



The digitalisation of SME Finance in Asia

Expanding the rewards and assessing the risks



Foreword by Rama Sridhar, executive vice-president, digital and emerging partnerships and new payment flows, Asia-Pacific, Mastercard

In the Asia-Pacific region, small and medium-sized enterprises (SMEs) make up over 95% of all enterprises, employ around half of the workforce, and contribute around 20% to national GDP in low-income countries and as much as 50% in those with high incomes.

For good reason, promoting growth in this sector is top of mind for almost every government and market in Asia—emerging or developed—as SMEs clearly impact innovation, job creation, economic growth and competitiveness.

Today's digital world is a strong enabler of these efforts. It has swiftly expanded and equalised SMEs' access to their respective customers and new markets. It is also able to connect SMEs to cutting-edge technologies (including artificial intelligence and robotics), tools to digitise existing business processes, marketing channels, grants and government initiatives that incentivize SME digitisation, and a number of other resources that support growth.

However, the ability of SMEs to fully leverage these opportunities is being hampered by a lack of adequate access to financial resources, specifically credit and e-payment tools. The same digitalisation that has democratised the e-commerce markets needs to happen in the finance markets as well.

Specifically, three key problems need to find resolution for today's digital democracy to continue thriving in the future.

 Access to bank finance is an ongoing challenge for young and subscale SMEs

Most conversations about SMEs quickly converge on a recognised need for access to capital: small, medium and micro merchant finance; new lending models; new credit behavioural assessments; and alternative financing options that lower the costs of borrowing.

As amply demonstrated in this article, this is what banks are rightly focusing on and new fintech players are trying to seize as a low-hanging lucrative opportunity. The role of fintechs in creating new capital markets, alternative financing models and new credit scoring models cannot be overstated even as they create constructive tension within traditional banks to generate competitive response strategies.

However, much more needs to be done. Asia's SME funding gap is still significant and current solutions are not equally accessible by all viable businesses that need capital.

2. SMEs must get paid on time

Cash flow challenges impact all small business operations, as most businesses are caught in the classic gap between their consumers' low-value but high-volume credit-based payments and their own high-value but low-volume payments to procure supplies.

To address these, SMEs need access to multiple payment options beyond cheques—cards, faster digital payments and peer-to-peer transfers are all digital options that should alleviate this challenge quite comprehensively. Beyond this, digitising payments across supply chains can help optimise account receivables and free up cash flows for working capital.

3. Digital payments need to be seamlessly integrated into businesses

Digital payments enable businesses to shift their operations from the physical to the the virtual realm. This is not just in the case of buyer and seller transactions, but also in business-to-business ones.

As the number of payment instruments expands—like digital currencies, real-time payments, contactless payments, chip-based payments and others—SMEs will need to be able to seamlessly integrate all forms of payment into their business processes.

The digitisation of payments also gives SMEs access to valuable information to improve their businesses. This data can allow sellers to offer innovative loyalty programmes or customer rewards to incentivise prompt payment, provide a foundation for process automation, improve payment reconciliations, and create better business analytics for buyers and sellers alike.

Beyond these tools, the mind boggles at all else that a small business needs to learn and cope with in today's digital world. To address the next generation challenges, Asia's digital democracy needs to consciously evolve, and quickly, towards creating equal access to fundamental capital resources so SMEs can mature and the benefits born from that sector can continue to grow.

ABOUT THE RESEARCH

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- Ivan Tambunan, CEO and co-founder, Akseleran
- Kelvin Teo, CEO and co-founder, Funding Societies

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THE DIGITALISATION OF SME FINANCE IN ASIA: EXPANDING THE REWARDS AND ASSESSING THE RISKS

Alternative financing for companies ranging from peer-to-peer (P2P) business lending to invoice factoring and equity-based crowdfunding is growing rapidly and disrupting traditional access to capital in Asia. This opens up new funding opportunities for companies that previously faced difficulties accessing capital, particularly small and medium-sized enterprises (SMEs), while introducing new risks and tensions with traditional capital-raising models.

On the borrower side, the need for these new sources of capital for SMEs in the region is significant. A joint report released in 2017 by the International Finance Corporation (IFC) and SME Finance Forum estimates that the global funding gap for formal micro, small and medium businesses in developing countries is US\$5.2trn a year. Furthermore, the East Asia and Pacific region represent 58% of total global potential demand.¹

On the lender side, this growth is being driven by interlocking factors, according to the World Economic Forum.² Regulations that constrain traditional capital flows have driven investors to seek out new markets to fulfil the demand for opportunities and returns. Technology is enabling new types of loan origination by being able to access and mine more sources of credit data. Platforms are also innovating to better connect investors to markets that need capital.

As a result, the Cambridge Centre for Alternative Finance estimates that alternative lending increased from US\$11bn in 2013 to US\$284bn globally in 2016, with China being the largest market at US\$240.9bn and the rest of Asia at US\$1.8bn.3 Since then, volumes at P2P lending platforms in Indonesia alone jumped from US\$20m in 2016 to approximately US\$1.4bn in 2018, according to Ivan Tambunan, CEO and co-founder of marketplace lending platform Akseleran.4

¹ https://www.smefinanceforum.org/sites/default/files/Data%20Sites%20downloads/MSME%20Report.pdf

² World Economic Forum, Alternative Investments 2020: The future of capital for entrepreneurs and SMEs, 2016 http://www3.weforum.org/docs/WEF. AI FUTURE.pdf

³ BIS, Fintech credit markets around the world: size, drivers and policy issues, September 2018 https://www.bis.org/publ/qtrpdf/r_qt1809e.htm

⁴ Indonesian Fintech Association (Asosiasi Fintech Pendanaan Bersama Indonesia)

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CREATING NEW CAPITAL MARKETS

Traditionally, the large banks that have controlled capital investments in emerging markets have been reluctant to lend beyond large corporates. With minimal or even non-existent credit bureau coverage in many countries, assessing the creditworthiness of SMEs has been seen by banks as more difficult and expensive.

Accessing financing has thus been a challenge for SMEs, especially companies with less than three years of operating history. These companies have had to go to non-bank financial institutions or moneylenders at interest rates as high as 4% per month and fees as much as 10% of loan principal.

New funding platforms are tackling these challenges. "These SME digital financing platforms focus on under- or un-served segments, such as unsecured short-term financing, urgent financing and niche industries," says Kelvin Teo, CEO and co-founder of SME crowdfunding platform Funding Societies.

To enable the rise of SME financing, firms are using innovative credit-scoring models that go beyond financial assets and performance to include parameters such as online behaviour, customer reviews and cash flow. They are also leveraging digital platforms to accelerate credit assessment. For example, Ant Financial's 3-1-0 online lending model boasts a three-minute application process and one-second loan approval with zero manual intervention.

In many markets, SMEs can also now access money at lower interest rates than could be gotten at banks and with little to no collateral needed. Akseleran can provide 70-80% of the value of receivables for the 2-3 months until invoices are paid, Mr Tambunan explains. This gives borrowers working capital to take more contracts. "The interest rate is 18-21% per annum. Their margin can be 20-25%. If (borrowing) costs 4.5% for three months, they get a superb margin from their work."

Easier and faster access to capital helps SMEs survive daily business volatility and invest in longer-term growth. New e-commerce merchants can use alternative financing to buy more inventory at cost-effective prices and be more competitive in the market, says Mr Tambunan. In another example, an interior designer that received a loan through his platform increased revenue more than threefold because he was able to take on more work.

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ADDRESSING THE RISKS

On the credit side, performance by alternative lending platforms has been even better than some banks. "Our (non-performing loans (NPLs)) are about 0.5% of disbursements," Mr Tambunan explains, "much lower (than) the average NPL in Indonesia of around 2-3%. These borrowers are really good."⁵

However, in other ways, alternative lending comes with higher risks. "The primary risks are a debt spiral for SMEs and investment loss for investors," says Mr Teo, "which, if allowed to happen at scale, is no different from a bank crisis."

Those risks became very visible in recent years in China, where the ratio of new P2P loans to new bank loans rose to almost 40% in June 2016 before falling to less than 10% in June 20186 due to the result of a rise in inappropriate and fraudulent market practices.

Those events have sent ripples of concern across the region, leading regulators to proceed more cautiously. "Given their novelty and benefit of hindsight from the blow-up in China, regulators have taken a careful approach to allow these platforms to exist but (are) learning and monitoring to avoid macro-prudential risk," says Mr Teo.

Striking the right balance between prudence and opportunity is the challenge ahead. In Indonesia, for example, Mr Tambunan says "there are Chinese players coming into Indonesia. They affect the regulator, which is developing new regulations to rein in the risks. At the same time," he says, "we also work together with the (fintech) association to make sure (the) government doesn't impede innovation."

⁵ Otoritas Jasa Keuangan, Statistik Perbankan Indonesia, Indonesia Banking Statistics, December 2018, https://www.ojk.go.id/id/kanal/perbankan/data-dan-statistik/statistik-perbankan-indonesia/Documents/Pages/Statistik-Perbankan-Indonesia—Desember-2018/SPI%20Desember%202018.pdf
6 BIS, Fintech credit markets around the world: size, drivers and policy issues, September 2018, https://www.bis.org/publ/qtrpdf/r_qt1809e.htm

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DISRUPTING TRADITIONAL FINANCE

As the alternative financing sector grows, it is increasingly placing pressure on traditional banks to look inwards and find new ways to innovate and stay competitive. A 2018 Economist Intelligence Unit report describes this impact on the corporate banking sector in India, where market pressures and digitalisation have pushed banks to learn how to work with SMEs, particularly in the way they assess their creditworthiness.

"For SMEs, the analysis must be much more cash-flow driven and must include information from cash management/trade and other transaction-related services. It must include an understanding of where a company is in the business cycle and where it is in the entire value chain in the market in which it works," says Nilesh Shrivastava, portfolio manager for the IFC in India, in the report.

This competitive pressure is expected to continue, particularly as business to business e-commerce or P2P software-as-a-service companies that provide invoicing, procurement and other data processing systems develop the ability to also analyse their clients' business and extend them credit.

Moreover, the lending sector is anticipating more disruptions in the future by "bigtechs" as companies like Amazon, Google and Facebook look to jump into financial services businesses in the future.

All of this signals both the presence of untapped market opportunities and more growth and change in financial markets ahead. "While digital e-commerce platforms have been the growth driver for digital financing platforms overseas, the deployment of this capital to the e-commerce platforms has only started in the last one to two years, primarily in Indonesia, the focus of most companies. Other countries remain unready for such option," says Mr Teo.

"(And) we're just getting started," adds Mr Tambunan. "Total disbursement is about US\$1.4bn while the funding gap is US\$70bn to US\$80bn a year.8 This is still very early. Indonesia will see massive growth in alternative funding the next one to three years."

⁷ The Economist Intelligence Unit, Restructuring Corporate Banking in India, September 2018, https://eiuperspectives.economist.com/sites/default/files/Restructuring_corporate_banking_in_India_0.pdf

⁸ OJK: Fintech Bisa Isi Gap Pembiayaan Rp 1.035 Triliun, September 2016, https://finansial.bisnis.com/read/20160919/90/585107/ojk-fintech-bisa-isi-gap-pembiayaan-rp 1.035-triliun

Key takeaways for SMEs seeking ways to take advantage of the growing alternative funding market:

- Understand your funding requirements and options with the new digital players.
- Understand which payment mechanisms are available and suitable for your business.
- Determine the full cost and benefits of these options.
- Consciously rebalance your business processes towards digital mechanisms.

