Webinar: Maintaining Finance for Firms Impacted by COVID-19: Perspectives for East Asia

Maintaining Financing for Firms: Perspectives from Singapore

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**Pandemic’s Winners & Losers (Mostly Losers)**

**Source:** Bloomberg

### SPX Index

**Negative Price Return**

<table>
<thead>
<tr>
<th>Groups (158)</th>
<th>Return Positive Price Return</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>S&amp;P 500 INDEX</strong></td>
<td><strong>-12.38%</strong></td>
</tr>
</tbody>
</table>

#### Best Performing

1. S&P 500 GOLD INDEX
2. S&P 500 INTERNET RET IDX
3. S&P 500 FOOD RETAIL IDX
4. S&P 500 SYSTEMS SFTW IDX
5. S&P 500 WIRELESS SFR IDX
6. S&P 500 Int Svc & Inf
7. S&P 500 Inter Home Ent
8. S&P 500 BIOTECH INDEX
9. S&P 500 HYPR & SUPRCNTRS
10. S&P 500 TRUCKING INDEX

#### Worst Performing

11. S&P 500 AUTOMBL MANF IDX
12. S&P 500 MCYCL MANF INDEX
13. S&P 500 RETAIL RETS IDX
14. S&P 500 MLTTLNS INS IDX
15. S&P 500 APRL & ACCES IDX
16. S&P 500 HOTELS IDX
17. S&P 500 AIRLINES IDX
18. S&P 500 OIL & GAS EQU IDX
19. S&P 500 DEPT STORES IDX
20. S&P 500 OIL&GAS DRIL IDX

### MXASJ Index

**Negative Price Return**

<table>
<thead>
<tr>
<th>Groups (11)</th>
<th>Return Positive Price Return</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>MSCI AC ASIA x JAPAN</strong></td>
<td><strong>-11.93%</strong></td>
</tr>
</tbody>
</table>

#### All Groups

1. MSCI AC AS x/JLTH CARE
2. MSCI AC AS/JP/COMM SVC
3. MSCI AC AS/J CON STPL
4. MSCI AC AS/J INF TECH
5. MSCI AC AS/J UTIL
t
6. MSCI AC AS/J CONS DIS
7. MSCI AC AS/J MATER
t
8. MSCI AC AS/J REAL E
t
9. MSCI AC AS/J INDUSTRI
10. MSCI AC AS/J FINANCE
11. MSCI AC AS/J ENERGY

### Total Return

- **-12.38%**
- **-11.93%**
Here comes the cavalry

• When financial markets & products can’t provide safety – a.k.a. market incompleteness – the state undertakes responsibility to insure its members against exogenous systemic negative shocks

• Singapore did just that on multiple fronts: for households, businesses, self-employed, etc.

• On the business front, government:
  ❖ mitigated job market disruptions to prevent permanent damage to businesses’ organizational capital by subsidizing wages; up to 75% for some industries
  ❖ maintained market-wide financial stability and financial security, mostly via forbearance programs, interest / principal payment deferrals, rental relief (including waiver of government rental charges), contractual obligation temporary relief
  ❖ offered property and corporate income tax rebates
  ❖ introduced ultra-low interest bridge loans via banks to cover short term cash shortfalls at SMEs
Case study: An average SG restaurant’s operating cost structure

<table>
<thead>
<tr>
<th></th>
<th>Normal times</th>
<th>During Pandemic</th>
<th>Subsidized costs</th>
<th>Govt subsidy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annualized Sales</td>
<td>$1,000,000</td>
<td>$200,000</td>
<td>$200,000</td>
<td></td>
</tr>
<tr>
<td>Food Costs</td>
<td>$305,882</td>
<td>$61,176</td>
<td>$61,176</td>
<td></td>
</tr>
<tr>
<td>Rent</td>
<td>$200,000</td>
<td>$150,000</td>
<td>$150,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Manpower</td>
<td>$329,412</td>
<td>$164,706</td>
<td>$164,706</td>
<td>$164,706</td>
</tr>
<tr>
<td>Other costs</td>
<td>$164,706</td>
<td>$98,824</td>
<td>$98,824</td>
<td></td>
</tr>
<tr>
<td>Profit (Loss)</td>
<td>$-</td>
<td>$274,705</td>
<td>$274,705</td>
<td></td>
</tr>
</tbody>
</table>

- Average SG restaurant still in the hole for $275K!
- Restaurants usually only have 30 days of cash on hand**
- Share of food service value in Singapore: S$9.9bn in 2019
- Back of the envelope: S$2.7bn in F&B financing needed!

Source:
iCHEF Club SG https://www.ichefpos.com/en-sg/blog/budgeting-for-your-restaurants-operational-costs

**Didier, Tatiana; Huneeus, Federico; Larrain, Mauricio; Schmukler, Sergio L. 2020. Financing Firms in Hibernation During the COVID-19 Pandemic. Research and Policy Briefs, no. 30; World Bank, Washington, DC. (Figure 2)
Saving Singapore’s SMEs

In 2019 small and medium-scale enterprises (SMEs) in Singapore contributed:

• 45% of value-add to Singapore’s 2019 GDP of S$507.6 billion
• Provided around 72% of the 3.5 million in total jobs
• Constituted 99% of all its enterprises, comprising of 273,100 firms
• Most have no link to capital markets; rely almost exclusively on bank finance or the resources of the owners

• **April 14**: Cherian & Subrahmanyam propose state-led “pseudo-equity” financing for Singapore’s SMEs (Business Times)
• **April 17**: Judd & Schmedders propose US govt-led preferred equity financing for large listed US companies in trouble (Fortune)
• **April 20**: MAS & Enterprise Singapore (ESG) announce eligible SG banks can borrow at 0.1% over two-years for lending to SMEs (Straits Times)
• **April 23**: MAS-ESG Financing Schemes disburse **S$500m** in loans (Straits Times)
• **April 29**: US poised to unveil bridge loans for ailing oil companies along with financial stakes (Bloomberg News)

Source: Business Times (Singapore), 16 April 2020
How about a hybrid solution for SMEs as well?

**MAS-ESG Enhanced Enterprise Financing Scheme - SME Working Capital Loan**
(Existing Subsidized Term Loans via Banks)

• Capped at SGD$1mn
• 0.1% lending rate from MAS to FIs for a 2 year period
• Up to **90% risk-share** by SG govt on the SME loan
• Final interest rate charged to SME by FI is determined per the cost of funds, SME’s risk profile, etc.
• Banks claim interest rates between 2% and 3% p.a.
• 1 year deferral of principal repayment allowed, subject to FI’s assessment
• Disbursed **S$500m** in SME loans between Mar 2 and Apr 23

**Cherian-Subrahmanyam Proposal: Add State-led Pseudo-Equity Financing via a g-SPV (NEW)**

• Determine which SMEs qualify via quantitative filters (say, past 3 years PAT)
• Provide arms-length, pseudo-equity term financing via a “g-SPV”. Say, 25% of 2017 – 2019 average revenues
• Like preferred equity, has no voting rights but has priority over owners’ equity => the SME pays “dividends” in the form of higher corporate taxes (post tax holidays)
• SME can buy equity back from g-SPV at appropriate buy-back / forward price (post a fixed duration)
• Has been done in the US before: In late 2008, the Fed issued a loan to AIG in exchange for 79.9% of the company’s equity
State-led equity is like a first-loss protection mechanism

• SME needs S$1 million in financing:
  ❖ Option 1: SME borrows $1 million at 3% under MAS-ESG Enhanced Enterprise Financing Scheme with 10% risk-share by the FI (=S$100,000) and 90% risk share by the government (=S$900,000)
  ❖ Option 2: SME borrows $750,000 at (3% - xx bps) under MAS-ESG Enhanced Enterprise Financing Scheme with 10% risk-share by the FI (=S$75,000) and 90% risk share by the government (=S$675,000) + S$250,000 in state-led pseudo-equity financing
• On the business front, the SME faces a lower interest rate (↓ by xx bps) and lower monthly loan payments
• On the FI front, it frees up $250,000 in balance sheet capital for other lending, plus the perceived risk reduction on its balance sheet given the govt’s participation via pseudo-equity, ceteris paribus
• On the government front, it benefits from keeping the economy humming, and the potential upside through higher taxes and the forward sell-back price
• Note: In the case of AIG, the U.S. government cut its 79.9% stake to about 21.5% in 3Q2012, making a profit of $12.4 billion!
Appendix: Risk management 101

• There are the standard risk management issues the g-SPV must worry about, like *adverse selection* and *moral hazard*

• Example 1: Due to *adverse selection*, the SME would know more about its true health, condition and commitment than the g-SPV does, *ex ante*
  ❖ Solution: An appreciation for long-term reputational effects, and if necessary, the g-SPV can apply an adverse selection “haircut” to the financing amount

• Example 2: *Moral hazard*, which arises when the SME recipient of g-SPV financing, *ex post*, siphons off the funds for unauthorized purposes, be it unnecessary risk-taking or consumption of perquisites
  ❖ Solutions:
    o Governments have punitive authority: any fraud or egregious wrongdoing can be prosecuted
    o The SME could be “blacklisted” by the government

• In a well-managed small country like Singapore, where tax compliance is good and long-term reputation is paramount, these effects would be smaller than in many other jurisdictions

• Apart from the FI’s loan credit officers, reputable institutions like the Singapore Business Federation or Enterprise Singapore (ESG) could be roped in to assist the state in risk managing the state-led financing program