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BREAKING BARRIERS

Why Financing Reforms Matter for Midsized Companies

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Key Takeaways

- Results of the June 2023 Dun & Bradstreet Business Financing Survey affirms the significance of access to financing as a key determinant in the growth of Micro, Small, and Medium Enterprises (MSMEs)

- Governments and financial institutions should prioritize access to financing for midsized companies because of their willingness to obtain external funds, potential for better unit economics for investors, and impact on business dynamism

- Addressing the issue of finance involves two broad approaches: One, enhancing the conventional and traditional bank credit system. Two, exploring opportunities to strengthen capital markets as alternative sources of financing

- Extending credit guarantee scheme coverage to midsized companies is a crucial step to enhance the flow of bank credit

- On the equity side of the capital market, lowering the costs associated with Initial Public Offerings (IPOs) and simplifying regulatory requirements will increase the chances of listing

- On the debt/ hybrid side of the capital market, the establishment of a marketplace financing platform to connect midsized companies with domestic and international investors is a much-needed initiative

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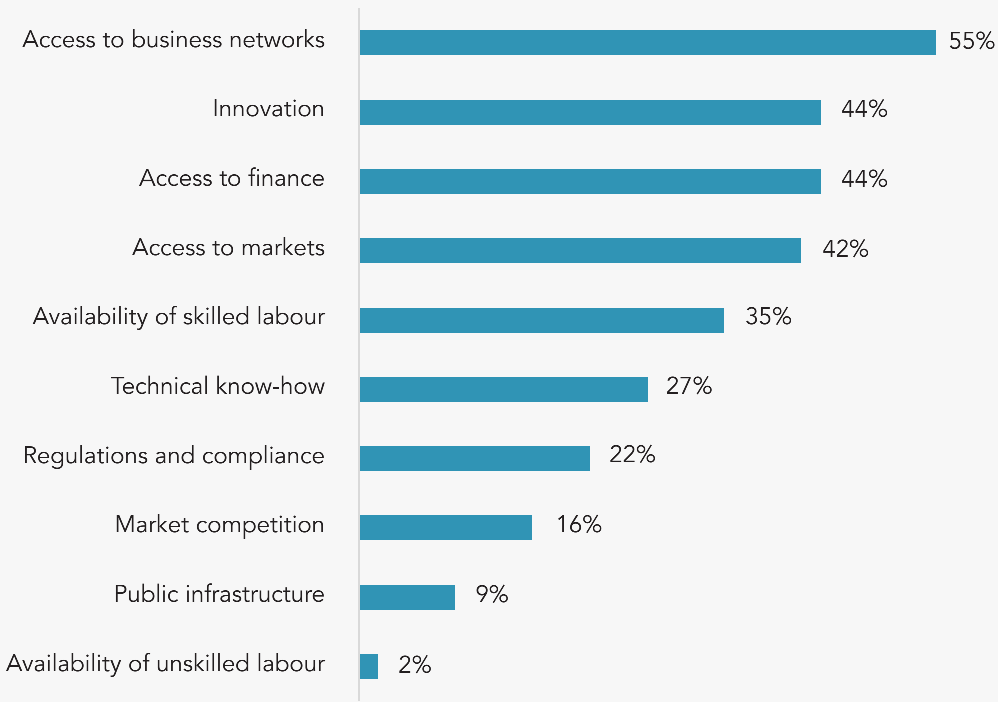
Introduction

Over the course of the last two decades, Dun & Bradstreet has engaged with thousands of Micro, Small, and Medium Enterprises (MSMEs), offering a wealth of data that reveals a common theme: the struggle to secure financial resources to fuel growth and expansion. Seeking deeper insights into this issue, we conducted the Dun & Bradstreet Business Financing Survey in June 2023. The results affirmed the significance of access to finance as a key determinant in the potential to support and accelerate business growth. Interestingly, more than half of the respondents expressed a desire for access to business networks, recognizing the role they play in not only connecting with customers and vendors but also crucially, investors. These investors provide strategic guidance and mentorship on approaches to drive business expansion. Business networking opportunities also open doors to tailored programs with favorable financing terms. This interplay between finance and business networks bears considerable implications for the growth and sustainability of MSMEs.

Growth Enabling Factors (% of respondents)



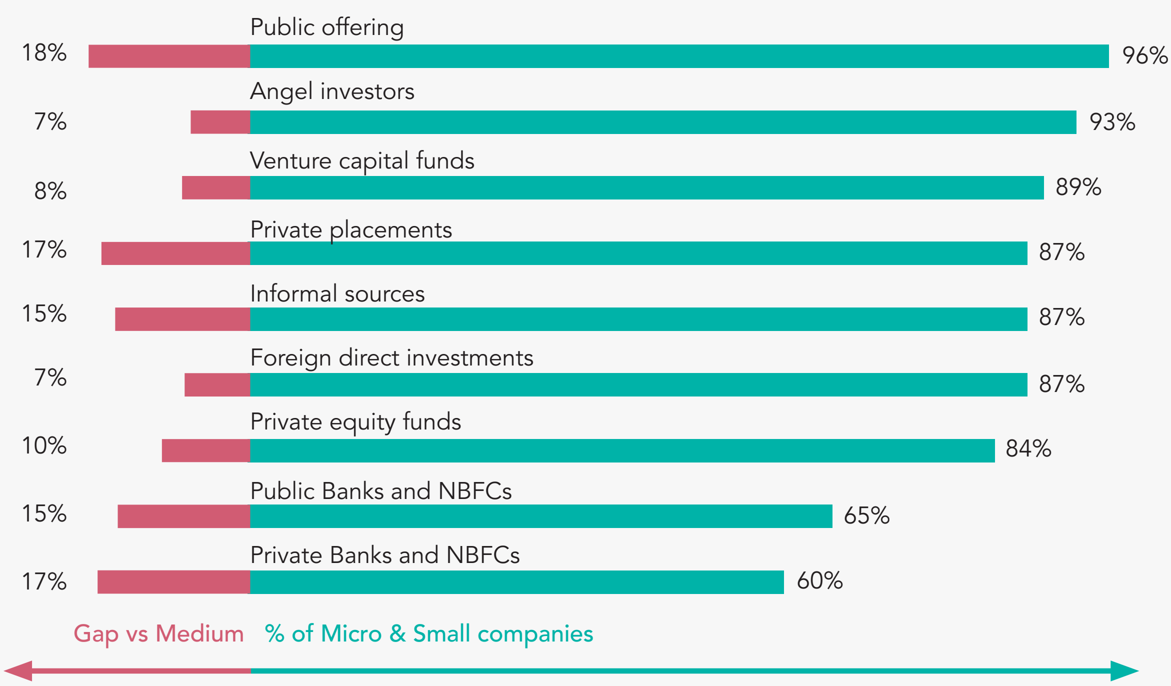
Source: Dun & Bradstreet

Prioritizing Support for Midsized Companies

In one of our earlier whitepapers, we estimated that Indian MSMEs need external financing worth at least US$4 trillion over the next 25 years to scale up. While it is undeniably essential to address the issue of access to finance comprehensively, focusing our efforts on midsized companies is a prudent approach for three compelling reasons.

1. First, the level of willingness to obtain external finance. Data from the Dun & Bradstreet Business Financing Survey indicates that a higher percentage of midsized companies, 12 percentage points more than small and micro companies, have actively sought out bank loans and other means of financing This suggests that midsized companies are open to leveraging external funding to support their growth and expansion initiatives. On the other hand, a significant portion of small and micro companies appear to be uninterested in scaling their business and hence do not pursue external financing options. Up to 65% of micro and small companies stated that they have never pursued a bank loan. This percentage significantly increases to a range of 84% to 96% when considering other complex sources of finance, such as public offerings, private placements, and angel investors. Hence, by focusing on mid-market companies, resources can be directed towards businesses that are more willing to utilize financial support to drive growth.

Never Sought Financing (% of respondents)



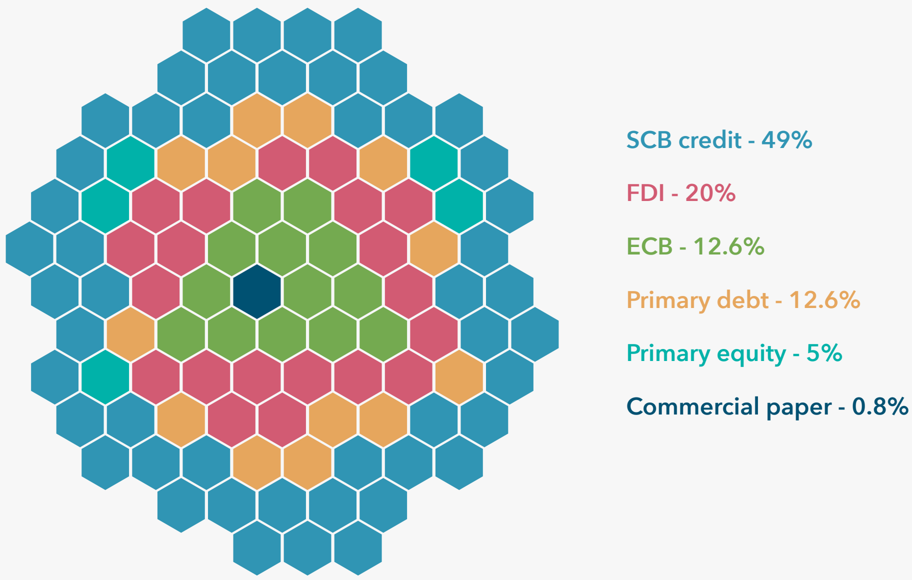
Source: Dun & Bradstreet

2. Second, the ticket size. Financing options often come with certain fixed costs and overheads that can make it prohibitive to serve smaller companies. The ticket size for midsized companies is generally larger than that of small and micro companies, leading to a reduced per-unit transaction cost for financial institutions or investors. This efficiency makes serving midsized companies a more attractive option from a business standpoint. Furthermore, serving midsized companies fosters the potential for long-term partnerships, as these companies tend to have sustained funding requirements and may seek to establish ongoing relationships with reliable financial partners. This contrasts with the smaller firms, which are more prone to fluctuations and can pose higher risks to investors.

3. Third. the impact on business dynamism. The upward mobility of midsized companies is vital for a healthy and competitive market environment. Midsized companies create competitive pressure on larger companies, encouraging them to innovate and improve their operations. This competition can lead to higher overall market efficiency and better products and services for consumers. The churn rate of top companies is considerably high in peer countries. In China, for example, 65% of the Top 500 companies have been replaced over the last decade. In India, by contrast, only 36% of the Top 500 companies were replaced. By supporting midsized companies, there is a greater likelihood of promoting a dynamic and competitive business landscape.

However, it is essential to recognize that while addressing the financing problems of midsized companies first, may have its advantages, it doesn't mean that small and micro companies should be neglected entirely. Addressing the issue of finance at a broad level involves two main approaches. The first centers on enhancing the conventional and traditional bank credit system. The second approach involves exploring opportunities to strengthen capital markets as alternative sources of financing.

Share of Funds Raised by Indian Businesses by Source



Note: SCB – Schedule Commercial Banks, FDI – Foreign Direct Investments, ECB – External Commercial Borrowings
Source: CMIE

First Approach - Within the Conventional: Smoothening the Bank Credit Flow

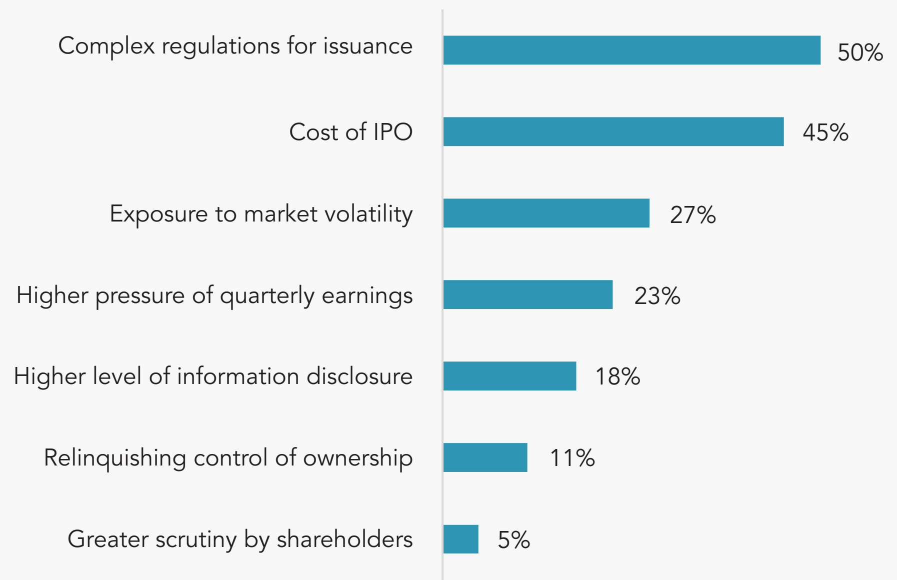
Banks play an important role in improving access to finance in India, contributing to nearly half of the funds raised by corporates. In our previous whitepaper, we addressed challenges concerning bank credit and offered policy measures to enhance the credit guarantee scheme, expand financial data coverage, lower the premium on lending rates, and simplify bankruptcy laws. These measures, when effectively implemented, will benefit not only small and micro companies but also midsized ones.
Furthermore, 2 in 5 respondents in our June 2023 survey emphasized the necessity to extend the credit guarantee scheme's coverage to midsized companies. Although, midsized companies typically possess more collateral than smaller ones, it might not be adequate to secure the required credit, as the average collateral value needed for a loan currently stands at 191% of the loan amount. Including midsized companies in the scheme will help them obtain collateral free loans by instilling greater confidence in creditors. Additionally, since capital markets still lack depth and accessibility for midsized companies, improving bank credit warrants significant attention.

Second Approach - Beyond the Conventional: Tapping into the Capital Markets

Banks predominantly focus on short-term lending due to their liability structure. In contrast, capital markets serve as a preferred source of long-term funding at favorable rates. Investors in capital markets are willing to commit funds for extended periods, enabling companies to access capital for long-term. However, only a small fraction of midsized companies have effectively utilized the broader spectrum of financing options to its advantage.

Equity: While the Bombay Stock Exchange (BSE) boasts the highest number of listed companies compared to any other stock exchange worldwide, the percentage of registered midsized companies listed on the BSE is less than 3%. Strikingly, nearly 40%

Reasons Holding Back Companies from IPOs (% of respondents)



Source: Dun & Bradstreet

of midsized companies surveyed by Dun & Bradstreet expressed no intentions of conducting an Initial Public Offering (IPO) at any point in the future.

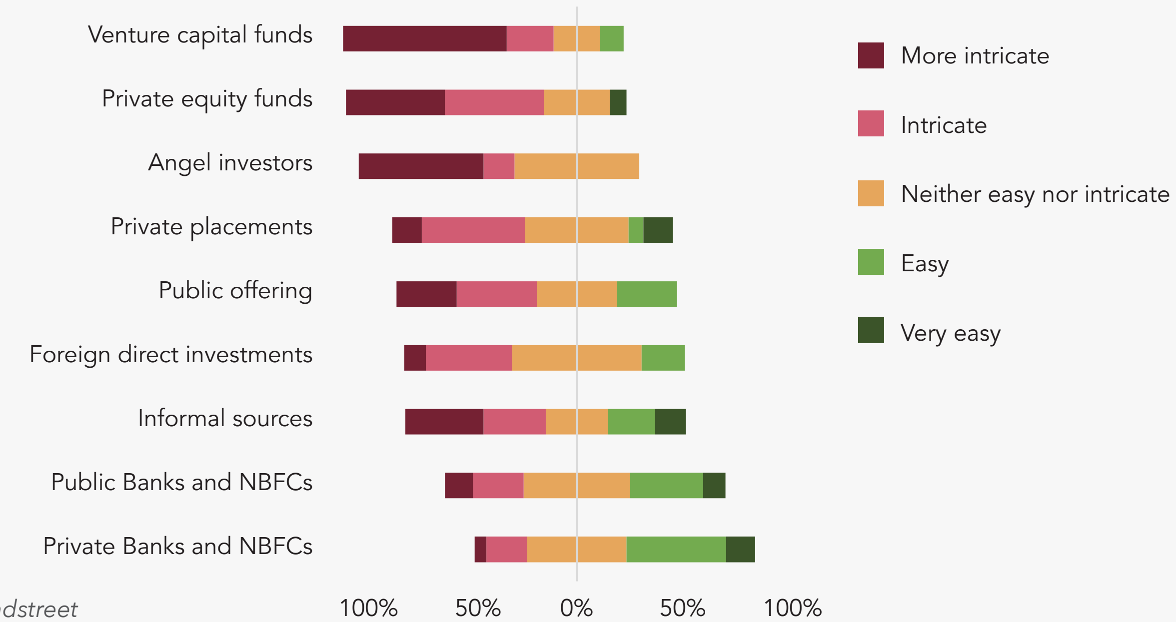
Nearly half of the companies that have aspirations of getting listed have yet to take the leap, mainly due to concerns regarding the high costs associated with IPOs and the intricate regulatory requirements involved. While the Securities Exchange Board of India (SEBI) has taken various measures to address these challenges, a clear imperative exists for the implementation of additional coordinated efforts aimed at effectively and comprehensively improving the prevailing situation.

Debt/ Hybrid: The Indian corporate bond market has experienced remarkable growth, expanding nearly four-fold from FY12 to reach Rs 42 trillion in FY23. This is undoubtedly a positive development for the country's financial landscape. However, it is essential to acknowledge that the market's size, when measured against the GDP, falls significantly short in comparison to other Asian nations. India's corporate bond outstanding, stands at just 15% of its GDP, notably lower than China's 36% and Asian Tiger economies' 54%. Moreover, only a little over 4,200 companies had bonds issued by the end of FY23 compared to the registered universe of 1.5 million companies in India.

One of the contributing factors to the low issuance and limited funds raised is the challenge of accessing alternative sources of funding beyond bank credit. Data from the June 2023 Dun & Bradstreet Business Financing survey shows that 50% of midsized companies perceive raising funds through public offerings as intricate or very intricate, while 47% feel the same about private placements. In contrast, only 19% of companies find it challenging to obtain a line of credit from private banks.

The difficulty in raising funds through the issuance of bonds is further exacerbated by the prevailing preference of current investors towards highly rated securities. According to data from SEBI, during FY23 (April 2022 to March 2023), 51% of bond issues were rated AA and above, with an additional 28% rated A. The distribution becomes even more skewed when considering the value of these securities, as a staggering 81% of the total amount raised in FY23 came from AAA-rated securities. The dominance of regulated entities like banks, mutual funds, and insurance companies in the existing investor base leads to a preference for highly rated

Ease of Access to Finance (% of respondents)



Source: Dun & Bradstreet

bonds due to regulatory constraints and risk-averse investment practices. Consequently, companies seeking to issue bonds with lower credit ratings encounter difficulties in attracting investment from the current pool of investors.

The development of a robust Credit Default Swap (CDS) market will significantly boost the issuance of lower-rated securities.

The actions taken by the Reserve Bank of India (RBI) in recognizing CDS as qualified financial contracts for netting and broadening the scope of issuers and participants, to encompass all major non-bank regulated entities represent a positive and progressive move.,

Beyond the Conventional: What Additional Actions are Required?

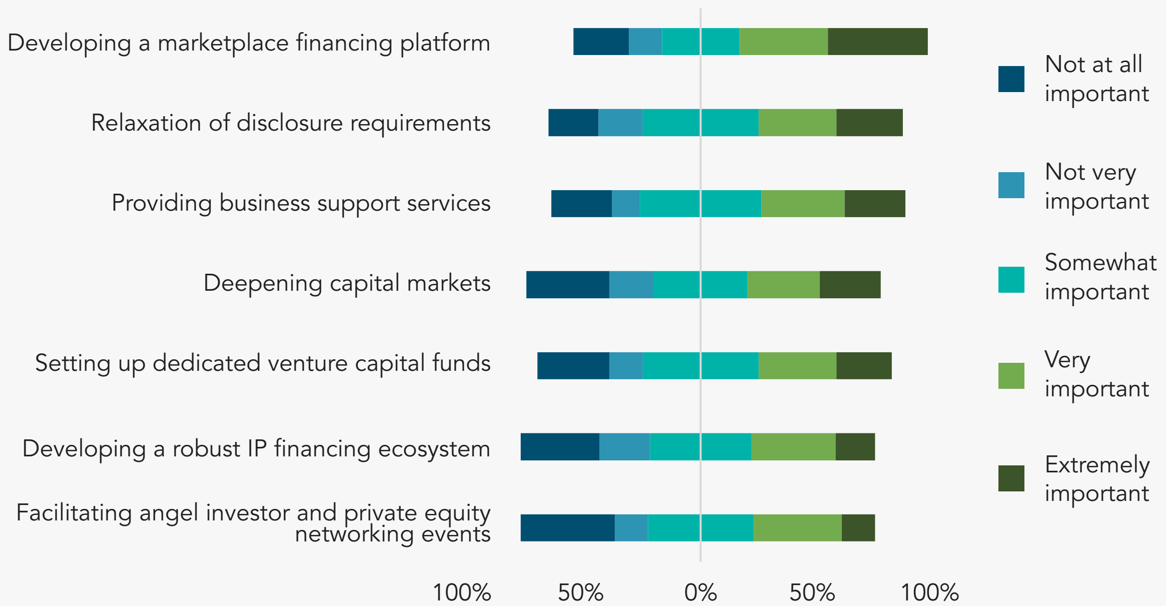
When asked about the measures sought to enhance their long-term funding prospects, over half of the **respondents expressed their desire for a marketplace financing platform that would connect them with both domestic and international investors.** Additionally, more than 40% of the respondents sought to ease discourse requirements and avail business support services, including credit mediation and advisory assistance.

A marketplace lending platform offers a multitude of advantages for midsized companies seeking financing solutions. One of the key strengths is its extensive network of lenders, which not only increases the likelihood of finding suitable financing options but also fosters competition among lenders, leading to potentially more competitive interest rates and favorable terms for the borrowing company.

These lending platforms also offer a level of flexibility in credit standards that is often unmatched by traditional banking channels. Traditional bank loans often come with standardized terms and conditions, which might not suit the unique needs of midsized companies. Alternative financing options allow businesses to negotiate more flexible and customized deals that align with their growth plans and risk appetite.

Moreover, the faster funding disbursement process is a huge plus for companies looking to address immediate financial needs. Unlike the lengthy approval processes often associated with banks, alternative financing methods often provide faster access to capital, enabling companies to seize time-sensitive ventures and maintain competitive edge.

Interventions Sought to Secure Financing (% of respondents)



Source: Dun & Bradstreet

In conclusion, even as we acknowledge the significance of banks as a crucial source of finance, it is imperative to focus on strengthening our capital markets to facilitate midsized companies in accessing finance at more favorable rates. But more importantly, decisive steps are required towards establishing a marketplace financing platform. By seamlessly connecting midsized companies with both domestic and international investors, we can foster a thriving ecosystem that promotes economic growth and stability for the future.

How Dun & Bradstreet Can Help

Establishing brand credibility is a crucial factor in achieving sustainable business growth. Every day, millions of companies rely on the Dun & Bradstreet Data Cloud to perform comprehensive checks before engaging with any organization. These checks are conducted by key stakeholders such as bankers, investors, customers, suppliers, and others who evaluate your company's creditworthiness, capabilities, payment terms, sustainability, scalability, and more.

Your business credit scores and ratings hold significant influence over your company's success. The better they are, the greater your opportunities to:

- Qualify for loans
- Secure lower interest rates
- Enhance your cash flow
- Negotiate favorable payment terms
- Attract new B2B customers

To assist you in managing your business credit file effectively, Dun & Bradstreet offers a range of online tools. These tools provide you with 24/7 access to view information within your business credit file, along with the potential to impact your scores and ratings. By leveraging these resources, you can not only gain global visibility but also present an accurate representation of your company, establishing credibility with confidence.

Dun & Bradstreet, the leading global provider of B2B data, insights and AI-driven platforms, helps organizations around the world grow and thrive. Dun & Bradstreet's Data Cloud, which comprises of 500M+ records, fuels solutions and delivers insights that empower customers to grow revenue, increase margins, build stronger relationships, and help stay compliant – even in changing times. Since 1841, companies of every size have relied on Dun & Bradstreet to help them manage risk and reveal opportunity. Dun & Bradstreet is publicly traded on the New York Stock Exchange (NYSE: DNB).

Dun & Bradstreet Information Services India Private Limited is headquartered in Mumbai and provides clients with data-driven products and technology-driven platforms to help them take faster and more accurate decisions in domains of finance, risk, compliance, information technology and marketing. Working towards Government of India's vision of creating an Atmanirbhar Bharat(Self-Reliant India) by supporting the Make In India initiative, Dun & Bradstreet India has a special focus on helping entrepreneurs enhance their visibility, increase their credibility, expand access to global markets, and identify potential customers & suppliers, while managing risk and opportunity.

India is also the home to **Dun & Bradstreet Technology & Corporate Services LLP**, which is the Global Capabilities Center (GCC) of Dun & Bradstreet supporting global technology delivery using cutting-edge technology. Located at Hyderabad, the GCC has a highly-skilled workforce of over 500 employees, and focuses on enhanced productivity, economies of scale, consistent delivery processes and lower operating expenses.

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