Institute of Policy Studies

IPS Closed-Door Discussion: Financing for SME Development in Singapore

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The availability of financing is imperative for the development, survival and expansion of a company. Given Singapore's current economic restructuring to boost productivity, many companies require adequate and sustainable financing to carry out the long-term investments needed to transform their businesses. In particular, small and medium enterprises (SMEs) often face difficulties in financing their business needs. They tend to be subjected to higher levels of capital rationing due to the existence of informational asymmetries and risks associated with small businesses.

To better understand the SME financing landscape in Singapore, identify areas of financing gaps, and explore possible solutions to address those gaps, the Institute of Policy Studies (IPS) held a closed-door discussion with participants from the public and private sector on 30 July. The session was chaired by IPS Adjunct Senior Research Fellow, Manu Bhaskaran, and featured opening presentations by Linus Goh, Head of Global Commercial Banking at OCBC, and Tan Chin Hwee, Partner at Apollo Global Management.

In his presentation, Mr Goh identified three key SME financing gaps in Singapore:

1) Financing for start-ups and young businesses: Conventionally, banks typically require companies to have two to three years of operating experience before they would consider providing financing. There is a gap between the time a company first begins operation and the time it can get its first loan.
2) Financing for internationalisation: Given that more companies are expanding overseas, sufficient internationalisation support is very important.
3) Equity funding: There are gaps in equity financing options for middle-of-life SMEs, especially those in post-seed and growth stages.

Mr Tan commented that the collaboration between the government and banks under the micro-loan scheme is very useful for uncovering the credit worthiness of SMEs and allowing banks to develop a more qualitative-based credit worthiness framework that incorporates behavioural pattern assessments. However, while providing loans to more SMEs is good, it is important to also balance the issue of moral hazard.

Highlights from the rest of the discussion are summarised below.

Assessing the SME Sector Development in Singapore

Assessing the state of SME development is not a straightforward process. For example, Singapore may have a higher SME failure rate than Taiwan and South Korea, but that does not mean that Singapore's SME landscape is more vulnerable. The SME failure rate is dependent on a number of factors and not just on the availability of financing.

The SME non-performing-loan (NPL) ratio in Singapore at 0.5%–1% is lower than that in Malaysia and Indonesia. At the same time the SME loan approval rate is also very high. When one participant asked what a healthy NPL threshold range is, the general consensus was that the acceptable range is relative to the economic and business environment. More pertinent is how to manage the NPL ratio. Bank officers actively engage their customers through dialogue, education and alerts to help maintain their ability to repay their loans.

One participant also responded that although the current NPL ratio in Singapore is low, the SME loan growth rate has been high and recorded double-digit growth for the past few years. The robust loan growth dismisses some of the claims that banks are too conservative in their SME lending.

Gaps in SME Financing

A participant pointed out that many SMEs are pre-assessed even before they submit their loan application. Hence, the high SME loan approval rate in Singapore may in reality suffer from upward bias. Many young companies have difficulty getting a bank loan because of the lack of credit history. These young companies have to fall back on informal channels of financing like support from their friends and families. Without these alternative channels, many of them would not be able to survive and much less grow. Crowd-funding builds on this idea of financing from the community, he said.

However, there is some improvement to the situation as banks are beginning to move beyond the conventional checklist or parameters, and now incorporate behavioural methods to assess the credit-worthiness of a young business. The micro-loan programme, where the government takes on 70% of the loan risk to young SMEs, allows banks to develop a more qualitative based credit-worthiness assessment framework.

One participant said that other financial entities play an important role in SME financing by offering more financing options. While his point is acknowledged, more financing options do not necessarily bring about more benefits, especially if these options are transient and die out after a short period of time. The inconsistency and unsustainability of many novel financing ideas can be quite disruptive for the development of businesses.

The Importance of Business Aspirations

Ultimately, the ability of a business to move up the life-cycle and graduate as a SME depends on the aspirations of its business owner. While many start-ups have huge aspirations to grow, a lot of the existing medium-sized SMEs are more concerned about wealth preservation and maintaining status quo.

For those SMEs with aspirations to grow, the main challenge lies in internationalisation. Many of them find it very challenging to expand their business overseas and unseat Singapore as the centre of their business activities. More internationalisation support is thus required.

A number of SMEs gave the feedback that when they venture overseas, they sometimes find themselves fighting even harder than the native companies to win jobs from big Singapore companies. One participant suggested having more coordinated support to encourage overseas projects involving a consortium of local companies.

Having more schemes that encourage mergers and acquisitions are useful too, because consolidation in sectors that are over-concentrated would allow the remaining companies to scale up, which would consequently improve their capabilities to expand overseas.

Creating a State Institution that Oversees SME Development in Singapore

Some participants stated that the SME bank in Malaysia generally does not crowd out private credit providers like commercial banks since the degree of business overlap is not high. However, there are also voices cautioning against generalising Malaysia's experience because each SME bank has its own mandate.

Moreover, while many countries have their own SME bank or Export-Import (EX-IM) bank, not all of them are profitable or sustainable. Germany's SME banking model is held in high regard precisely because of its success in achieving national goals while remaining sustainable. In Singapore, it might be difficult to sustain the operations of an EX-IM bank because there may not be sufficient overseas projects to finance. More generally, given the state's objectives, is there a role for a SME bank, EX-IM bank or other forms of state-related financing institution to fulfil?

Adequate financing is not the only necessary condition for a company's development and most participants agreed that in Singapore it is not a major obstacle preventing SMEs from growing. In particular, a number of participants felt that there might be more value in creating an agency that oversees the development of SMEs instead of just a SME bank. Such a state institution would institutionalise knowledge across public agencies and consolidate the government's resources required to develop SMEs as a driver of the Singapore economy.

In terms of capital funding, Singapore could consider the approach used by the German government-owned development bank KfW Bankengruppe, which funds itself mainly through the capital markets. Most of the government financing programmes in Singapore are currently funded through the national budget. The capital markets can be a much larger source of funding.

Lastly, the current SME categorisation covers a huge range of companies. In reality, small and micro companies are very different in nature from medium-sized companies. Instead of creating a SME bank or SME development agency, it may be more useful to create institutions or agencies that look after the development and needs of small and micro enterprises. Unlike their medium-sized peers, this group of enterprises is most in need of assistance to develop their businesses.

Conclusion

There is an evident need to speed up the regionalisation of our SMEs as Singapore's economic model changes. However, the financing gaps in the growth stage and the internationalisation stage of the SME life-cycle could potentially hinder progress on this front. On the debate of having a SME or EX-IM bank in Singapore to support national objectives of SME development, the decision is not clear-cut partly because the definition of SME itself is so wide that it includes a motley collection of companies with varying needs and at different stages of growth.

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