



ASIA-PACIFIC TRADE FACILITATION FORUM 2013
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“Trade Finance : SMEs Emerging Needs ”
Is there a Need for Financial Innovations and Systemic Change?

BY

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Is there a Need for Financial Innovations and Systemic Change ?

Trade finance is the lifeline of trade because more than 90% of trade transactions involve some form of credit, insurance or guarantee. However, SMEs often have limited access to trade finance, making it difficult for them to engage in international trade or to participate in international supply chains

*(Source: International Trade Centre (2009), How to Access Trade Finance:
A guide for exporting SMEs.)*

“ This session will bring together selected experts and practitioners to discuss how to facilitate trade financing for SMEs in Asia-Pacific developing countries, both through banks as well as through more innovative arrangements” : APTFF 2013.



SMEs Trade Finance : Prevailing System & Modalities In Asia & The Pacific

- ❑ Trade Finance is short-term & transaction-based financing system
- ❑ Need not be Debt-Equity based transaction
- ❑ Covers both domestic and international trade, including exports
- ❑ Contributes to payments, financing, risk mitigation & collection of information
- ❑ Trade Finance comes in two stages: (a) Pre-shipment & (b) Post-shipment
- ❑ Trade finance instruments are: Letters of Credit (L/Cs); Import bills for collection; Import financing, Shipping guarantee, L/C confirmation; Documents' negotiation; Pre-shipment export financing; Invoice financing; Receivables purchase, etc.
- ❑ It also includes export credit guarantees or insurance.
- ❑ More than 90% of trade transactions involve trade finance including guarantees or insurance coverage.
- ❑ Four common payment methods in international trade are:
cash-in-advance, letters of credit , documentary collection and open account.

Whether SMEs and Banks See Eye to Eye ?

How SMEs as Borrowers Perceive Banks

- Banks are not confident & consider SMEs vulnerable to fluctuations, SME financing is taken more as a social cause / obligation rather than viable business
- Banks unsympathetic to start-ups and unhelpful when SMEs are in distress
- Credit extended always falls short of genuine demand
- Complex procedure, high credit cost, delayed disbursements
- Very unreasonable and high collaterals demand (100-200%), trade finance instruments are not innovative and relevant to market, many activities and services are not accepted for trade finance assistance

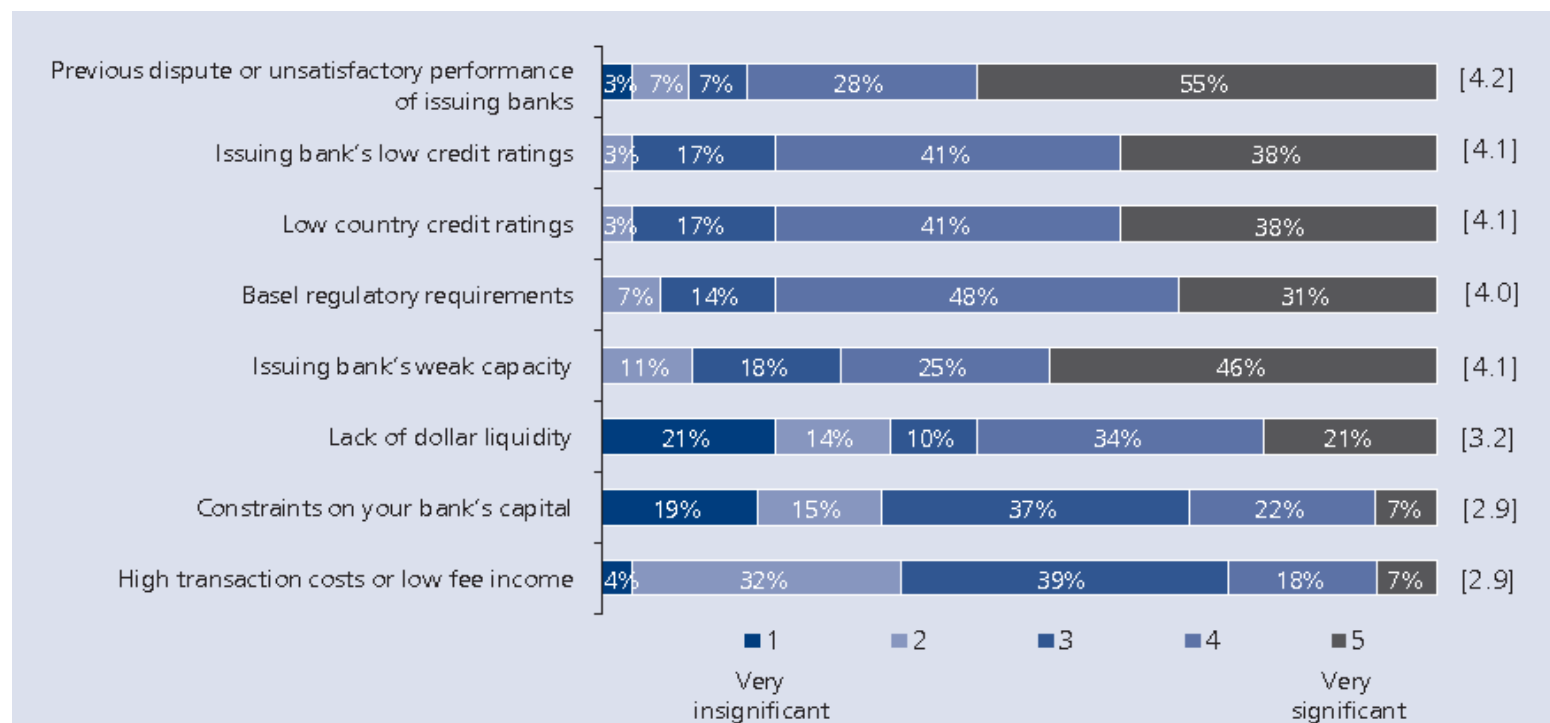
How Banks as Lenders Perceive SMEs

- SMEs as a sector not bankable, generally due to unviable business plans
- SMEs borrow short and invest long, , possessive and secretive of giving reliable information, averse to change, lack technical feasibility and economic viability
- Highly vulnerable to market fluctuations especially in international trade due to low capital base and high defaults
- Can offer only limited collaterals
- Globally not competitive, enter global markets without adequate export preparedness and skills

Relevance of the Prevailing System & the Instruments

Obstacles aggravating the Trade Finance gap for International Banks

Source: Asian Development Bank Trade Finance Survey, March 2013



Value of Trade Finance Proposed & Rejected Globally and in Asian Developing Economies

REGION	Total in \$ Billion
<i>Global</i>	
Value of proposed trade finance	4,598.08
Value of trade finance rejected	1,643.76
<i>Asian Developing Economies</i>	
Value of proposed trade finance	2,076.01
Value of trade finance rejected	424.72
<i>[Source: Asian Development Bank Trade Finance Survey, March 2013]</i>	

Trade Finance : Unmet Demand and the Gap :

Asian Development Bank Trade Finance Survey, March 2013- 147banks and 500 companies surveyed

- ❖ A gap in trade finance lending and guarantees globally is \$ 1.6 trillion in trade, \$425 billion of which is in developing Asia
- ❖ An increase of 5% of availability in trade finance could result in an increase of 2% in exports, 2% in production and 2% more jobs
- ❖ Obstacles aggravating Trade Finance Gaps:
 - =Unsatisfactory performance of banks issuing trade finance (83% of banks surveyed)
 - =Issuing banks' low credit ratings, low country ratings, Basel regulatory requirements (79%)
 - =Basel III if implemented, in full : banks indicated reduction in trade finance support by about 13%

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A recent World Bank study (*Beck, Demiguc-Kunt, and Peria -2008*) **however** shows that banks overwhelmingly consider the SME segment as a big market with great prospects and high profitability.

A Need for Systemic Change and Financial Innovations

The Trade Finance banking model is severely constrained on a global level with greater selectivity in risk-taking in many emerging markets. New regulations are making access to finance more difficult for SMEs

“The future of trade finance may look quite different in coming years: Regulations will become more complex, reducing the capacity of financial institutions to provide lending. A two-speed economic and financial system may also emerge, with developed markets in slow gear and developing markets in higher gear. Finally, new SME entrants are being starved of trade finance in many countries due to the prevailing trade finance gap,” **National Enterprise Development Authority** July 2013. World Trade Organization Annual Aid-for-Trade Review

Traditional Trade Finance system is not able to meet the changing needs of SMEs to compete in the global market and hence needs systemic reform / change.

A Need for Systemic Change and Relevant Financial Innovations

The concept of Trade Finance should be re-visited and redefined to include Market Development in its comprehensive sense

SMEs future depends on being competitive in the global market. Market development has become an integral part of international trade system. The present definition and modalities of Trade Finance does not recognize market development for any assistance.

Trade Finance should have three phases: (i) Market Development (ii) Pre-shipment , and (iii) Post-shipment

Service sector needs to be served better and in greater measures. More assistance needed for Factoring, Supply chain, Export backed loans, Warehouse receipts (bonded ware house receipts) assistance, etc.

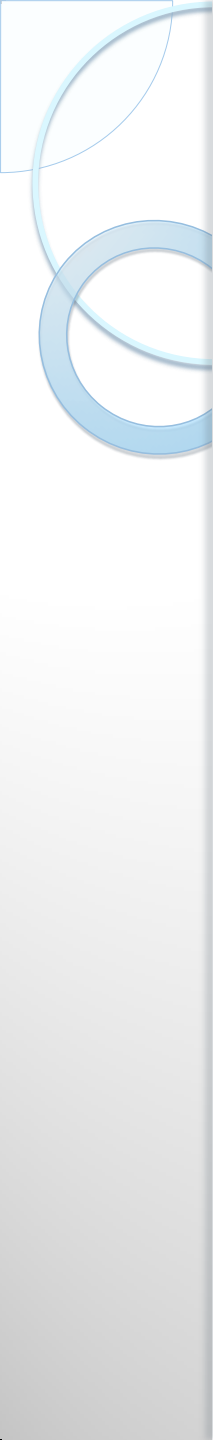
A Need for Systemic Change and Relevant Financial Innovations

Risk Mitigation is the major factor which dominates banks' decisions. The Risk averse banks' mind-set has to change

The concept of collaterals to secure SME loans / Trade Finance is a myth and needs to be demystified. Collaterals alone do not guarantee loans recovery

Collateral -free and Third Party Guarantee free Credit Guarantee Scheme needs to be encouraged and introduced
(SIDBI Scheme in India is a successful example)

An Asia-Pacific Trade Finance Fund should be set up by ADB with the involvements of banking and financial sector of member countries.
This will make Trade Finance System more relevant and the access easier



THANK YOU