Volume 4 Issue 1 July 2016 ISSN: 2321 – 4643

DEVELOPMENTS AND CHALLENGES OF E – FINANCING IN SME SECTOR

M. Vijaya Lakshmi[1] & S. Anisha[2]

[1,2]MBA, Anna University, Madurai

Abstract

This paper would bring out the outlining importance of Small and Medium Enterprises (SMEs) in a developing country like India, the distinctive profile and needs of an SME customer and the unique challenges in SME banking. Against this backdrop the paper would then highlight the weaknesses in traditional lending models followed by Indian banks. The paper would then emphasize how e-finance is a window to a new opportunity for SME customers. A brief perspective of the peculiarity found in the Asian and Indian business environment would be included to underline the complexity and therefore the added difficulties faced by Banks to facilitate e-finance models for SME customers.

E - Financing

An electronic financial transaction is a financial transaction that depends on the Internet or a similar network to which households or non-financial enterprise have access.

E - Financing GAP in SME Sector

Many financial institutions in developed and developing countries find it difficult to serve small and medium-sized enterprises (SMEs) because of high perceived risk and high transaction costs and lack of experienced personnel and appropriate corporate structures which bias them against SMEs including those created by women entrepreneurs. The key to securing access for SMEs was to improve the ability of financial institutions to seriously expand and make more efficient the delivery of financial products both offline and online for different segments of SMEs. It was important for financial institutions to know their markets, customer needs and offer packages of tailor-made products as well as automatic and standardized ones.

International and national financial institutions think that there are number of innovations can be used to facilitate SME finance by reducing transaction costs and risks. Local financial institutions in developed countries, which had been particularly successful in serving the SME market, found that it was highly profitable. Their strategy was to improve their core competencies by adopting sophisticated credit techniques such as credit scoring, strengthening management and information systems and developing highly efficient automatic processes, efficient marketing and distribution and developing close ties to clients. The experts have also discussed about the complements to finance such as insurance and other guarantee schemes that could increase the bank's ability to and interest in servicing SMEs. Innovations could be widely applied to developing countries where the conditions for SME development are often much less favourable.

Scope of E - Financing in SME sector

The revolutionary impact of various online payments with or without use of cards, Internet banking, e-trade finance and e-credit insurance was centered on adopting the online financial services to the needs of SMEs and in particular for SMEs from developing and transition economies. Internet-based data mining technologies permitting to build up huge credit information databases and apply modern credit analysis and related credit appraisal, scoring and rating techniques, permitting the appraisal of SME credit risks and the rapid processing of their credit applications. The provision of medium and long-term finance should be closely linked to the delivery of business development services so as to improve both the viability of SMEs and their ability to repay loans. Partnerships can be struck between financial institutions, business associations, networks of entrepreneurs and business development service providers.

E - Financing Services

E-Banking

E-Banking is also called internet banking or online banking. The service enables customers to perform basic financial transactions such as enquiring bank accounts; make bill payments; transfer funds etc. E-banking is relatively easy to set up, the barriers to entry are low. FIs offer services such as e-banking, like ATMs and branches, has become a basic service that customers expect.

E-Payment

E-Payment includes electronic payment in the physical world and the virtual (internet) world. E-Payments are delivered through channels such as debit cards, credit cards, pre-paid cards, Internet banking and mobile banking. The most important existing core payment networks, and in particular the Society for Worldwide Interbank Financial Telecommunications (SWIFT), which is a huge bank co-operative including 7,000 financial institutions from 190 countries, have begun to formulate and implement a strategy of migration to the Internet. The payment system initiatives taken by the Reserve Bank of India have resulted in deeper acceptance and penetration of non-cash payment modes. Cheques, however, continue to be the dominant mode in retail payments constituting 54 percent in terms of volume and 82 percent in terms of value (2011-12) with retail electronic payments lagging behind.

E-Trade

Trade finance is traditionally paper-based, making it slow, costly and error-prone. The advent of Internet has created an opportunity to streamline such processes through electronic documents. Typical services provided in e-trade finance are:

- LC (Letter of Credit) applications
- Apply for shipping/ airway guarantees to clear cargo in the absence of transport document

- Apply for bank guarantees to secure advance payments or as performance or tender bonds
- Apply for import financing (trust receipts/ bills receivable purchased)
- Foreign Exchange
- Digital commerce market stood at Rs 8,146 crore in December 2007 and it grew to Rs 47,349 crore by the end of 2012.At the end of December 2013, digital commerce in India grew to Rs 62,967 crore.

E-Credit and E-Loans

In e-credit and e-loan, SMEs are able to apply for credit facility or loan online from the bank. When the credit or loan is approved, the amount will be credited directly to the customer's account. In the area of e-credit, some implementation has gone fully automated. Credit facility is automatically granted once the application is approved. One critical consideration in such situation is that the bank must have sufficient information about the SMEs and have sufficient risk management system built in place.

E-Insurance and E- Guarantees

E-insurance and guarantee services enable SMEs to apply for insurance and guarantee online. As the processes involve fairly complex documents flow, it is usually done through human intervention as soon as the customer submits the application electronically. As for insurance, banks normally partnership with large insurance companies to jointly provide such a service. In this case, information captured from the bank system will feed the bank's financial partners. This involves the privacy of customer data, thus the bank has to make clear to customers that such information will be forwarded to a third party.

Currently, the Export Credit Guarantee Corp (ECGC) provides most of the coverage, accounting for about 80 per cent of the $90 million premium paid for short-term trade credit insurance last year.

E-Rating

Credit rating of SMEs is highly important for both: banks and SMEs. To manage their risk and to safely execute their credit or payment transactions, FIs need to know the credit and payment track records of the parties involved in the transactions. This need is particularly important for SMEs, who have difficulty accessing finance due to the perceived lack of creditworthiness. This perception could be avoided if reliable data and information are available.While banks have their own risk management and credit assessment units, they also rely on specialized services, which provide credit information and assessment data, as well as ways and means, such as credit risk insurance, to reduce the credit and transaction risks.

National Small Industries Corporation (NSIC) not only encourages SMEs to get credit rating by allowing subsidies in the fee structure but also offers various credit support programs to these SMEs i.e procurement of raw materials, vendor due diligence etc. More than 14 lakh SMEs operating in the country, only a meager 8.5% of bank loans go to them. Today the rating agencies approved for the purpose are ICRA, Crisil, Care and Fitch. In the first scheme there are four rating agencies that have been empanelled by RBI. Apart from these four, two others are SMERA and ONICRA.

SME Lending the Traditional Model

Banks in India, traditionally, have not been flexible enough to design new products. Most Indian banks have no targeted or differentiated value proposition. SME business globally has necessitated an innovative organizational response and which has been lacking in India till recently. The complexity and variety in SME banking space requires a matching flexibility which only the new or foreign banks have demonstrated. These responses are largely through the help of e-finance models.

Larger banks have typically been unable to extend the informality and convenience so essential for the SME customer which not surprisingly the smaller, locally based and thus more flexible co-operative banks have been able to provide to some extent. Most banks have no coherent strategy for SME lending and have undifferentiated product offerings. Banks have traditionally looked at SMEs either as a low cost source of deposits or as priority sector obligated lending. Banks have thus made only feeble attempts at building relationship-based products despite good working relationships at the branch level. However newer banks have found that e-finance models can greatly facilitate such relationship-based selling of products.

E- Finance a Window of Opportunity

At about 150 million Internet users, India now has 3rd largest Internet population in the world after China (at 575m) and the US (at 275m). At 150 million total Internet users, the Internet penetration in India remains at 12 per cent vs. 43 per cent in China and 80 per cent in the US. India will likely see golden period of the Internet sector between 2013 to 2018 with incredible growth opportunity and secular growth adoption for E-Commerce, Internet advertising, social media, search, online content, and services relating to E-Commerce.

For SMEs in most developing and "transition" nations - which often face high costs for official financial intermediation, or which are trapped in the informal economy - this is a window that can lead to rapid growth and the capacity to compete more effectively on world markets. Putting in place regulations and systems enabling credit information and credit ratings through the active use of information and communication technology may greatly improve the access of such firms to other services as well, such as credit insurance, factoring and leasing. But in most developing countries, financial service providers are not in a position to use modern credit-risk management techniques and provide capital- particularly trade finance capital - to local enterprises on competitive terms. The trends identified in e-finance for SMEs in emerging countries so far looks rather encouraging. Some achievements can be cited:

1. High level acceptance of technology by customers and financial institutions
2. Many innovative approaches
3. Initial tangible results in terms of market access and revenues generation.

However, most projects are still in the pilot stage or still have not been deployed on the large scale. It is therefore much too early to determine which are likely to be most successful and therefore should provide the “best practice” benchmarks to be replicated in other countries. More importantly, the key question as whether e-finance will fundamentally change the conditions of access of SMEs to finance remains unanswered. Nevertheless, from the experience so far, two broad key success factors can be identified: adaptation to local requirements and strong support from public authorities.

Adapting Global Technology to Local Requirements

Internet technologies are global and their core is standardized, their applications can and need to be adapted to local circumstances. Internet offers this amazing capability to reconcile global uniformity and local flexibility. It makes it easy to cross borders but at the same time create new configurations of networks and clusters. Distinctions between proximity and remoteness remain highly pertinent, even if the distance under consideration becomes virtual rather than geographical. Internet user base in India projected to reach 243 million by June 2014: IAMAI

Government Support and Commitment

E-finance developments have taken place through an interplay of competitive market forces, with limited public sector intervention. Some of them, particularly in Internet banking, have been launched by foreign institutions. The situation is quite different in the case of e-finance for SMEs, where public sector intervention is quite frequent. It is not only that the public authorities have to create the broad framework conditions for e-commerce development (appropriate legislation and technological infrastructure, to mention two most important) but also they need to ensure that SMEs take advantage of the new environment and opportunities it creates. The great majority of e-SMES success stories emerging countries described above were largely due to the public sector involvement.

Challenges to E- Finance in SME Sector

There is no commercial bank in India which has exclusively targeted the small business segment (like for example, Wells Fargo in the US) with customized value propositions to meet the specific needs of the SME customer. Banks in India have focused on SME segment largely as a generic group rather than on a comprehensive relationship footing with specific product offerings. The Branch based delivery of credit is high cost with an adverse risk-return trade off. The cost of servicing and the returns from SME also did not justify focus on this segment. New generation banks like ICICI Bank have thus looked at alternative ways to address the segment. SMEs in India, unlike the US, have generic problems like inability to provide quality data and exhibit formal systems and practices and lack of asset cover. This has resulted in the unwillingness of banks to increase their SME lending. Legal and regulatory compliance has also been inadequate. Traditional drawbacks like opaque and asymmetric data and low capital base continue to characterize SME balance sheets. This problem is further compounded due to preponderance of a large cash economy in this segment. SME lending has thus met with limited success. The lending in the past has not been hugely successful and self-sustaining also due to the lack of forward and backward linkages in the economy due to which SMEs had a low survival rate. SME banking space has also been skewed by major Indian banks, which account for most of the volumes in SME business, restricting themselves to low cost but rigid lending with no focus on cross-sell or flexibility.

Current State of E-Finance in India

The state of e-financing is in the nascent but growing stage in India. The transition to a full-scaled digital economy would depend on speedier deregulation which will follow once the macro-economic reforms process matures further. The gradual acceptance of e-finance models is precisely the indicator of this interconnectedness of e-financing structures with parallel developments and advances in the legal, regulatory spheres as well as the modernization of business and industrial markets. Corporates have however taken up modernization like implementing ERP systems which permit the use of advanced management techniques like CRM, Data warehousing etc., with enthusiasm and are thus more and more prepared to bring their entire supply chains onto e-financing structures.

According to the survey, India's e-commerce market, which stood at $2.5 billion in 2009, reached $8.5 billion in 2012 and rose 88 per cent to touch $16 billion in 2013. The survey estimates the country's e-commerce market to reach $56 billion by 2023, driven by rising online retail. According to the Internet and Mobile Association of India (IAMAI), the Internet user base in the country stood at 190 million at the end of June, 2013. The Internet user base in the country is projected to touch 243 million by June 2014, a year-on-year growth of 28 per cent.

Asian Obstacles to E-Financing

Asian and Indian markets rely on traditional market intermediaries which are not amenable to formal business practices and maintain opaque financial records. The lack of willingness for transparency leads to low acceptability of the Internet as a channel for doing business. The half-hearted legal and regulatory compliance cultures also add to the general apathy towards formal business structures. In some spheres like wholesale trade of commodities for example, there are too many market intermediaries often with an ancestral lineage of involvement in that market and who operate like community networks and closed clubs. Such islands also do not support or facilitate the open architecture of e-markets. As privatization and deregulation have just begun, regulation in areas like digital certification, cyber laws etc., are only now catching up. Even if online practices (online pre-sale processing like ordering, price discovery, invoicing etc., on the internet) are followed, progress in smoother offline fulfillment (actual payment and delivery of goods) is crucial and is still dependent on the legacy clearing and payment networks of state owned banks. Even necessary advancement in third party logistics (transporters which take up integrated Carrying & Forwarding Contracts with companies) and payment gateways (where online instructions for payment to and from a bank account are executed and completed by a bank) have only just begun.

References

1. http://www.tradeforum.org/Innovation-Specialization-and-E-finance-for-SMEs/
2. http://www.unescap.org/pdd/publications/bulletin03-04/bulletin03-04_ch6.pdf
3. Fahri, K., & Omar, K. (2001). Electronic Commerce Use in Small and Medium-Sized Enterprises in Towards the E-Society E-Commerce, E-business, E-Government, edited by Schmid, B, Stanoevska, K and Tschammer, V, Kluwer Publishing, Zurich, 329-340.
4. Smith, Katherine T(2008), An Analysis of E-Commerce: E-Risk, Global Trade, and Cyber crime. Working Paper, Available at SSRN: http://ssrn.com/abstract=1315423.
   http://www.thehindubusinessline.com/industry-and-economy/india-needs-a-flexible credit -insurance-regime-for-sme-prosperity/article4474744.ece