Non-Bank Finance Options for SMEs

Variety of non-bank finance tools that SMEs can use when they suffer from cash flow problems.

Cash is the lifeblood of any organization. Get your cash management wrong and no matter how good your product or service offering, you will not survive for long. For many SMEs, poor cash flow happens when they have to pay suppliers and staff before receiving money from their customers. Late payment by customers has played a major part in the failure of many companies.

In the UK, the 1999 Late Payment of Commercial Debts (Interest) Act was introduced in an attempt to speed up payments. However, recent research has revealed that the average time taken by the UK companies to pay bills has actually increased by two days. The research was based on the payment patterns of 366633 companies. It revealed that the average UK business still takes 60 days to pay its bills. Large companies take an average of 21.4 days longer than small companies and 20 days more than mid-sized firms. The issue has much to do with the bargaining power of the large over the small; in need of trade what is the smaller business to do but bow down to the excessive demands of their larger, and more powerful customer?

Leasing

A well regarded point of sale finance tool, leasing has many benefits for both customer and vendor, not least in helping the customer source higher specification equipment than they would be able to if using cash. One of the less highlighted benefits is that, as the finance provider takes title to the equipment and the customer then pays a rental, the finance provider will pay the invoice on the same day as receipt of correctly completed documentation, i.e. on the date of sale completion. This effectively reduces debtor days to zero. It is also worth noting that many companies, if not offered finance by a supplier, will often then use their own finance providers to recoup the investment in the sale and leaseback approach.

Traditionally leasing was only available for the financing of tangible assets, e.g. photocopiers, vehicles, plant and machinery. Yet the vast majority of companies now provide services, training, consultancy and consumables as part of a total solution, which still includes the hardware. A number of finance providers have recognized this development and are now able to finance hard and soft costs on a single invoice or as part of an ongoing managed solution approach. Gone are the days when providing finance was a simple 'fire-and-forget' transaction or when finance providers could pick and choose what they wanted to finance. Finance providers have recognized that long-term customer satisfaction is only achieved by working in partnership with their customers to understand each unique financial situation, so that financing arrangements can be suitably tailored.

Receivables Finance

Another alternative is receivables finance, where the customer is able to raise cash on the back of unpaid and overdue invoices. There are two approaches to this. The first is where a loan is provided using the unpaid invoices as security. The cash is advanced immediately and repaid when the monies are received. The second, called invoice discounting, is where the invoices are sold to the finance provider, typically for between 90 - 97.5% of their full value, who then become responsible for collecting the debt.

Source: Rod Tonna-Barthet, Siemens Financial Services Limited

Recommendations on SMEs by the Committee on Financial Sector Plan for North Eastern Region (July 2006)*

SME sector

Major banks operating in the region may identify a dedicated branch for encouraging entrepreneurs who want to make investments in agro-processing, agro-based industries and SME sector. Such branches may be equipped with staff and systems for helping the entrepreneurs in preparation of project reports and identifying their capacity building needs.

SIDBI/ NEDFi/CIBIL

SIDBI and NEDFi may prepare typical bankable projects in a variety of industries in the SME sector and disseminate the same as these could be used by potential entrepreneurs. Such schemes should cover the handloom and handicraft sectors.

SIDBI, NEDFi, NABARD as also major banks may sponsor RUDSETIs for training potential entrepreneurs/borrowers in the SME including small business services related to the sector.

SIDBI and NEDFi may provide financial assistance on concessional terms to identified marketing outlets for various industries in the sector and provide assistance for display and marketing of the products

NABARD/SIDBI /NEDFi/ may sponsor Rural Industries Programmes (RIPs) in areas where clusters have been identified and in areas having concentration of other non-farm economic activities for training of weavers, artisans, small entrepreneurs, etc.

Normally, the risk cover under CGTSI scheme is available to the extent of 75 per cent subject to a maximum of Rs.25 lakh. In NER, CGTSI may increase this cover up to 90 per cent. Normally, a guarantee commission of 1.5 per cent (payable upfront) and an annual service charge of 0.75 per cent are payable. In NER, CGTSI may consider charging only 50 per cent of the applicable fee (both guarantee commission and annual fee).

SIDBI, in association with major banks in the region, may set up a dedicated SME debt fund to provide co-finance up to 25 per cent of project cost to first time entrepreneurs, where a bank is willing to provide the required funds. The fund may have experts from the region and outside as members.

SIDBI may open counseling wings at all state capitals for first time entrepreneurs.

SIDBI may promote SHGs/ MFIs in urban areas.

SIDBI may disseminate/ educate potential borrowers from the SME about its SMERA rating criteria.

CIBIL may disseminate credit record of borrowers in the NER among the financial institutions in the region separately to enable the banks to have ready access to the track record of borrowers who have in the past borrowed from banks.

Role of NEDFi may be reviewed with a view to repositioning it as development financial institution for long-term finance and equity support for industry and services sector.

The Reserve Bank of India constituted on January 25, 2006 a Committee on Financial Sector Plan for North Eastern Region under the chairmanship of Smt. Usha Thorat, Deputy Governor, Reserve Bank. The report submitted by the Committee on July 19, 2006 is available on website of the Bank: www.rbi.org.in