Financing SMEs in Asia and the Pacific: Trends and Challenges

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Agenda

I. SMEs in ADB Economies
II. Access to Bank Credit
III. Access to NBFIs
IV. SME Capital Markets
V. Access to Finance by Development Stage
VI. SME Finance Policies
VII. Challenges
VIII. Policy Implications
SMEs in ADB Economies

- Recent global economic slowdown requires a new growth model for Asia, where SMEs play a key role in boosting national productivity.

Notes: Data in 2014 for CAM, KAZ [SMEs to total and employees], and MYA [SMEs to total]; data in 2013 for KYR, MON, IND, INO, SRI, THA, PRC [SMEs to total], MAL [employees and GDP contribution], and KAZ [GDP contribution]; data in 2012 for BAN, KOR, VIE, PHI [SMEs to total and employees], and PRC [exports]; data in 2011 for PRC [employees]; data in 2010 for MAL [SMEs to total]; data in 2006 for PHI [GDP contribution].

Source: Compilation from the ADB Asia SME Finance Monitor 2014.
Limited access to bank credit decelerates growth pace of SMEs.

Lending to SMEs has declined over the course of the GFC and in 2014. SME received only 18.7% of total bank loans. SME NPLs ranged 2%-18%.

**SME Bank Loans to Total Loans (%)**

**SME NPLs (%)**

--- SME NPLs to SME loans, - - - SME NPLs to total loans.* June/2014 (KOR), September/2014 (PNG [Q3]), December/2014 (BAN, INO, and THA).

Notes: NPLs based on the national loan asset classification. For BAN, the ratio of borrowers with SME NPLs to total SME borrowers. For KOR, the ratio of SME classified loans to total SME loans.

Source: Asia SME Finance Monitor 2014.
Credit guarantee as a tool to improve SME access to finance but limited outreach with a problem on business sustainability.

Access to Bank Credit

Net Profit & Loss of Credit Guarantee Institutions


Note: Net profit & loss = (Recovery + Fee income)/Payment under guarantee
Access to Bank Credit

- Basel III may negatively affect bank lending attitude to SMEs.

- Basel III requires banks to have tighter risk management as well as greater capital and liquidity.

- Resulting asset preference and deleveraging of banks could limit the availability of funding for SMEs.
  - Capital requirements: Banks may encourage finance to large firms with good ratings (investment grade) rather than unrated SMEs to reduce total high-risk assets.
  - Liquidity framework: Banks may be willing to hold “easy-to-sell assets” or high quality liquid assets, resulting in constraining the provision of long-term credit.
  - Leverage ratio framework: Controlled leverage of banks including off-balance transaction may limit financing options for SMEs, e.g., trade finance availability.
Access to NBFIs

- The nonbank finance industry is small in scale. 11.5% of bank loans.

Access to NBFIs

- The nonbank finance industry is influenced by bank performance.
  NBFI financing accounted for 3.1% of GDP. NPF stood at 2.7%

**NBFI Financing to GDP (%)**

**NBFI Nonperforming Financing (%)**

*Notes: Microfinance institution (MFI) loans disbursed (KYR, IND, and TAJ), MFI loans outstanding (BAN [NGO-MFIs], CAM, PRC, LAO, and MYA), NBFI financing (FIJ, INO, MAL, MON, and SOL).
Source: Asia SME Finance Monitor 2014.*
SME Capital Markets - Equity

- Although still in the trial stages, positive performances on SME equity markets and government reform efforts have been seen in Asia.

Market Capitalization (% of GDP)

Number of Listed Companies

GDP = gross domestic product; SME = small and medium-sized enterprise. *Data as of 31 Oct for KOSDAQ, 28 Nov for ACE, and end-2014 for others.

Note: Emerging Asia comprises the People’s Republic of China; Hong Kong, China; the Republic of Korea; Malaysia, Singapore, and Thailand.

Source: Author’s calculation based on data from respective stock exchange websites and the ADB Asia SME Finance Monitor 2014 (provisional data).
SME Capital Markets - Bonds

- A new movement of creating an SME bond market.

* Data as of 31 Oct 2014.
Source: Author’s compilation from the ADB Asia SME Finance Monitor 2014 (provisional data).
Access to Finance by Development Stage

- Diversified SME financing tools can push up economic development.

Notes: Data in 2013. Nonbank financing includes financing by microfinance institutions, finance companies, credit unions, leasing, factoring, and venture capital investments. SME equity markets include SME exchanges in BSE & NSE (IND), Diri Savi/CSE (SRI), IDX (INO [10 SMEs listed]), SME Board/PSE (PHI), UPCoM (VIE), SME Board & ChiNext/SZSE (PRC), ACE (MAL), mai (THA), and KOSDAQ/KRX (KOR). Country classification refers to the World Bank classification for FY2015.

Source: Author's calculation based on data extracted from the ADB Asia SME Finance Monitor 2014.
SME Finance Policies

- A balanced approach is required to design extensive policy measures for improving SME access to finance and for safeguarding their financial stability.

### National SME Finance Policies in Selected Asian Countries

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* Funded by private and public sectors. ** TReDS in India: Trade Receivables Discounting System for facilitating trade receivable finance for MSMEs, proposed by the central bank. *** Mandatory creation of microfinance units in banks.

Challenges: Financing Sophistication and Diversification

- Financial infrastructure
  - Credit data infrastructure (credit bureau)
  - Legal framework for secured transactions (collateral registry)

- Sustainable credit guarantee systems

- Innovative product design
  - Asset based finance (ABL, factoring, financial lease, and ABS)
  - Credit score based lending
  - SME cluster financing
  - Debtor-in-possession (DIP)/Exit financing
  - Crowdfunding

- Trade finance & supply chain finance
  - Foster the supporting industries
  - Stimulate internationalization of SMEs
Challenges:
Financing Sophistication and Diversification

- Diverse players not yet involved in SME finance space
  i. Specialized financiers (e.g., factors and leasing firms)
  ii. Market organizers
  iii. Risk-taking/contractual savings institutions

- Capital market financing for SMEs
  i. Respond to long-term funding needs of growth-oriented SMEs
  ii. Equity finance, bond issuance, and mezzanine finance
  iii. Develop the venture capital industry as a growth capital provider

- Roles of public financial institutions in SME finance
  i. Outreach to the underserved
  ii. Timely response to external shocks, e.g., financial crisis and disaster
Issue 1: Secured Lending for SMEs

- In developing Asia, many countries still suffer a lack of legal framework to promote secured transactions.

- Broadening the range of pledgeable assets help enhance SME access to finance, especially women-owned SMEs.
  
  ✓ **Pledgeable assets**: movable assets, e.g., machinery/equipment, inventory of final goods, and receivables; intellectual property rights, etc.

- For the legal reform on secured transactions:
  
  ✓ A wide-range of pledgeable assets as collateral covered by the secured transaction law/collateral law.

  ✓ A sound registration system on movable assets.

  ✓ A speedy & efficient collateral enforcement mechanism.
Issue 2: Sustainable Credit Guarantee Systems

- **Business sustainability**
  - Cost efficiency & profitability
  - Diversified & demand-driven business approach
  - Self-funding (shift from public-dependent to market-based)

- **Risk control arrangements**
  - Develop re-guarantee system (credit insurance)
  - Develop risk-sharing schemes (partial credit guarantee)
  - Strengthen second credit screening by guarantee institutions

- **Decentralization or centralization**
  - Promote a regional CG system with a proper legal framework
  - Develop product design for the centralized CG system (e.g., Portfolio CG)

- **Infrastructure**
  - Establish a credit risk database or credit bureau
  - Credit database supports proper pricing and risk-based management by guarantee institutions.
Issue 3: Trade Finance Facilitation for SMEs

China-Korea Currency Swap Trade Settlement

- Enable importers & exporters to settle their trade transactions in their local currencies.
- Promote LCY invoicing & settlement, reduce transaction costs for importers & exporters, and potentially benefit SME exporters & importers, especially in ASEAN countries after AEC establishment in 2015.
- ...but not yet an established system.

Source: Extracted from the ADB presentation material "LCY Trade Settlement in ASEAN+3" prepared by D. Park and I. Shin in the ABMI Task Force Meeting, Myanmar, 27 February 2014.
Issue 4: SME Capital Markets

Growth Capital Funding and Risk Capital Providers

Seed/Start-up/Early  Expansion  Steadily growing

Founders, family & friends
Angel investors
Venture capital
Sophisticated investors

Formal & informal lending
Private equity, mezzanine finance, etc.
Organized OTC
Exchange markets
IPO

Exchange markets
- Domestic market for emerging corporations (SME board)
- International market for smaller growing firms (AIM)

Organized OTC
- Trading venue for unlisted SME shares (non-exchange markets)

Size of investment capital
Growth capital needed

Firms’ life cycle

Source: Author’s illustration.
What:

Provide timely financing opportunities for SMEs while responding to their needs with flexibility and innovation.

- Poor access to finance limits the ability of SMEs to survive and grow.
- Limitations of bank lending under global financial uncertainty, e.g., possible negative impact of Basel III.
- No one-size-fits-all financing solution. Diversification of SME finance models is needed.
- Long-term funding needs increase as SMEs grow further. Potential for developing SME capital markets in Asia.
Policy Implications

Why:

New environment requires new financing solutions for SMEs.

- Economic integration and increasing FDI inflows to Asia stimulate the structural change of SME business models.
- A globalized economy will bring more SME internationalization and new financing demands from SMEs.
- Increased importance of supply chain finance and trade finance to involve SMEs in global value chains.

Limitations to relying on own- or quasi-capital for SMEs to sustain their business.

- Diversified financing models besides traditional bank credit should be developed for healthy debt-equity structure of SMEs.
- Long-term financing for growth-oriented SMEs is key.
Policy Implications

- **How:**

  Flexible and holistic policy approaches for SME financing beyond measures already established.

  i. Support for SME bankability

    ✓ Promote SME credit data infrastructure.
    ✓ Promote secured lending for SMEs (movable assets as collateral).
    ✓ Establish sustainable credit guarantee schemes

  ii. Support for nonbank & market-based financing to SMEs

    ✓ Facilitate new financing models rather than strictly regulate them, e.g., crowdfunding.
    ✓ Support the creation of long-term financing venue for seed firms, start-ups, and entrepreneurs with growth and innovative mind.
    ✓ Promote nonbank financing instruments, e.g., lease & factoring.
    ✓ Develop the base of professionals supporting SMEs, e.g., CPAs.
    ✓ Develop the venture capital industry serving SMEs.
    ✓ Tax incentive schemes for priority SME sectors.
Discussions

✔ Roles of policymakers to improve SME access to finance in your country. What are key policy components and challenges for financing SMEs?

✔ Ways of enhancing bankability for SMEs. What kind of innovative product design can be considered with technology?

✔ Potential of developing nonbank and market-based financing for SMEs. What are challenges and solutions for developing trade finance and supply chain finance?
References

Asia SME Finance Monitor 2014

Asia SME Finance Monitor 2013
Thank you for your attention.

For further questions:

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