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An Ecosystem Approach to Financing SMEs in Singapore

Introduction

In today's challenging times, especially for a small and open economy like Singapore, an article looking at how the financing needs of small and medium-sized enterprises (SMEs) will change over their business life cycles is timely. As a start, we will paint the landscape of why SMEs matter to Singapore's growth, not just over the past decades, but even more so, going forward. In addition, we will examine what some of the key post-pandemic challenges faced by many of the SMEs are before proceeding to identify the common financing options currently adopted by SMEs. In the recent five years, both capital availability and financing options have taken many forms, ranging from venture investment, private equity and buyouts to peer-to-peer lending to ensure that SMEs are not handicapped in their ability to seek growth capital. In fact, the way forward is getting even more exciting, with SMEs having access not just to private capital and government financing but also via the set-up of private exchange and alternative family business-based sources of financing with mentoring.

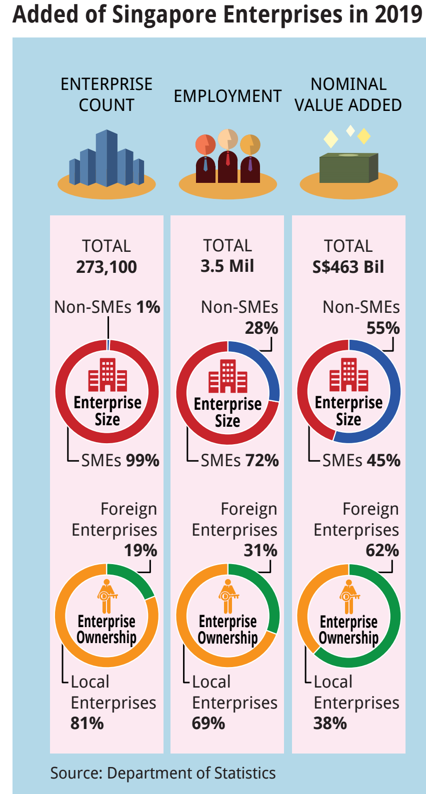
A Brief Overview of the SME Landscape and Challenges

The early history of Singapore growth was powered predominantly by an export-led strategy driven by large multinational companies (MNCs). In the 1970s and 1980s, through creating clusters in industries such as electronics, transport and machinery, the government promoted inter-firm linkages, and SMEs played a supporting role to MNCs as subcontractors. In 1987, SMEs contributed 90% of the total number of establishments, generated 44% of employment and contributed to 24% of value added (SME Master Plan, 1989).

The first active push to entrepreneurship and small enterprises in policy making came with the publication of the Economic Review Committee (ERC) report in 2003 in the aftermath of the Asian financial crisis. The report called for developing Singapore into a creative entrepreneurial nation where locally competitive SMEs co-exist with larger MNCs. This was followed by the Economic Strategies Committee (ESC) report in 2010 and the report of the Committee on the Future Economy (CFE) in 2017, urging the economy to move further towards knowledge-based and innovation-driven activities.

Fast forward to today when 99% of 273,100 Singapore enterprises are SMEs, and they contributed nearly half of nominal value added while employing 72% of the workforce in 2019 (Figure 1). In 2014,

Figure 1: Number, Employment and Value Added of Singapore Enterprises in 2019



the Ministry of Trade and Industry (MTI) updated the definition of an SME to include enterprises having at least 30% local shareholding, in addition to having annual sales turnover under SGD 100 million and employing fewer than 200 employees.

Key Challenges Faced by SMEs Post COVID-19 Pandemic

Many studies and reports have identified the challenges faced by SMEs over the economic cycles that Singapore experienced in the past 55 years of the country's independence. However, the authors believe that those challenges pale in comparison to what the SMEs are currently facing post-pandemic. While the impact of Covid-19 is felt across the full range of SMEs, like in the United States, smaller businesses and businesses that rely especially on retail foot traffic have been disproportionately affected. In addition, Singapore, being relatively open to trade and tourism, is finding that SMEs which are heavily dependent on the travel and hospitality industry are struggling to survive, let alone thrive. Current challenges include the following:

Finance-related problems

Poor management of financial and human resources was often the main source of the problem in many troubled SMEs in the past. Now, with the wider choices of SMEs in Singapore (both online and off-line) than previously, customers have become more discerning, resulting in stiffer competition. These customers often stockpile debts with the smaller SMEs in particular and threaten to end their patronage if the business should insist on repayment. Under such conditions, many small businesses find it impossible to meet their obligations with their suppliers and as a result, undesired friction and broken business relationships arise. As such, cash flow management has become an important imperative for survival, and, as we discuss later, choices such as supply chain financing or invoice financing have taken on greater utility and attractiveness.

Labor inadequacy and rising operating costs

Like other national markets, manpower appears to be in short supply in Singapore. Coupled with higher rentals and rising wage demands, SMEs often have to bear the brunt. For the past 20 years, many jobs in the food and beverage, construction and retail sectors have been manned by foreign labor. Covid-19 is a good wake up call for many SMEs, and beyond short term cost management, their medium to long term challenge is to leverage more on technology and reduce dependence on foreign labor.

Absence of an entrepreneurial mindset (in general) and failure to embrace technology

Many of the SMEs in Singapore appear to be living in the past, following archaic business models and able to keep afloat because there is growth all around the region. While the rest of the world is going digital at a fast pace, many SMEs in Singapore have retained business as usual practices or lagged behind in terms of technology adoption to help their trade. With the digitization of business, failure to embrace technology and its accompanying tools is considered entrepreneurial suicide. Many SMEs in Singapore that are culpable have complained of the lack of resources and manpower required to sustain, not to mention grow, their businesses. Interestingly, Covid-19 may have accelerated a change in mindset, and we are seeing some attempts to change business models, adopt technology, diversify demand, including target markets and leverage on partnerships to stay afloat. We discuss one such encouraging case in a later section of the article.

Stiff competition

SMEs are considered the driving force of the Singapore economy. The Singapore government has introduced targeted policies to support SMEs. However, many of the policies are also aimed at helping startups grow and thrive, especially in the fintech area, including incubating foreign ones. These startups are becoming even more rampant, and many of the new entries have the singular objective to dislodge existing competitors using distinct strategies and have a more regional outlook than traditional, incumbent players. With the dawn of the digital era, a myriad of options is now opened to consumers, leaving many small (and traditional) businesses struggling to survive.

Economic downturn and pandemic impact

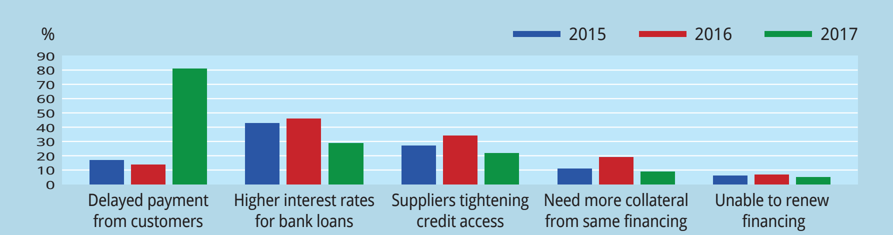
One of the expected repercussions of the impending economic downturn is the dwindling cash flow available to SMEs in the wake of the pandemic. To stay afloat under such crippling conditions, small and medium-sized businesses will have to think outside the box to get ahead of the pack. Although this article is about financing options available to SMEs, other enabling drivers beyond financing are needed to help SMEs thrive and become the engine of growth they are meant to be for the Singapore economy.

Traditional Financing Options Available to SMEs

Having reliable cash flow and working capital is crucial to sustain financially strapped SMEs. The small size of SMEs often implies that they are unable to benefit from economies of scale to reduce both their operational and compliance costs. SMEs not only face difficulty in raising funds, they also have limited ability to pass on these costs to their customers.

The SME Development Survey 2017 found that 35% of companies surveyed faced financing issues, up 13% year-on-year, and at the highest level since the survey began tracking this challenge in 2011. Among the financing issues SMEs faced, all categories showed improving trends with the exception of delayed payment from customers, which increased nearly six times from 14% in 2016 to 81% in 2017 (Figure 2).

Figure 2: Key Financing Issues Facing SMEs in Singapore



Source: SME Development Survey 2017, DP Information Group

Delayed payments can create ripple effects affecting the cash flow position of the SME community; when a debtor company delays payment, the creditor company may also slow down its payments to other companies in the supply chain. The proportion of SMEs making losses has also increased to 21%. Of the profitable SMEs, 42% have thin margins of 0 to 5%. We believe the financing situation worsened for many SMEs in the first six months of the Covid-19 pandemic since the start of 2020.

Bank financing

As such, it is not surprising that when asked about their sources of financing, only 6 in 10 SMEs in Singapore answer they are financed by bank loans and facilities. The remaining 4 in 10 do not have banking support. SMEs are not well established and may not have a stable outlook. As a result, given their lower risk appetite, financial institutions are less willing to lend to SMEs and support small business lending. In fact, the lack of SME cash flow visibility and credit information for small and medium-sized businesses increases the cost of credit risk assessment by financial institutions and makes it less attractive for them to service certain segments of the SME market. As a result, financial institutions are placing more emphasis on collateral requirements when assessing SME credit risk. However, SMEs are often unable to supply such collateral, leading to rejection of their loan applications. Therefore, SMEs have to resort to alternative funding options when they are unable to secure financing from banks. The government in Singapore has made a number of grants available for SMEs through different government agencies. We will showcase several such schemes in the section that follows and include a case study of one SME tapping on the government ecosystem for holistic support.

The Singapore government has launched a series of financial schemes to aid SMEs with their finances and these are administered by Enterprise Singapore (ESG). Here is a summary of the various loan-related schemes:

- **Temporary Bridging Loan Programme**
  - Introduced in 2020 to help SMEs deal with Covid-19's impact
  - Maximum funding of up to SGD 5 million
  - Repayment period up to 5 years
- **SME Working Capital Loan**
  - For local SMEs with group turnover less than SGD 100 million or group employment under 200
  - Maximum funding up to SGD 300,000
  - Repayment period up to 5 years
- **SME Equipment and Factory Loans**
  - For automating or upgrading equipment or purchasing government premises
  - Maximum funding up to SGD 15 million
- **Loan Insurance Scheme (LIS)**
  - Credit insurance for SMEs to obtain trade finance facilities from financial institutions
  - A portion of the credit insurance is supported by Enterprise Singapore
  - Financing of inventory, receivables discounting and pre-delivery working capital

What matters to many SMEs is not just the availability of government financing options, but rather grants which can help them cushion costs of innovation and investing in training or help SMEs transform over the life cycle of the business. We describe the case of Commune Lifestyle as an example:

The Singapore Furniture Industries Council (SFIC) in March 2018 unveiled its 2021 Furniture Industry Roadmap which outlined strategic directions for the sector's competitiveness and long-term growth. The new roadmap sought to transform the industry by encouraging local companies to adopt new business models that leverage on technology, innovation and design to broaden their knowledge, skillsets and value chains instead of relying on traditional business concepts and supply chains. One of the goals was for Singapore to become the Asian hub to influence tomorrow's urban living by 2021 (2021 Singapore Furniture Industry Roadmap Press Release, 2018).

A company which rose to this challenge was Commune Lifestyle Pte Ltd. Commune is Singapore's home-grown furniture design and lifestyle company and aspires to become more than just a furniture showroom. Commune is in many ways a forerunner in transforming the landscape of furniture design. Commune was born out of a design thinking project funded by SPRING Singapore (an agency under the Ministry of Trade and Industry responsible for helping Singapore enterprises grow and building trust in Singapore products and services).

Commune had been proactive in tapping government funding in various forms to constantly innovate its business models and to support its overseas expansion. Some of the projects that Commune has undertaken with government funding include:

- **Franchise Development Programme (funded by SPRING under Capability Development Grant (CDG))**
  Together with the help of consultants to develop a franchising package, Commune was able to scale its business internationally using the franchise model.
- **Customer Centric Initiative (funded by SPRING under the Customer-Centric Initiative)**
  Working closely with the consultants, Commune was able to understand how to create better experiences for its customers.
- **3D Floorplanner/ VR Project (funded by SPRING under CDG)**
  Working with another government agency, A*Star and its startup, Commune co-developed this solution to provide its customers with a first-of-its-kind experience through better visualization of their living space to support customer confidence in decision making.
- **E-Learning Project (funded by SPRING under CDG)**
  Commune was able to provide training more effectively across its network of stores through the development of an E-Learning Programme for employees.
- **Omni-Channel Project (funded by ESG under Enterprise Development Grant)**
  An omni-channel platform that linked Commune's online and in-store systems for a seamless customer journey was developed. Using an AR app, customers are able to view Commune's products in their living spaces on a mobile device. An iPad-based point-of-sale system that was developed, allows its in-store sales team to access a customer's in-

formation from online shopping or to apply in-store shopping information to online purchases.

- **New market expansion (funded by International Enterprise/ ESG under International Marketing Activities Programme/ Market Readiness Assistance)**
  The funding supported Commune's participation in international trade fairs and business missions and its engagement of consultants for market research.

Not letting Covid-19 hamper its business, Commune promptly identified gaps in its customers' digital experience and is currently revamping its online store to include more content. As e-commerce alone would not be the main form of business due to Commune's price point, a good online platform will help customers decide whether a trip to the physical store is necessary.

The example of Commune illustrates how SMEs can utilize a variety of government grants to help them innovate and scale beside tapping on government financing to meet their cash flow needs. Moreover, SMEs should keep in mind that government financing is often part of the total finances needed. In addition to bank loans and government financing, two other funding options which have gained some traction in recent years are invoice financing and crowdfunding. We will include these together with other examples of how SMEs are using various non-traditional options like Platform-based "Marketplace" or Specialized SME Exchange (like CapBridge Financial), and Business Ecosystem funding, to seek additional financing and unlock their cash flows.

Alternative Financing Options to Unlock Cash Flows

The lack of access to affordable and available funding can lead to more credit erosion for SMEs, trapping them in a downward spiral. Fortunately, SMEs can turn to various alternative funding options when they are unable to secure financing from banks. In order to remain sustainable during times when it is challenging to obtain bank financing, alternative channels of financing and funding, including those which are tech- or platform-related, have emerged in the last few years to address this demand. These alternative funding options include the following:

Invoice financing (including e-invoice financing)

Invoice financing, also known as invoice trading, is a short-term alternative solution which allows firms to draw down cash against outstanding receipts due from customers. By allowing SMEs to get an advance on funds for which they have already invoiced their customers, this funding option helps the SMEs improve their cash flow so that they can continue to cover their business expenses and pay suppliers and employees. In general, an SME pays a percentage of the invoice amount to the lender as a borrowing fee and can access 70% to 90% of the funds due upfront. Invoice financing appeals particularly to SMEs which do not have a long credit history or substantial assets to serve as collateral for traditional financing through a bank. What's more, it can take months to get the credit assessments and loan approvals for bank financing.

Ecosystem platform-based "marketplace" financing

Closely related to the invoice financing model is the channel by which online marketplaces such as Lazada and Zeemart capitalise on E-invoicing processes to arrange financing through tie-ups with their banking and venture funding partners. As E-invoicing enhances transparency and efficiency of the invoice processing, it removes manual invoice processing costs, decreases the time needed to send and receive transaction information, and reduces exposure to risks historically associated with manual processes, such as fraud. Hence, this platform technology has allowed factoring and reverse factoring businesses to dramatically decrease approval and processing times, a key benefit for SMEs with imminent liquidity needs. As a result of the reduction in transaction costs, digital invoice financiers are able to serve SMEs which are typically deemed too small and unprofitable for traditional factoring entities. Overall, invoice and E-invoice financing can potentially solve problems associated with overdue payments by customers and difficulties in obtaining other types of business credit. In addition, this source of alternative funding can definitely help businesses improve their cash flow.

Dedicated investment platforms have also been established in the last few years, tying up with banks (including digital ones) to help SMEs and larger corporate firms raise private capital via their investment platforms or affiliated private exchanges, e.g., 1exchange (1X). Such online capital raising platforms enable investors to efficiently access promising private companies, while providing orderly and transparent exit options (other than the traditional Initial Public Offering) for investors in these private companies. CapBridge Financial's ecosystem exchange fund-raising model is an illustrative case of this funding option:

CapBridge Financial

CapBridge Financial (CapBridge) provides private market solutions that help companies and investors unlock value via a uniquely integrated primary syndication and secondary trading approach. Based in global financial hub Singapore, CapBridge is regulated by the Monetary Authority of Singapore. The CapBridge primary syndication online platform holds a Capital Markets Services Licence (CMSL), while Singapore's first regulated private securities exchange, 1X, holds a Recognised Market Operator licence to facilitate secondary trading.

CapBridge works with late-stage growth or pre-Initial Public Offering private companies seeking growth or expansion capital. The online platform intelligently seeks and matches companies with private capital and facilitates the entire capital raising process with technology. Private investors on CapBridge gain access to institutional grade private opportunities, previously limited to large institutional investors. CapBridge also deploys the lead and co-lead business model to ensure institutional grade transactions. With CapBridge, companies and investors interact in a seamless, safe, and secure online environment.

CapBridge also owns Singapore's first regulated private securities exchange 1X. Widely regarded as the third board in Singapore, 1X is a "light- touch", cost- effective, and fully digital private securities exchange designed specifically for family owned businesses, growth and pre-IPO businesses. 1X is built on the blockchain and features state of the art security and robust online processes, providing a secure online trading experience for all participants. Market-oriented solutions such as direct private listings and trading of employee share options are facilitated via fully online processes, providing growth companies, founders, and business owners optimal options for partial exits while retaining flexibility and control. Private equity investors on 1X can securely and freely trade in and out of their private positions to achieve liquidity anytime, anywhere via fully online trading functions.

CapBridge is backed by Singapore Exchange, South Korea-based Hanwha Investment and Securities Co., Singapore government-owned SGInnovate, and HKSAR government-backed Hong Kong Cyberport (Figure 3).

Crowdfunding

Crowdfunding is a form of alternative financing that pools small amounts of capital from many individuals to fund a project or business venture. Entrepreneurs can pitch their business ideas on crowdfunding forums or platforms, and investors will then chip in a small amount to ideas which sparked their interest. Success depends on a sound creative idea and also a thorough understanding of online campaigns. While the advantages of raising money through crowdfunding are obvious – the outside possibility of obtaining full financing, complete control of these finances in most cases, using it to supplement existing financing, little or no money required to float a crowdfunding programme – it is also a very uncertain method of raising finance. The number of required investors tends to be large and funding amounts skewed towards the low end for many campaigns.

Peer-to-Peer lending platform

Another method of crowdfunding is peer-to-peer lending which is a relatively new online lending concept. Peer-to-peer lending platforms are online sites where individuals or small businesses can lend to one another. The advantage for the investor is a potentially higher return on savings and for the SME a lower interest rate. Interestingly, Funding Societies, an SME digital financing platform in South East Asia ended 2019 by crossing the SGD 1 billion mark in SME loans across its three markets in Singapore, Malaysia and Indonesia. They attributed the growth in SME loans with Funding Societies as reflective of the increasing openness amongst businesses towards new generation funding options.

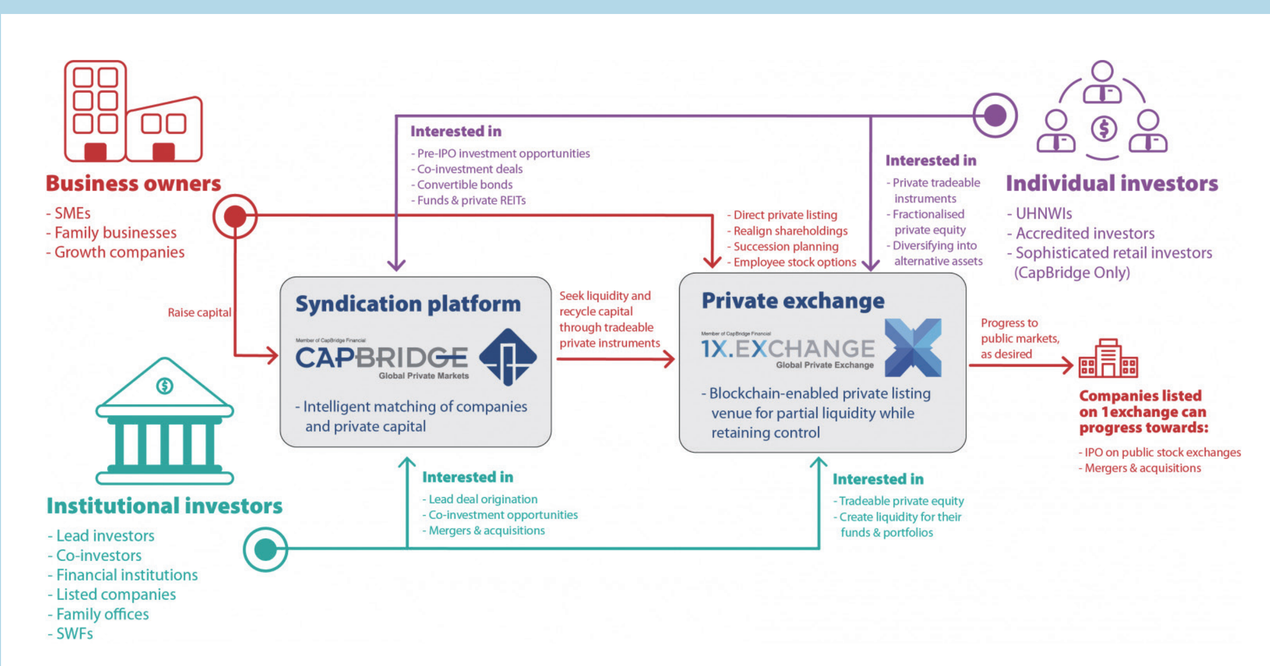
Business ecosystem funding

The business models of some investment funds, conglomerates and family businesses have continued to evolve with the times. Some funds and conglomerates like the global trading houses (e.g., Cargill), Temasek and GIC, have been investing or financing venture companies and SMEs in their supply-demand chain ecosystem as well. They often invest in their suppliers or provide supply-chain financing as these entities constitute an integral part of their business eco-system, while at the same time, often provide growth and diversification opportunities as well. These funds, conglomerates, and family businesses, especially, have also started to invest in SMEs and start-up companies with new products, technologies, or business processes that would add value to their existing businesses. Funding the SMEs in their business ecosystem helps ensure the sustainability and resilience of their own core businesses as well.

Conclusion and the Way Forward

The main aim of this article is to provide readers with a comprehensive view and

Figure 3: Value Proposition of CapBridge Financial Private Markets Integrated Ecosystem



Source: CapBridge Financial

understanding of the financing and funding landscape for SMEs in Singapore. In particular, we showcase those options which are closely aligned to the government's initiatives and objectives to enhance Singapore's status as a financial and economic hub. Very often in association with private sector partners with industry-specific target markets in mind, some of these financing and funding channels are innovative in helping transform SME business models and industry sectors, going beyond the normal "one size fits all" SME financing approach.

We have observed that these funding mechanisms are meant not merely to support and help SMEs in managing their sustainability and liquidity risks but are often tied to the government's objectives in industry transformation, innovation and internationalisation, so that the focus is also to motivate positive change. In addition, we hope we have provided some useful insights into how the approach to financing SMEs in Singapore will continue to evolve in a more innovative fashion. In fact, more change is expected going forward with the impending announcement of five digital banking licenses to be awarded towards the end of 2020. We believe this ecosystem approach to SME financing will be the catalyst in helping our SMEs transform their businesses, leveraging on trust forged with government and partners, embracing technology to build greater efficiency and transparency and garnering talent to build resilience and sustainability. The SME financing space in Singapore is definitely well worth watching.

Acknowledgements

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Since 2010, the Singapore Management University (SMU) has recognised the emergence of Asian business families and discerned that they require specifically contextualised thought leadership and applied knowledge. In response to the growing needs of business families in Asia, SMU established the Business Families Institute (BFI) in August 2012. BFI@SMU collaborates with various partners, academic or practice, to be a leader in Asian business family-related knowledge. The Institute also encourages business families to Think Generations, Think Growth, Think Giving and Think Global. In doing so, BFI@SMU addresses business family-specific issues such as succession, family governance, entrepreneurship and wealth management. The mission of BFI@SMU is to enable business family members to be engaged and responsible stewards of their families, businesses and communities, through education, research and ecosystem support.