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Investment Readiness Toolkit N°2

for: SME BlueImpact Asia

GUIDANCE REPORT:

Raising Debt Finance –

Strategies & Resources for SMEs

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PREFACE:

PURPOSE OF THE TOOLKIT

This document provides the narrative of the Investment Readiness Toolkit ("the Toolkit") for SME BlueImpact Asia. This initiative was established by a consortium of Asian Development Bank (ADB), United Nations Development Programme (UNDP) and the United Nations Environment Programme (UNEP). In 2022, the consortium produced the Blue Economy Knowledge Product (BEKP) – Financing the Blue Economy which called for a blended finance initiative to mobilise investment for a sustainable blue economy focusing on Small-Medium Enterprises (SMEs). SME BlueImpact Asia is executed primarily by Ocean Assets Group (OAG), with support from the consortium of ADB, UNDP and UNEP.

OAG runs a parallel program for blue economy SMEs in the Global South: BlueDeals. The digital platform of BlueDeals hosts the Investment Readiness Toolkit, with user-friendly media tools to make the content of this Report more accessible to SMEs and other stakeholders.

Recommendations for actions and resources are designed to help SMEs in the blue economy to efficiently raise capital in today's marketplace. Each section includes detailed step-by-step guidance, sample pathways and documents. Links to supporting experts and institutions will also be provided should SMEs need to seek additional support. Users may access the sections most relevant to their needs:

I. UNDERSTANDING THE SME FINANCE ENVIRONMENT
II. ACCESSING DEBT FINANCE
III. ACCESSING EQUITY FINANCE
IV. UNDERSTANDING IMPACT METRICS
V. DEVELOPING BUSINESS PLANS

It is our hope that this Toolkit will speed up the financing of sustainable enterprises upon which the coastal communities and marine ecosystems of Asia and the Pacific depend. *Since the Toolkit is directed primarily at managers of SMEs, with whom this initiative has a close relationship, we will address the reader henceforth as "You".*

A. WHY CHOOSE DEBT FINANCE?

Debt finance can be considered by SMEs in certain situations, but it may not always be the right choice. Here are some factors to consider when deciding whether to pursue debt finance or to explore alternative options:

1. Consider Debt Finance When

a. Funding Specific Projects:

Debt finance is suitable when you have a specific project or investment in mind, such as purchasing equipment, expanding facilities, or launching a new product line. The borrowed funds can be allocated to these targeted initiatives, and the returns generated from the projects can be used to repay the debt.

b. In a State with Stable Cash Flow:

Debt finance is a viable option for SMEs with stable and predictable cash flow. If the business has a reliable revenue stream and sufficient cash flow to cover loan repayments, taking on debt can be manageable and sustainable.

c. Seeking Growth Opportunities:

If you have identified growth opportunities that require upfront investment, debt finance can provide the necessary capital to seize those opportunities. Whether it's entering new markets, acquiring competitors, or expanding distribution channels, debt financing can support growth initiatives and help you capitalise on favourable market conditions.

d. Retaining Ownership and Control:

Debt financing allows you to raise capital without diluting ownership or giving up equity. If you wish to maintain control of their business and decision-making, and can meet the requirements, you should opt for debt financing since it allows you to borrow funds while keeping ownership intact.

e. In Favourable Market Conditions:

When interest rates are low, accessing debt finance can be cost-effective. Lower borrowing costs can make debt financing more attractive, especially if the returns generated from the borrowed funds are expected to exceed the interest expenses.

f. Financing Short-Term Needs:

Debt financing can be suitable if you have short-term capital needs, such as bridging cash flow gaps or covering temporary working capital shortages. Short-term loans or lines of credit can provide the necessary funds to address these immediate needs. Once cash flow stabilises, the debt can be repaid.

2. Consider Alternatives When

a. Cash Flow is Uncertain:

If your business has an unpredictable or volatile cash flow pattern, debt finance may not be the best option. The uncertainty of cash flow can make it challenging to meet regular loan repayments, potentially leading to financial stress or default. In such cases, exploring alternative financing options that align with cash flow fluctuations, such as equity financing or revenue-sharing arrangements, may be more suitable.

b. Carrying Existing Debt Burden:

If you are already carrying a significant amount of debt, taking on additional debt may not be advisable. Excessive debt levels can strain cash flow, limit financial flexibility, and increase the risk of default. In such situations, it might be more appropriate to focus on debt reduction strategies or explore equity financing to strengthen the balance sheet.

c. In Early-Stage or For High-Risk Ventures:

Startups or SMEs in high-risk industries or early stages of development may find it challenging to secure debt financing. Lenders often prefer established businesses with a proven track record of revenue and profitability. In these cases, alternative financing options such as angel investors, venture capital, or government grants may be more suitable.

d. Requiring Long-Term Capital:

If you require long-term capital for ongoing operational expenses or continuous investments, debt financing may not be the optimal solution. Long-term debt commitments can strain cash flow over an extended period. Exploring equity financing, strategic partnerships, or retained earnings may be better options for meeting long-term capital needs.

e. Collateral or Credit History is Limited:

Lenders typically require collateral or a strong credit history to mitigate their risk when providing debt financing. SMEs with limited assets or credit history may face challenges in accessing debt finance. In such cases, seeking alternative financing options like invoice financing, crowdfunding, or supplier credit may be more accessible.

lenders become more cautious and tighten their lending criteria - especially to SMEs, which are viewed as relatively risky.

HIGHLIGHTS: PRIVATE DEBT IMPACT REPORT [1]

- 219% growth in the number of private debt funds since 2014.
- 67% of private debt impact funds are allocated to emerging markets.

[1] Impact Report: Private Debt Funds at a Glance. Phoenix Capital, June 2023

B. TYPES & TERMS OF DEBT FINANCE

The best type of debt and its terms for SMEs depend on various factors, including the specific needs of your business, its financial position, and the availability of financing options. Here are some common types of debt financing for SMEs and their typical terms:

1. Bank Loans:

a. Term Loans: You can secure term loans from banks with repayment terms typically ranging from 1 to 10 years. The interest rates can be fixed or variable, and collateral may be required.

b. Lines of Credit: Banks provide lines of credit with revolving terms, allowing you to borrow and repay funds as needed. Interest rates are usually variable, and the borrowing limit is determined based on the SME's creditworthiness and financial standing.

2. Equipment Financing:

a. Equipment loans: You can obtain loans specifically for purchasing equipment. The loan term generally matches the useful life of the equipment, typically ranging from 1 to 7 years. Collateral is often the equipment itself.

b. Equipment leasing: You can lease equipment for a fixed period, usually 1 to 5 years. Monthly lease payments are made, and at the end of the lease term, you may have options to purchase the equipment or renew the lease.

3. Invoice Financing:

a. Factoring: You can sell your outstanding customer invoices to a factor at a discount, typically receiving a percentage of the invoice value upfront (e.g., 70-90%). The factor collects the full payment from the customer and deducts a fee before remitting the remaining amount to you.

b. Invoice discounting: You can use your invoices as collateral to secure a loan from a financial institution. The loan amount is a percentage of the invoice value, and interest is charged on the borrowed amount until the customer pays.

4. Government-Supported Loans:

Terms and conditions for government-supported loans vary depending on the specific program and country. These loans often provide favourable interest rates, longer repayment periods, and may have additional benefits such as guarantees or reduced collateral requirements. Government-supported loans are designed to support SME growth and development.

5. Peer-to-Peer (P2P) Lending:

Terms for P2P lending can vary depending on the platform and the agreement between the borrower and lender. The interest rates are typically determined by the borrower's creditworthiness and the perceived risk of the loan. Loan terms can range from a few months to several years.

It's important to note that the terms for SME debt financing can vary based on factors such as the SME's creditworthiness, industry, loan amount, collateral, and the prevailing market conditions. SMEs with stronger financial profiles, established credit history, and solid business plans may have more favourable terms and lower interest rates.

When considering debt financing, you should carefully review the terms, including interest rates, repayment schedules, fees, and any associated requirements or restrictions. It's advisable to compare multiple options, seek advice from financial professionals, and select the type of debt financing that aligns with your specific needs, financial situation, and growth objectives. The next section will discuss impact loans.

C. IMPACT LOANS

Impact loans, also known as social or sustainable loans, are provided by financial institutions that prioritise social and environmental impact alongside financial returns. These loans are specifically designed to support SMEs that have a focus on sustainable and responsible business practices. Here's how impact loans work for SMEs:

1. Financial Institutions:

Impact loans are offered by various financial institutions, including banks, credit unions, microfinance institutions, and specialised impact investing funds. These institutions have a mission to support enterprises that generate positive social, environmental, or community impact.

2. Impact Assessment:

When SMEs apply for an impact loan, the financial institution assesses the social and environmental impact of the enterprise. This evaluation involves analysing your business model, practices, and potential impact on stakeholders, communities, and the environment.

3. Loan Structure:

Impact loans typically have terms and structures similar to traditional loans. The loan amount, interest rates, repayment period, and collateral requirements depend on the enterprise's financial position, creditworthiness, and the specific terms set by the financial institution. However, impact loans may have more flexible terms or lower interest rates compared to conventional loans due to their social and environmental objectives.

4. Impact Measurement:

Alongside financial metrics, financial institutions that provide impact loans also assess the social and environmental outcomes generated by the business. They may require you to report on specific impact indicators or participate in impact measurement and reporting processes. This helps ensure that you are delivering on your sustainability goals and aligning with the intended impact objectives.

5. Sector Focus:

Some financial institutions offering impact loans may have sector-specific focus areas. For example, they may prioritise lending to SMEs in renewable energy, healthcare, fair trade, sustainable

agriculture, or social enterprises. SMEs operating in these sectors may have a higher chance of securing impact loans due to their alignment with the financial institution's impact goals.

6. Support and Networking:

In addition to financial support, financial institutions providing impact loans often offer non-financial assistance to SMEs. This may include mentoring, training, capacity-building programs, or networking opportunities with other impact-focused businesses. These resources can help you strengthen your impact performance and create a positive ripple effect within the sustainable business ecosystem.

7. Alignment with Impact Objectives:

SMEs seeking impact loans should ensure their business activities align with the specific impact objectives and criteria set by the financial institution. Demonstrating a clear commitment to sustainable practices, social responsibility, or environmental stewardship increases the likelihood of securing an impact loan.

> Impact loans may provide you with access to capital while also supporting your sustainability and social impact goals. These loans can help you finance sustainable initiatives, adopt eco-friendly practices, promote social inclusion, or address community needs. If you are interested in impact loans, you should research financial institutions that specialise in impact investing or sustainable finance, understand the institution's impact criteria, and prepare to showcase their positive impact potential during the loan application process.

D. Loans: How to Apply & Succeed

To prepare and qualify for various types of loan applications, SMEs can follow these steps:

1. Assess Financial Needs:

Determine the specific purpose for the loan and calculate the amount required. Have a clear understanding of how the funds will be used and the expected return on investment.

2. Review Creditworthiness:

Evaluate your business creditworthiness by reviewing its credit history, financial statements, and credit scores. Address any discrepancies or issues that may affect the loan application.

3. Prepare Financial Documents:

Gather essential financial documents, including balance sheets, income statements, cash flow statements, and tax returns. Prepare these documents with accuracy and ensure they are up to date.

4. Develop a Business Plan:

Create a comprehensive business plan that outlines your objectives, strategies, market analysis, financial projections, and repayment plan for the loan. The business plan should demonstrate the viability and profitability of the business.

5. Improve Credit Profile:

Take steps to improve your business credit profile by paying bills on time, reducing outstanding debt, and addressing any negative credit history. This can help enhance the chances of loan approval and secure more favourable terms.

6. Research Lenders:

Research and identify lenders that offer the type of loan that aligns with your needs. Consider factors such as interest rates, loan terms, eligibility criteria, and the lender's reputation and track record.

7. Understand Loan Requirements:

Familiarise yourself with the specific requirements of each loan type, such as collateral, personal guarantees, down payments, or minimum credit scores. Ensure you meet these requirements before applying.

8. Prepare Loan Application:

Complete the loan application accurately and thoroughly. Provide all requested information and supporting documents, including financial statements, tax returns, business licences, and any other documentation required by the lender.

9. Build Relationships:

Establish relationships with bankers, lenders, and financial advisors who specialise in SME financing. These professionals can provide guidance, answer questions, and advocate for the SME during the loan application process.

10. Demonstrate Repayment Ability:

Highlight your ability to repay the loan by showcasing a strong cash flow, a solid business plan, and a history of profitability. Provide detailed financial projections that illustrate the capacity to generate sufficient revenue to cover loan repayments.

11. Seek Professional Assistance:

Consider engaging the services of financial advisors, accountants, or business consultants who can help navigate the loan application process, review financial documents, and provide guidance on improving your financial profile.

12. Be Responsive and Follow Up:

Be responsive to any requests or inquiries from the lender. Promptly provide any additional information or documentation they may require. Follow up with the lender to ensure the application is progressing and address any concerns or questions they may have.

RESOURCES

I. CHECKLIST

DOCUMENTS FOR SME LOANS IN ASIA & PACIFIC

When applying for SME business loans in Asia, you will typically be required to provide a set of financial documents to the lending institution. The specific requirements may vary depending on the lender and the nature of your business. However, here are some commonly requested financial documents:

1. Business Plan: A comprehensive business plan that outlines your company's background, market opportunity, competitive analysis, financial projections, and repayment plan for the loan.
See Section: Business Plans for guidance.

2. Financial Statements: Provide your company's financial statements, including:

   Income Statement: Also known as a profit and loss statement, this document shows your company's revenues, expenses, and net income over a specific period.

   Balance Sheet: This document provides a snapshot of your company's assets, liabilities, and shareholders' equity at a specific point in time.

   Cash Flow Statement: This statement tracks the flow of cash into and out of your business, showing the sources and uses of cash over a specific period.

3. Bank Statements: Typically, you will need to provide bank statements for a specified period, usually the past six months or one year. These statements should demonstrate your company's cash flow, transaction history, and overall financial stability.

4. Tax Returns: Submit copies of your company's tax returns for the past two to three years. These documents provide a clear picture of your company's income and tax obligations.

5. Accounts Receivable and Payable: Include reports detailing your outstanding customer invoices (accounts receivable) and your outstanding vendor invoices (accounts payable).

6. Business Projections: Provide a detailed forecast of your company's financial performance, including projected revenues, expenses, and cash flow. These projections should align with your business plan and demonstrate the ability to repay the loan.

7. Collateral Documentation: If the loan requires collateral, you may need to provide documentation related to the collateral, such as property deeds, vehicle titles, or inventory lists.

8. Legal and Corporate Documents: Include relevant legal and corporate documents, such as the company's incorporation certificate, business licences, articles of association, and any other agreements that may be required by the lender.

9. Personal Financial Statements: Depending on the size of your business and the loan amount, lenders may request personal financial statements from the business owners or guarantors. This helps assess the personal financial stability and capacity to support the loan.

10. Other Supporting Documents: Be prepared to provide any other documents requested by the lender, such as business contracts, lease agreements, supplier agreements, or customer agreements.

II. FURTHER RESOURCES

FOR SME DEBT FINANCE IN ASIA & PACIFIC

Here are some resources and references specifically for Asia-based SMEs seeking debt finance:

Asian Development Bank (ADB): The ADB provides resources and financing options for SMEs in Asia, including debt financing. Their website offers information on loan programs, guarantees, and access to technical assistance: https://www.adb.org/

International Finance Corporation (IFC): The IFC, a member of the World Bank Group, offers debt financing solutions for SMEs in Asia. Their website provides information on investment and advisory services: https://www.ifc.org/

Export-Import Bank of India (EXIM Bank): EXIM Bank provides export credit and financing facilities to support Indian SMEs engaged in international trade. Their website offers information on export financing programs: https://www.eximbankindia.in/

Credit Guarantee and Investment Facility (CGIF): CGIF provides credit enhancements and guarantees to facilitate access to debt financing for SMEs in the ASEAN region. Their website offers information on guarantee programs and partnerships: https://www.cgif-abmi.org/

Local Commercial Banks and Financial Institutions: SMEs in Asia can also explore local commercial banks and financial institutions that offer debt financing solutions. These institutions often have specific SME lending programs and customised loan products. It's recommended to research and reach out to local banks in the respective country or region.