

Alternative financing model for SMEs

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Across the globe, small and medium enterprises (SMEs) are considered to be the engine for economic growth and job creation. In Bangladesh, these enterprises are the largest employers, yet represent less than 30 percent of the GDP. A key factor that constrains the growth of SMEs in Bangladesh is the access to finance.

The challenge...

Debt financing provided by financial institutions (FIs) represent the primary source of institutional capital for SMEs in Bangladesh. Still, SMEs are underserved by these FIs, due to several reasons. First, financial institutions require borrowers to pledge as collateral, fixed assets such as land, which most SMEs are unable to provide. Second, SMEs, particularly those in the services sector, are perceived to be higher risk by FIs. Third, SMEs may require long-term growth capital, but often have access only to short-term working capitals. Fourth, the repayment terms of the financing often do not match the cash flow profile of the business: growing SMEs are often unable to meet the significant debt service requirements at the outset.

Beyond debt financing, small and medium enterprises have very limited access to institutional equity capital. Financial controls in SMEs are insufficient to ensure transparency to third-party equity investors. Among SME entrepreneurs, there is a lack of understanding of equity financing and a reluctance to share ownership with outsiders. Further, the exit alternatives for such investors are limited: the SMEs may not be growing to a sufficient scale within the investment period to achieve an exit through the stockmarket or strategic sale. Just as the traditional collateral-based lending model in Bangladesh is inadequate in supporting the growth of SMEs, the conventional venture capital model of developed markets also does not fit the business environment in which SMEs in Bangladesh operate.

Potential solution

Expansion of financing for SMEs in Bangladesh involves two critical components. First, it requires a re-thinking of alternative financing structures that



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Workers sew different kinds of covers for daily use at a factory in Dhaka.

provides the type of capital that can facilitate growth of SMEs. Second, it involves the development of alternative financial institutions that have the core competencies in supporting SMEs.

Mezzanine financing, which has the characteristics of both debt and equity, offers a potential alternative structure for institutional capital for SMEs. The type of best suited mezzanine financing to SMEs in Bangladesh would have the following characteristics: (i) not secured by fixed asset collateral (ii) lower principal pay-down requirement, which may range from a deferral of principal repayment for the first year, to putting off the entire repayment until maturity (iii) fixed coupon

payment during the investment period that can be accrued in case of cash flow constraint and (iv) variable coupon or premium payment at maturity, in the form of revenue or profit-share, which are tied to the underlying financial performance. This mode of financing can ensure that SMEs have sufficient capital during the critical phases of their growth, while providing an attractive rate of return to the investor.

An underlying reason for SMEs inability to access finance is the lack of a robust risk assessment and monitoring mechanism. Financial institutions lack the expertise to assess and the bandwidth to monitor the business risks of SMEs; these enterprises lack the reporting systems that can facilitate the risk assessment by FIs. Therefore, SMEs need specialised financial institutions that: (i) have the expertise in evaluating the fundamentals and financials of the business beyond simply assessing the quality of the collateral and (ii) can help develop the financial reporting systems of the SMEs post-investment to ensure proper monitoring. Such institutions must also recognise that providing the financing alone can neither maximise their own financial returns, nor achieve the growth potential of the SMEs. To this end, they must provide advisory support, share best practices, implement financial controls and link the SMEs to broader markets.

According to the 2011 Development Impact Report, published by Small Enterprise Assistance Funds (SEAF), an emerging markets investment firm that has financed over 340 SMEs globally since 1989, every \$1 invested by them generated, on average, an additional \$13 in value in the local economy -- among employees, customers, suppliers, competitors and the government. Therefore, improving access to finance for SMEs can not only catalyse growth of this segment in Bangladesh, but also create a tremendous multiplier effect on the entire economy.

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India's food evangelists

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A quiet revolution is brewing in India's food industry. Average middle-class Indians are regularly eating things they'd barely heard of ten years ago: pizza, pasta, cinnamon rolls and nachos (never mind cranberry juice, coffee, margaritas and mohitos). But foreign food is only half the story.

To an outsider, Indian food is one of the most distinct cuisines on earth. Yet anyone living in India knows what a misnomer the phrase is. It's like using "European food" to describe both Italian and French cuisines, because India is a land of over a dozen definitive cultures and cuisines.

So for most Indians, this food revolution began by experimenting with food from other Indian regions. A Delhite, used to meat in a thick and spicy gravy we all know as curry, might feel adventurous having a dosa for lunch. The fermented crepe served with a coconut sauce is a food from south India, where people might feel a little jaunty eating momos from India's northeast. The list goes on.

And where is this selection most commonly found in one convenient place? Food courts in shopping malls.

Go on a Saturday or Sunday to any of the mushrooming shopping malls in India and you'll see multi-generations tucking in to all sorts of food. Grandma can stick to her own cuisine, but her son might have a dosa and her daughter-in-law might have something from the North West Frontier Province, while her granddaughter might opt for a pizza or even a salad.

Food courts might have been the first enablers of adventurous eating in India, but an even bigger evangelist is on the scene: modern grocery stores.

Slick new shops provide a wide range of food from all over the country and beyond, neatly stacked in big clean aisles. And these are not just the preserve of India's upper class. As many stores streamline their supply chains, they can offer food that's often in better condition and sometimes even cheaper than open-air markets, making it hard for shoppers to resist, especially given the convenience of having everything in one, air-conditioned shop.

Many of these stores have even kicked off the



Indian customers buy vegetables at a night market on the streets in Hyderabad.

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culture of laying out food samples for patrons to try. The sight of a sari-clad auntie nodding her head in approval at the piece of parmesan cheese she's sampled is as endearing as seeing the northeast Indian girl chomping appreciatively on the kuzhalappam, a savoury coconut pancake from the southern state of Kerala.

While some stores just offer samples of foreign brands, from Oreos to Sara Lee, one store really takes the cake in offering a wide variety of regional samples.

Go to any new Food Bazaar and you're likely to

find two dozen kinds of namkeen (a grain, dal and nut snack-food) and the same amount of mithai (Indian sweets) on offer with eager sales clerks happy to give you a sample. At the new Food Bazaar in New Delhi, I counted over 26 different pickles and mustards from all over India.

A food executive with Future Group, which runs Food Bazaar, told me a Gujarati Indian living in Chicago used to be able to get his favourite dal or bean easier than a Gurjарат living in Delhi because it was easier to freeze it and ship it overseas then send it across the country.

As that's changing, more and more Indians are getting to sample cuisines from the far reaches of their own country. Betting they'll like what they taste, Future Group is working with many small food firms to get them to mass produce even more local products.

Given this food evangelism, Bengali mustard could be soon packed into sachets and found in a food court near you.

Lyndee Prickitt tracks the India growth story for Reuters Insider as a senior reporter in New Delhi.