can raise funds through our platform via a variety of means," he says.

On top of traditional loan solutions, it also offers targeted credit solutions such as grant financing, retailer rental deposit financing and fast-tracked top-up financing, he adds.

THE FUTURE OF FINANCING

While the P2P lending options are dazzling, they are not without their own issues. For example, crowdfunding platforms tend to have higher interest rate loans compared to banks, so depending on such an arrangement may not be sustainable.

NUS Business School's Prof Duan says that the main difference between P2P lending platforms and banks rests in the former's ability to serve small-scale loans more effectively. "In order for P2P platforms to succeed, they need to go beyond service cost advantages to equip themselves with superior credit risk analytics made available through big data," he says.

Aside from cost, NTU's Prof Boh adds that using P2P platforms can appear as a negative signal as it indicates that the SME is "unable to obtain cheaper and smarter sources of financing".

Most of the risk of using P2P options rest on the investors, as defaults or even fraud could take place. Crowdfunding firm Capital Springboard shook the industry in April when it announced that it had unwittingly sold S$6.9 million of fake invoices to investors, all from a single SME. An expert team was said to vet every invoice that Capital Springboard sold. Yet, 60 invoices worth S$6.9 million slipped through the cracks.

It remains to be seen if the dent in confidence has affected the nascent P2P crowdfunding sector, but it was a cautionary tale on the need for due diligence.

The need for financing will always be present for SMEs, be it to invest in new technology, go abroad, or to expand their operations. But as the cliché goes: the best time for SMEs to get financing is when they do not actually need it. This requires a well thought-through strategy and foresight by SMEs to plan for their future so that they will not be caught unawares during a rainy day. ■