SME COMMITTEE (SMEC)
PROPOSED MEASURES FOR BUDGET 2012 TO HELP SMEs

INTRODUCTION

Challenging and Uncertain 2012

1. 2012 will be a challenging and uncertain year for the global economy. Weak growth prospect in developed nations and concerns about fiscal sustainability in the Eurozone continue to cloud the horizon. Volatile financial markets continue to affect businesses and dent consumer confidence, with demand remaining sluggish in the immediate quarters ahead. As an export-led economy, Singapore is affected to a large extent. With weakness in the external environment likely to persist, Singapore's gross domestic product for this year is projected at 1% - 3%. An outright recession scenario is unlikely but we cannot discount the possibility that the economy could deteriorate further with risks from the worsening European debt crisis, slowing growth in China and bursting of its asset bubble and tensions in the Middle-East.

SMEs Remain Vulnerable Segment of Business Community

2. Small and medium enterprises (SMEs) form a large bulk of our business fabric, employ 60% of our workforce and contribute about half of our value added. The evolving global economic and business landscape makes it especially difficult for them to keep pace. SMEs face many challenges. Without the financial means of multinational corporations, SMEs are perpetually cash-strapped and lack basic resources e.g. cash flow and manpower to grow their business or capitalise on emerging opportunities. In times like these, SMEs are the hardest hit and deserve our utmost attention.

Weak SME Sentiments for 1H 2012

3. Findings from the latest SBF-DP SME Index painted a less than rosy picture for 2012. (See below) Findings revealed that future business sentiment as reflected in the Index had stagnated at 51 since the last quarter of 2011 with most SMEs adopting a more cautious stance.

Overall Index (out of 100)	**2Q10 – 3Q10 F**	**3Q10 – 4Q10 F**	**4Q10 – 1Q11 F**	**1Q11 – 2Q11 F**	**2Q11 – 3Q11 F**	**3Q11 – 4Q11 F**	**4Q11 – 1Q12 F**	**1Q12 – 2Q12 F**
Commerce / Trading	54	61	57	56	57	54	51	52
Construction / Engineering	-	-	-	-	-	-	-	51
Manufacturing	55	51	57	57	55	56	48	48
Transport / Storage	50	68	55	57	57	54	50	47
Business Services	49	56	63	60	59	59	51	51
Overall	***51***	***56***	***60***	***58***	***59***	***57***	***51***	***51***

(Source: SBF-DP SME Index)

SME Committee Key Focus

4. As the apex business chamber, the Singapore Business Federation (SBF) has been championing the cause of SME members affected by the slowdown. In December 2011, SBF formed the Small and Medium Enterprises Committee (SMEC) as a platform for active engagement with the government. It seeks to influence policies that will benefit the SME community in tangible ways. The Committee has identified four key issues affecting SMEs. These are:

(1) Cost of doing business
(2) Manpower and productivity
(3) Financial and cash management
(4) Internationalisation and market access.

5. This paper seeks to discuss the afore-mentioned challenges as well as to propose measures for inclusion in Budget 2012.

COST OF DOING BUSINESS

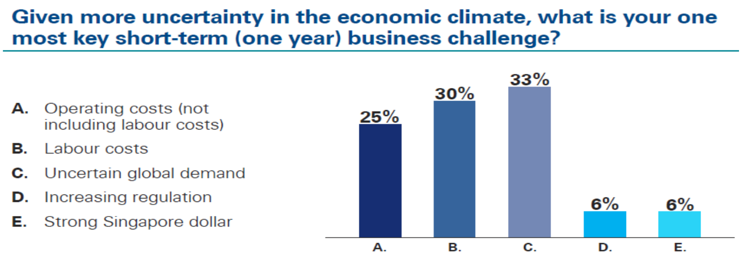
Rising Costs Eroding Business Competitiveness

6. The rising cost of doing business has been of most concern, with many SMEs seeing a steady increase in rental, manpower, raw materials and other ancillary costs. In October 2011, a survey by SBF found that 64% of SMEs were affected by 'high labour costs' while 52.8% struggled with 'high material costs'. Three-quarters of the respondents (76%) considered 'reducing business cost' as top of their wish list. A recent survey by DP Information Group (see below) also concurred that high manpower and operating costs (rental, material) were top concerns of SMEs while efforts to keep business costs down was the most important short-term strategy.

Sales & Cost-related Challenges	2011	2010	2009
High manpower costs	***54%***	39%	20%
High material costs	***51%***	28%	-
Increasing competition	47%	82%	45%
High rental costs	***44%***	38%	20%
Experiencing delay in receiving payments	23%	23%	44%
Slow growth in sales	10%	47%	76%

Source: SME Development Survey 2011 by DP Information Group

7. Similar findings were also reflected in the Pre-Budget 2012 survey by KPMG, with more than half of SMEs affected by rising operational cost (25%) or labour costs (30%).



8. The rising operational costs affect the cost-competitiveness and profitability of SMEs. Based on the SME Development Survey 2011 by DP Information Group, 22% of SMEs are not profitable (the highest in 5 years). Another 43% have margins of just 0% - 5%. Given

their threadbare resources, SMEs are thus most vulnerable to external shocks and they do not have room to make mistakes.

With limited resources, SMEs require greater government attention and support

9. It is recognised that SMEs need to adjust their business strategies and processes to manage costs. They would need to move up the value chain, relocate/restructure their operations, improve productivity and seek alliance and amalgamation to share costs. These are difficult transitions to make amidst uncertain economic times and changed policy environment. Government can help SMEs undertake these restructuring by providing greater attention, more resources and more latitude on the development of the SME sectors.

Returning cash to SMEs to meet rising business costs

10. Recognising that many SMEs are not profitable or indeed pay little taxes, cash pay-out rather than tax deduction incentives will be more effective in reducing their business costs. Government should also consider giving larger cash pay-out to smaller SMEs to reflect their more challenging financial position.

Recommendation

We propose that Government introduce a SME Cash Pay-out Scheme to replace the one-off SME cash grant. This cash pay-out should be more generous (up to $10,000 per year), skewed to help the smaller SMEs (using revenue and manpower employed as proxies) and should be extended for the next 5 years. SMEs particularly the smaller ones, will then be able to use this cash pay-out as 'base support" over the next 5 years to offset some of their rising business costs. **For other businesses, Government should extend the Corporate Income Tax Rebate for another year.**

Rental

11. Due to their low margin, rental continues to pose a challenge for SMEs. As rental across all categories are expected to rise steadily, relocating their operations to another part of the island is not an alternative. The high rental is reflective of the limited land supply in Singapore particularly for industrial land. This affects the competitiveness of the manufacturing industries in particular. Some of these which are land/labour intensive may no longer be competitive in Singapore.

Recommendation

Government should provide a one-off grant to increase the competitiveness of SMEs by helping them strategise and plan for their relocation to lower-cost countries. Such assistance would be useful for SMEs to leverage on lower cost countries' advantages while maintaining linkages to Singapore.

Government to play developmental role for affordable industrial land

12. Government's industrial land policies have also contributed to higher costs for SMEs. In the last two decades, many SMEs have operated in flatted factories managed by the Jurong Town Corporation (JTC). In recent years, the divestment of JTC premises to large property companies has exposed industrial rental to full market forces as these properties are subsequently injected into REIT instruments. As a result, many SMEs now pay higher rentals or forced to relocate to cheaper locations.

Recommendation

To help SMEs cope with the escalating rental, there is a need for JTC to reinstate its former developmental role of providing ready and affordable industrial facilities just as HDB had continued to provide industrial properties for smaller SMEs.

MANPOWER & PRODUCTIVITY

Manpower

Alleviating manpower constraints with incentives linked to productivity and training

13. SMEs continue to face the severe manpower issues. With the revised foreign labour quota and newly-imposed levies, many SMEs have found it more costly to hire foreigners. The tight job market and many locals continuing to avoid jobs in certain sectors have made the situation for SMEs much dire. The introduction of laws on the re-employment of older workers as well as possible increase in CPF rates for older workers will add costs to companies. In the Pre-Budget 2012 survey by our strategic partner KPMG, it surveys that 45.1% of SMEs felt that tightened foreign worker policy seriously affected their business. This impact is particularly felt in the manufacturing and construction sectors where the revised quotas and levies on work permits and S-passes have significantly increased overall operational costs.

Impact of revised foreign worker policy	Overall (all sectors)	Manufacturing	Construction	Services
Very serious	13.6%	16.3%	20.0%	12.4%
Serious	31.5%	51.0%	50.0%	23.5%
Acceptable	29.6%	18.4%	20.0%	34.0%
Not affected	21.1%	12.2%	10.0%	24.8%
Not stated	4.2%	2.0%	0%	5.2%
Total	100%	100%	100%	100%

(Source: KPMG Singapore Pre-Budget 2012)

14. We appreciate the constraints of adding more foreign workers to Singapore and support the economic strategy of driving productivity increases for our enterprises. Changes are proposed for the Productivity and Innovation Credit (PIC) Scheme and manpower assistance schemes.

Productivity and Innovation Credit (PIC)

A more flexible PIC Scheme to benefit more SMEs and services sectors

15. The PIC is a significant scheme introduced and enhanced in the last 2 Budgets to provide broad base tax benefits for a range of activities along the innovation value chain. Activities that qualify for PIC benefits are: (1) Acquisition or leasing of automation equipment; (2) Training of employees; (3) Acquisition of Intellectual Property Rights; (4) Registration of patents, trademarks, designs and plant varieties; (5) Research and development activities; and (6) Investment in approved design projects. The PIC tax deduction can be converted to cash (at 30%) with maximum cash pay-out of $30,000.

Recommendation

The PIC cash pay-out is a good scheme for SMEs as it returns cash back to them for undertaking productivity improvements. As more SMEs are in need of cash at this time, it is proposed that the maximum cash pay-out quantum be increased to $60,000. We should also introduce an element in the PIC to allow smaller SMEs to benefit more from this cash pay-out. The tax deduction cash conversion rate for smaller SMEs (using revenue and manpower employed as proxies) should be increased beyond 30%. We also propose that the cash pay-out option be extended from YA2013 to YA2015.

More flexibility for SMEs to use the PIC Scheme for leasing of Automation Equipment

16. Many SMEs e.g. those in the precision engineering industries lease their equipment through hire-purchase. As these equipment are expensive, lease period is normally beyond one year. The current rule for the PIC cash conversion option for expenditure on Automation Equipment does not allow leasing cost to be converted to cash if the installment period is

more than a year. This rule therefore limits the usefulness of the cash-conversion benefits for many SMEs who have leases of their automation equipment beyond a year.

Recommendation

We propose that the cash conversion option be given to companies who lease their Automation Equipment over more than one accounting period.

17. The activities that qualify for PIC benefits are more relevant for companies in the goods producing industries. As the service sectors will be important for Singapore's future economic growth, **the PIC qualifying activities should be reviewed to be more relevant to companies from these sectors.** As many SMEs provide supporting services to MNCs and do not own their IP, the activities and qualifying criteria for the PIC should also be broaden to benefit these SMEs.

Recommendation

Currently, 400% tax deduction/allowances are allowed on up to $400,000 expenditure per year in each of the 6 qualifying activities. **We suggest that companies be given the flexibility to double the expenditure cap for any of the 6 activities so long as the overall expenditure cap for all 6 activities is not exceeded.** With this, a manufacturing company will be able to claim more for productivity related equipment expenses whilst a service company with less equipment can claim more for productivity related training of its employees. **We suggest that the qualifying activities under PIC be expanded to include projects that help to improve the productivity of a company's operations e.g. operating processes.** The tax deductions allowed for such expenditure incurred should be the same as for existing research and development qualifying activities, subject to the expenditure cap and conditions imposed. Another proposal is to **broaden the qualifying in-house training expenditure to include internal training that need not be certified by Workforce Skills Qualification.** Presently, many internal training programmes to upgrade the knowledge, skills and productivity of employees are not accredited or approved. The government should include such training programmes under PIC if companies can furnish the objective and syllabus covered to demonstrate the productivity element in the programmes.

Manpower Assistance Schemes

18. The Government has introduced laws to mandate re-employment of older workers. There are discussions that CPF contribution rates for older workers may also be adjusted upwards.

Recommendation

To assist SMEs and to encourage them to reemploy or hire older Singaporean workers, Government can re-introduce a more focused Job Credit Scheme to provide grant support for companies who reemploy or hire older Singaporean workers.

19. Current foreign worker quota, set by broad industrial sectors, is a blunt instrument that does not take into the account the unique challenges faced by companies within the particular sector. With recent changes in S-Pass criteria, some companies have lost experienced technical specialists which disqualified them from retaining their S-Passes. This is a loss of valuable resources to the companies and the industry.

Recommendation

Government should consider refining the foreign worker quota by introducing a productivity training quota which is linked to efforts by companies who invest in building the long-term capability of their staff. The government should also consider the experience of the employee when deciding to renew the work permits or S-Pass.

The experience could be validated by third-parties including industry associations who would have relevant perspective of the companies' needs.

FINANCIAL & CASH MANAGEMENT

Tight cash flow and difficulty in getting bank loans

20. Smaller SMEs have continued to face difficult challenges to improve their cash flow. In the SME Development Survey 2011, 62% of SMEs experienced cash flow problems while 34% had difficulty in obtaining bank loans. Especially for start-up and SMEs in services sectors which do not have hard assets as collaterals, securing bank financing to build internal competences is still a challenge. Due to their low turnover or profitability, many smaller SMEs require more financial assistance through government incentives or grants.

Financing Issues	2011	2010
Experiencing cash flow problems	***62%***	63%
Difficulties in obtaining bank financing	34%	37%
Lack of funds to build internal competencies	***21%***	***18%***
Do not meet criteria for Government Schemes	17%	18%

Source: SME Development Survey 2011 by DP Information Group

Special Risks Sharing Initiatives (SRI)

21. The major risks to the global economy, particularly a worsened European sovereign debt crisis could affect Asia if European financial institutions pull back their lending.

Recommendation

In preparation that there may be a repeat of the 2008 financial crisis, business community request that **SRI and enhancements to existing loan schemes which were launched in 2009 be readied to ensure that viable companies will continue to obtain affordable credit access to sustain their operations and keep jobs.**

Bridging Loan Programme (BLP)

22. This SPRING-administered programme focuses on the needs of locally-owned or foreign SMEs by providing working capital of up to S$5 million offered through 16 participating financial institutions. Though the current adoption rate is lower compared to financial crisis period, there are still SMEs who are accessing these loans. Since the withdrawal of BLP in February 2011, many SMEs found it hard to obtain capital.

Recommendation

To equip SMEs with ready cash, we are proposing the BLP to be reinstated. Also, loan conditions of BLP should be enhanced to address concerns of startups and SMEs from the services sectors.

INTERNATIONALISATION & MARKET ACCESS

Challenges in Internationalisation

23. DP Information's SME Development Survey 2011 highlights that more SMEs appear to be focusing on the domestic market as the proportion of companies with revenue generated from overseas has dropped to 44% in 2011 from 68% in 2009. Amongst those with overseas operations, there is a reduction in the share of their overseas revenue. Whilst

the uncertain global situation may have contributed to this trend, this is not a good development as internationalization is critical to SMEs' growth. Our domestic market is small and saturated. SMEs should diversify to other growth markets. However, internationalization is not easy for SMEs particularly for the smaller ones. IE Singapore is now focused on helping the larger SMEs to be globally competitive but there remains a large group of SMEs who will benefit from further assistance. For instance, Government could provide support schemes for SMEs who pool their resources together to go abroad and compete. IE Singapore and SPRING can play an important role in this area. Overseas financing is one issue compounded after government loan schemes, Internationalization Financing Scheme and Loan Insurance Plus Scheme which helped firms access financing during the last financial crisis were scaled back from $50m to $15m and $15m to $5m respectively as the economy rebounded in 2010. Although several government agencies e.g. IE Singapore disburse grants for overseas expansion, many do not benefit SMEs due to certain prerequisites or find the application process cumbersome or time-consuming. Here are the proposed measures to help SMEs:

Export-Import banks (EXIM)

24. Entering new markets requires substantial funding which are not easy for SMEs who do not have established track record. In March 2011, MOF announced that EXIM banks will not be introduced due to insufficient economy of scale and that such an institution would crowd out financial institutions from the market space they are serving.

Recommendation

But in view of the economic slowdown, there is a need to reconsider the benefits that an EXIM bank can bring to propel SMEs into the international market. These would be especially needful for companies that need ready financing for infrastructure project financing (build-design-operate (BDO) projects especially in the environmental, water and process industries).

International Marketing Activities Programme (iMAP)

25. Introduced in April 2002, the iMAP grants under IE Singapore provide support for companies to access business opportunities when they participate in Trade Associations and Chambers (TAC) led activities. It supports up to 70% of eligible core expenses e.g. rental of exhibition space, booth construction cost and fair/mission consultancy expenses. The fact that iMAP no longer covers airfare and lodging has deterred many SMEs from participating in many international trade fairs and business missions.

Recommendation

We propose to increase the overall budget for iMAP programme to support the internationalisation efforts of SMEs. In addition, the quantum of support for iMAP should be increased beyond 70% for SMEs that are new to overseas markets and the covered markets and sectors could be more inclusive. Specifically we recommend that incentives for airfare and lodging be reinstated to iMAP.

Overseas Marketing Office (OMO)

26. To increase international sales, having a physical presence in overseas markets is crucial in generating leads and understanding the local business culture. However, setting up a physical presence in overseas markets involves huge cash outlay and risk.

Recommendation

We propose Government to provide cash incentive, rather than through Double Tax Deduction, to help SMEs establish their overseas presence in new markets for a period of 2 years.

Research and development (R&D)

R&D and IP Management important for SMEs' growth

27. Programs that encourage innovation in the private and public sectors such as the EDB's RISC grant and the PMO's TEC grant were very helpful to defray costs and mitigate risks for the SMEs. From our experience, it was due to these risk sharing programs in the past (wherein the government took a very high percentage of risk when it deemed the project worthy) that resulted in new sustainable businesses, creating dozens of new jobs and generating substantial growth for companies.

Recommendation

Government should consider providing more accessible and higher benefits, grants and subsidies for companies willing to embark on R&D activities that are assessed to be of high commercial viability in Singapore.

28. As most of our SMEs are engaging in trading or system integration activities without IP ownership, there is a need to engage in R&D to improve the value-added activities by generating more IP. R&D is a capital-intensive activity that is beyond the reach of most SMEs.

Recommendation

Current government grants allow R&D to be conducted in Singapore only. Given current land and manpower constraints in Singapore, some of the R&D activities are customized for targeted overseas markets (e.g. Tianjin Eco-city or Guangzhou Knowledge City). We are proposing for a **special grant for SMEs to conduct research into new industries, test-bed new products or marketing activities. This should also allow overseas R&D outsourcing or test-bedding expenditures.**

Intellectual property (IP)

29. For Singapore companies to be globally competitive, generating Singapore-owned IP or engage in service innovation is important. True competitive advantage lies in strategic IP management, which allow companies to effectively own and capitalise on the methods/features that make their products, services or operational processes unique.

Recommendation

IP management would help SMEs extract their core competence and effectively protect them when expanding overseas. While IPOS does provide incentivised IP management and road-mapping, however the costs of patent registration scale extensively to S$500,000 depending on the markets protected. There is also yearly maintenance cost for the patent registered. High costs have deterred many SMEs from lodging patents. We therefore **propose a one-off grant / incentive to help SMEs safeguard their patents to insure their future survival or overseas expansion. In addition, MTI agency can play a role as Singapore's IP Bank together with the private sector. SMEs can lodge their IP with this agency. If these have merit, it can help file the patent rights and maintain them. When the SMEs have grown up and have enough cash, they can "buy back" the IP from this agency.**

Funds for crisis management

30. There has been increasing business risks and uncertainties in recent years across various markets ranging from earthquake, tsunami (Japan), political unrest (Middle East), floods (Thailand), flu epidemic (China), etc. In 2011, some of our SMEs with operations in Japan and Thailand were affected by the tsunami and flooding.

Recommendation
For these companies, insurance is not enough to offset losses incurred from such disasters. As their operations are adversely impacted with loss of production capacity, they faced a loss of customers and the inability to deliver on hand contracts. It takes significant effort and financial resources to recover promptly without losing goodwill. As such, we are proposing Government consider **some financial assistance for these SMEs whose overseas operations are affected by unforeseen circumstances e.g. epidemics, natural disasters and political instability.**

CONCLUSION

31. This paper has highlighted some challenges faced by our SMEs. We hope that some proposed measures to tackle these challenges will be included in Budget 2012:

I. Cost of Doing Business

1. Introduce a SME Cash Pay-out Scheme of up to $10,000 per year, skewed to help the smaller SMEs (using revenue and manpower employed as proxies) for the next 5 years.
2. Extend the Corporate Income Tax Rebate for another year.
3. Provide a one-off grant to increase the competitiveness of SMEs by helping them strategise and plan for their relocation to lower-cost countries while maintaining linkages to Singapore.
4. Reinstate JTC's former developmental role of providing ready and affordable industrial facilities for SMEs.

II. Manpower and Productivity

5. PIC
   a. Increase the maximum cash pay-out from $30,000 to $60,000.
   b. Allow smaller SMEs to benefit more from the cash pay-out by increasing the tax deduction cash conversion rate for smaller SMEs to beyond 30%.
   c. Extend the cash pay-out option from YA2013 to YA2015.
   d. Allow cash conversion option for companies who lease their Automation Equipment over more than one accounting period.
   e. Review PIC qualifying activities to benefit service companies who undertake productivity improvements.
   f. Double the expenditure cap for any qualifying activity so long as the overall PIC expenditure cap for all 6 current qualified activities is not exceeded.
   g. Expand PIC qualifying activities to include projects that help to improve the productivity of a company's operations e.g. operating processes.
   h. Qualify in-house training expenditure without Workforce Skills Qualification certification.
6. Re-introduce a more focused Job Credit Scheme to provide grant support for companies who reemploy or hire older Singaporean workers.
7. Introduce a productivity training quota which is linked to efforts by companies who invest in building the long-term capability of their staff.
8. Consider the experience of the employee when deciding to renew the work permits or S-Pass.

III. Financial and Cash Management

9. Prepare to reinstate Special Risks Sharing Financing Schemes if the economic situation deteriorates further to ensure that SMEs are able to access affordable financing.

10. Reinstate Bridging Loan Programme and enhance its loan conditions to address needs of startups and services sectors.

IV. Internationalization and Market Access

11. Reassess feasibility of EXIM bank for cross border trades, international project and infrastructure financing.
12. Enhance iMAP grants to incentivise more SMEs to access overseas markets.
13. Provide cash incentive to help SMEs establish their overseas presence in new markets for a period of 2 years.
14. Provide more accessible and higher benefits, grants and subsidies for companies willing to embark on R&D activities that are assessed to be of high commercial viability in Singapore.
15. Provide a one-off grant/incentive to help SMEs safeguard their patents to insure their future survival or overseas expansion.
16. MTI agency in cooperation with private sector to function as Singapore's IP Bank taking "IP Deposits" from SMEs with subsequent buy-back provisions.
17. Provide financial assistance for SMEs whose overseas operations are affected by unforeseen circumstances e.g. epidemics, natural disasters and political instability.