Second Meeting of the GMS Task Force on Trade and Investment (TFTI)

Workshop on Digital Supply Chain

TSCFP
TRADE & SUPPLY CHAIN FINANCE PROGRAM

April 2023, Manila, Philippines

Session 3. Business Climate

1. The “Trade Finance Gap” – unmet demand for trade financing – will exceed US $2 trillion annually and demands attention to derive greater economic and development impact from trade
2. Much of the gap is linked to developing Asia, including the GMS; business climate factors like the rise of ESG and sustainability can either worsen the gap or help address it through capital infusion
3. Innovations like Deep Tier Supply Chain Finance can make a significant contribution to driving liquidity where it is most needed

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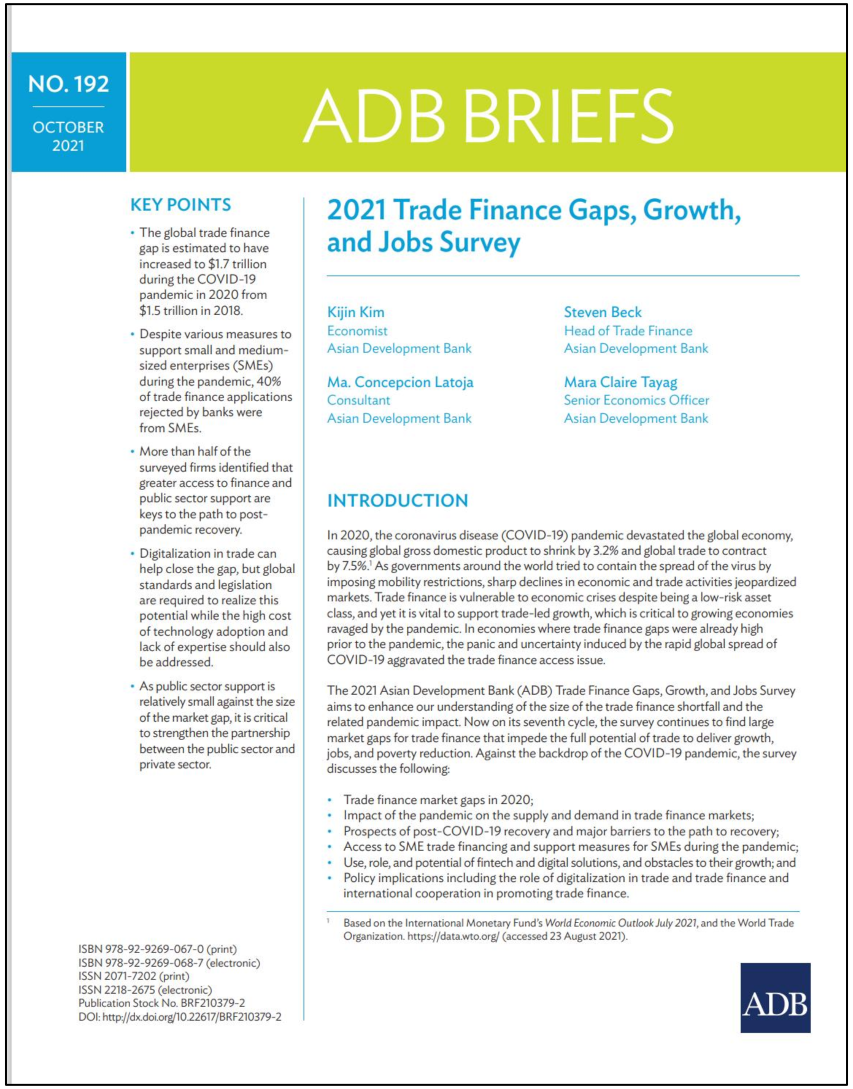

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ADB BRIEFS

KEY POINTS

- The global trade finance gap is estimated to have increased to $1.7 trillion during the COVID-19 pandemic in 2020 from $1.5 trillion in 2018.
- Despite various measures to support small and medium-sized enterprises (SMEs) during the pandemic, 40% of trade finance applications rejected by banks were from SMEs.
- More than half of the surveyed firms identified that greater access to finance and public sector support are keys to the path to post-pandemic recovery.
- Digitalization in trade can help close the gap, but global standards and legislation are required to realize this potential while the high cost of technology adoption and lack of expertise should also be addressed.
- As public sector support is relatively small against the size of the market gap, it is critical to strengthen the partnership between the public sector and private sector.

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2021 Trade Finance Gaps, Growth, and Jobs Survey

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INTRODUCTION

In 2020, the coronavirus disease (COVID-19) pandemic devastated the global economy, causing global gross domestic product to shrink by 3.2% and global trade to contract by 7.5%.[1] As governments around the world tried to contain the spread of the virus by imposing mobility restrictions, sharp declines in economic and trade activities jeopardized markets. Trade finance is vulnerable to economic crises despite being a low-risk asset class, and yet it is vital to support trade-led growth, which is critical to growing economies ravaged by the pandemic. In economies where trade finance gaps were already high prior to the pandemic, the panic and uncertainty induced by the rapid global spread of COVID-19 aggravated the trade finance access issue.

The 2021 Asian Development Bank (ADB) Trade Finance Gaps, Growth, and Jobs Survey aims to enhance our understanding of the size of the trade finance shortfall and the related pandemic impact. Now on its seventh cycle, the survey continues to find large market gaps for trade finance that impede the full potential of trade to deliver growth, jobs, and poverty reduction. Against the backdrop of the COVID-19 pandemic, the survey discusses the following:

- Trade finance market gaps in 2020;
- Impact of the pandemic on the supply and demand in trade finance markets;
- Prospects of post-COVID-19 recovery and major barriers to the path to recovery;
- Access to SME trade financing and support measures for SMEs during the pandemic;
- Use, role, and potential of fintech and digital solutions, and obstacles to their growth; and
- Policy implications including the role of digitalization in trade and trade finance and international cooperation in promoting trade finance.

[1] Based on the International Monetary Fund's *World Economic Outlook July 2021*, and the World Trade Organization. https://data.wto.org/ (accessed 23 August 2021).

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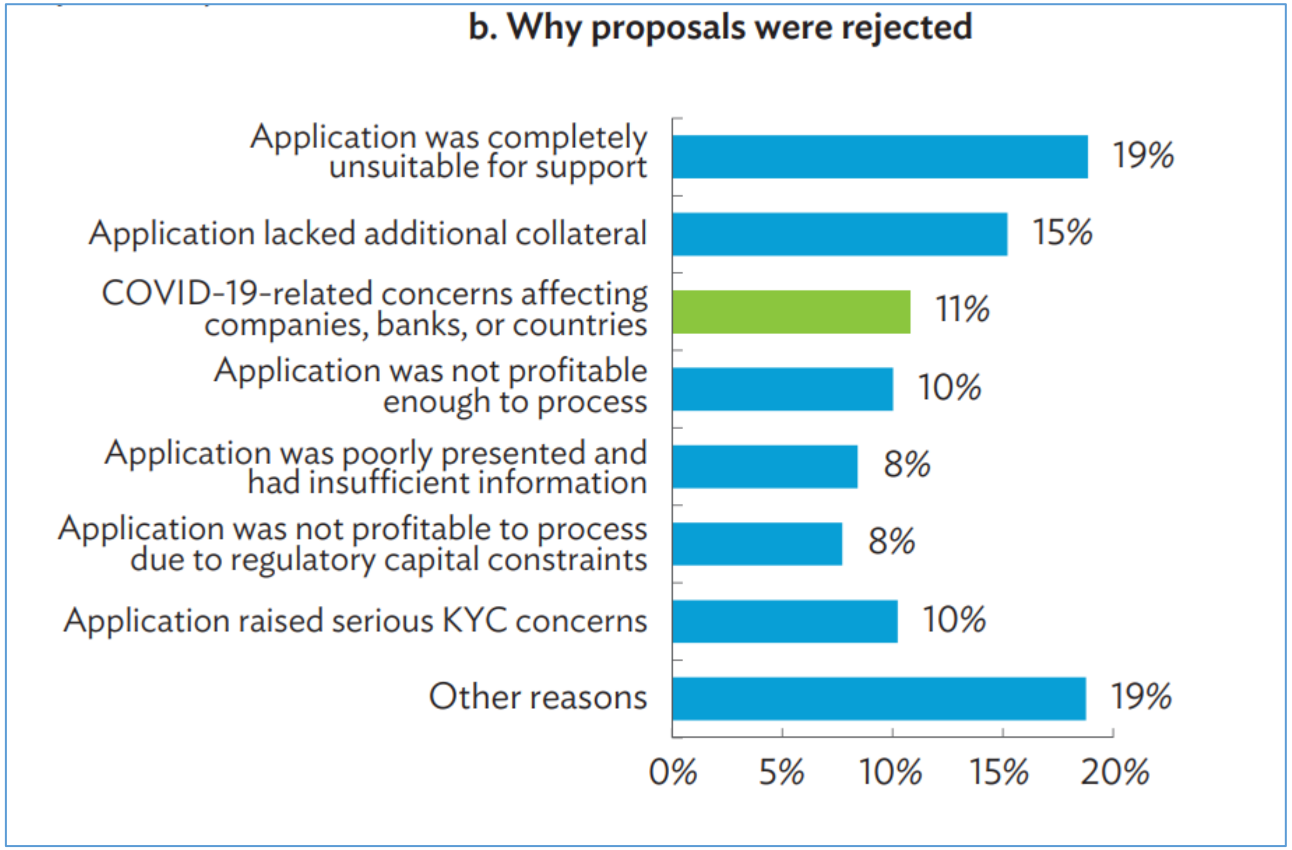


The ***ADB "Gaps Growth and Jobs Survey"*** was the first survey and resulting publication to ***identify the existence of high unmet demand for trade financing*** globally. This unmet demand or **"*Trade Finance Gap*"** has been at or **above US $1.5 trillion annually** since the inception of the survey and will exceed **US $2 trillion soon**.

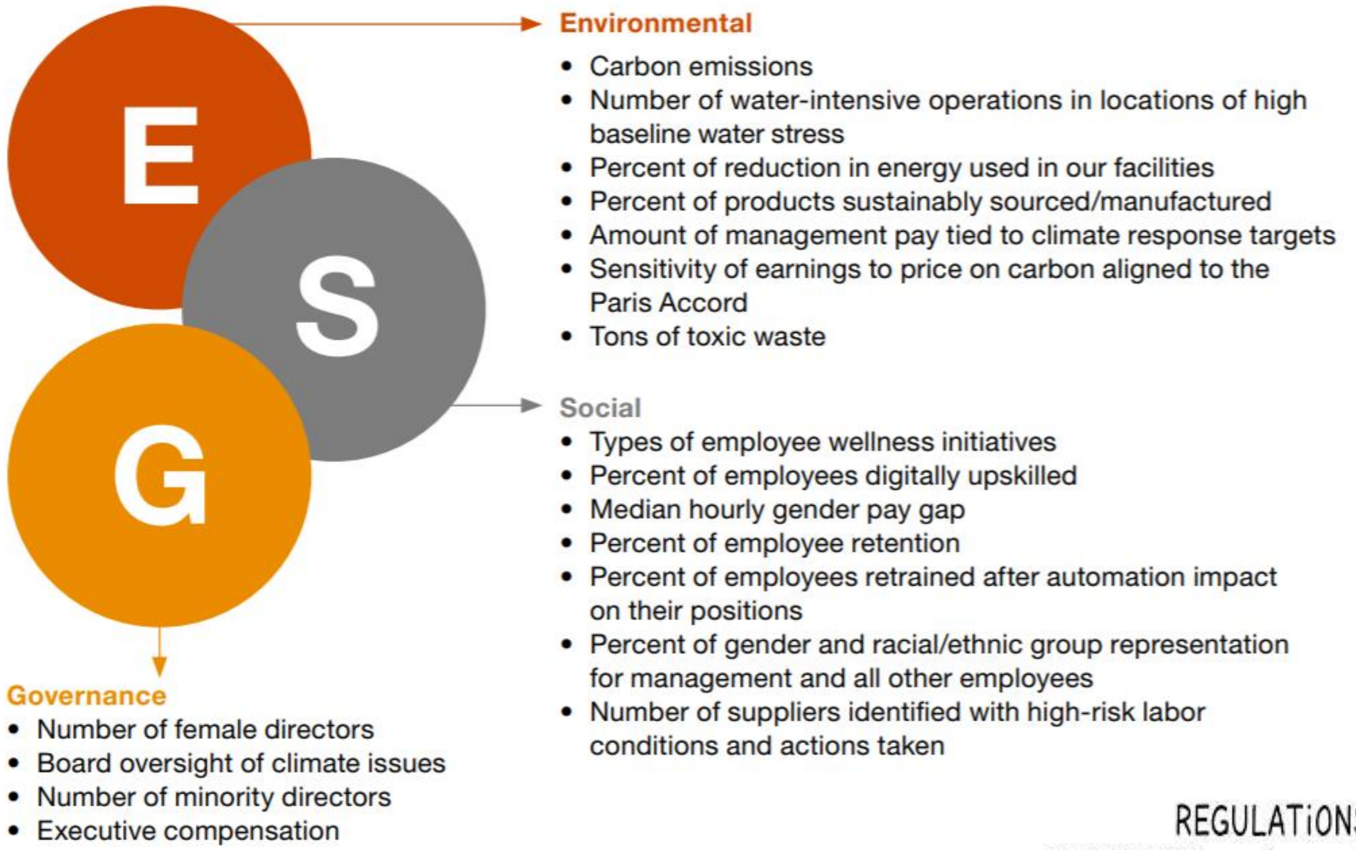
While there are "supply side" challenges around the provision of trade financing, including limits on (country/bank/counterparty) ***risk appetite***, ***capital cost*** and allocation constraints and others, are also "demand side" issues, including ***poor quality credit proposals***, lack of adequate ***collateral*** among SME clients and a range of other obstacles.

In some instances (collateral requirements), the challenge can involve issues (and solutions) on both the provider/supply side and the client/demand side.

Where SMEs are concerned, it must be acknowledged that the ***cost of servicing SMEs***, right from the due diligence and onboarding phase, ***is prohibitive*** for major commercial banks.

Narrowing the Gap

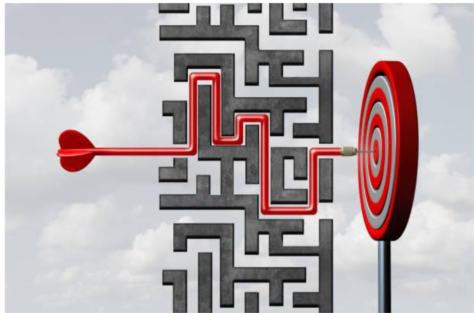
- ✓ Provision by Export Credit Agencies (ECAs) and International Financial Institutions (IFIs)
- ✓ Targeting ESG and Sustainability requirements and alignment
- ✓ Attracting new, non-bank providers and capital to support the financing of international trade
- ✓ Increasing efficiency and reducing friction and cost related to AML/CFT and other Financial Crimes Compliance
- ✓ Rethinking SME credit adjudication and collateral requirements
- ✓ Developing SME-targeted trade financing solutions
- ✓ Providing training, "technical assistance" and other forms of support
- ✓ Crafting policy to facilitate/motivate/educate around the provision and uptake of trade finance solutions and products
- ✓ Deep Tier Supply Chain Finance



[Making sense of ESG (pwc.com)](pwc.com)

The sustainability and ESG agendas are complex, evolving fast and can either exacerbate the Trade Finance Gap, or can be the basis for a solution that involves attracting non-bank capital to the financing of sustainable trade flows

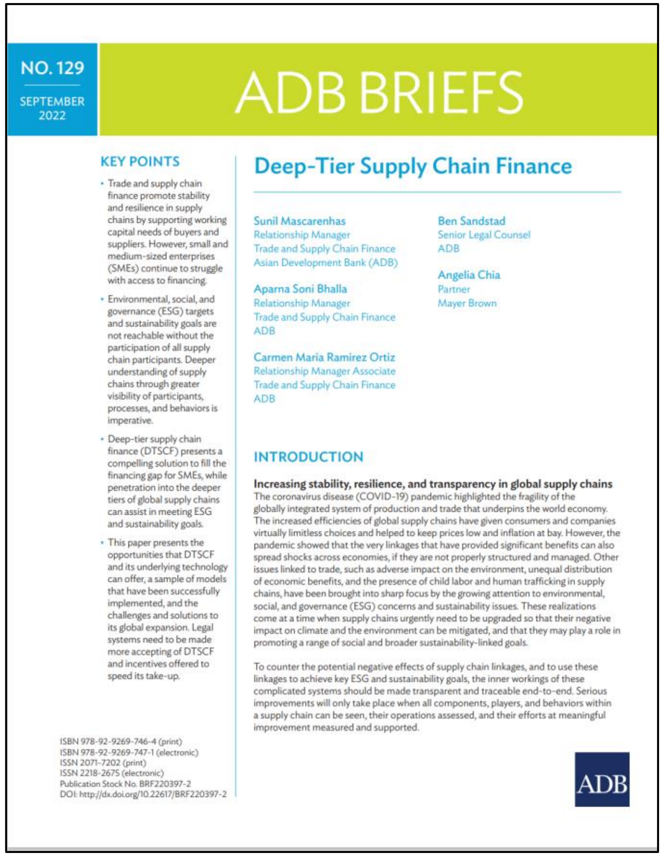
- ESG and sustainability are increasingly important, but, for the moment, moving targets
- Recent momentum from consumer and investor decisions and priorities
- Regulatory authorities arguably "catching up" and will start to increasingly shape the evolution of sustainable activity



https://resources.ecovadis.com/whitepapers/carbon-maturity-report-the-state-of-climate-action-in-global-supply-chains

Buyers with extended, complex global supply chains are increasingly required and expected to be accountable for the ESG and sustainability-related behaviours, processes and practices of their suppliers around the globe?

From a trade and trade financing perspective, this emerging reality poses significant additional complexity and risk, but may present an opportunity to bring new capital into the financing of trade



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ADB BRIEFS

Deep-Tier Supply Chain Finance

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KEY POINTS

- Trade and supply chain finance promote stability and resilience in supply chains by supporting working capital needs of buyers and suppliers. However, small and medium-sized enterprises (SMEs) continue to struggle with access to financing.
- Environmental, social, and governance (ESG) targets and sustainability goals are not reachable without the participation of all supply chain participants. Deeper understanding of supply chains through greater visibility of participants, processes, and behaviors is imperative.
- Deep-tier supply chain finance (DTSCF) presents a compelling solution to fill the financing gap for SMEs, while penetration into the deeper tiers of global supply chains can assist in meeting ESG and sustainability goals.
- This paper presents the opportunities that DTSCF and its underlying technology can offer, a sample of models that have been successfully implemented, and the challenges and solutions to its global expansion. Legal systems need to be made more accepting of DTSCF and incentives offered to speed its take-up.

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INTRODUCTION

Increasing stability, resilience, and transparency in global supply chains
The coronavirus disease (COVID-19) pandemic highlighted the fragility of the globally integrated system of production and trade that underpins the world economy. The increased efficiencies of global supply chains have given consumers and companies virtually limitless choices and helped to keep prices low and inflation at bay. However, the pandemic showed that the very linkages that have provided significant benefits can also spread shocks across economies, if they are not properly structured and managed. Other issues linked to trade, such as adverse impact on the environment, unequal distribution of economic benefits, and the presence of child labor and human trafficking in supply chains, have been brought into sharp focus by the growing attention to environmental, social, and governance (ESG) concerns and sustainability issues. These realizations come at a time when supply chains urgently need to be upgraded so that their negative impact on climate and the environment can be mitigated, and that they may play a role in promoting a range of social and broader sustainability-linked goals.

To counter the potential negative effects of supply chain linkages, and to use these linkages to achieve key ESG and sustainability goals, the inner workings of these complicated systems should be made transparent and traceable end-to-end. Serious improvements will only take place when all components, players, and behaviors within a supply chain can be seen, their operations assessed, and their efforts at meaningful improvement measured and supported.

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Learn more: scan this QR Code:

- Narrowing (eliminating) the Trade Finance Gap is at the core of TSCFP's mission and mandate
- Through core business activities, financing, guarantee and risk products and solutions
- And through a range of initiatives, advocacy work, and innovation
- Activities extend to the design and deployment of Technical Assistance, Training and Capacity Development

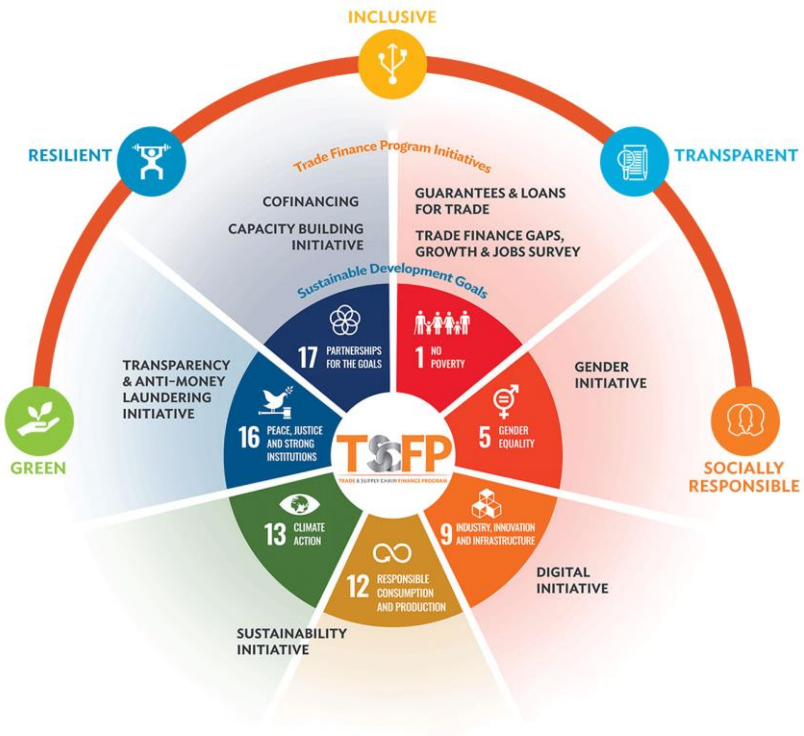
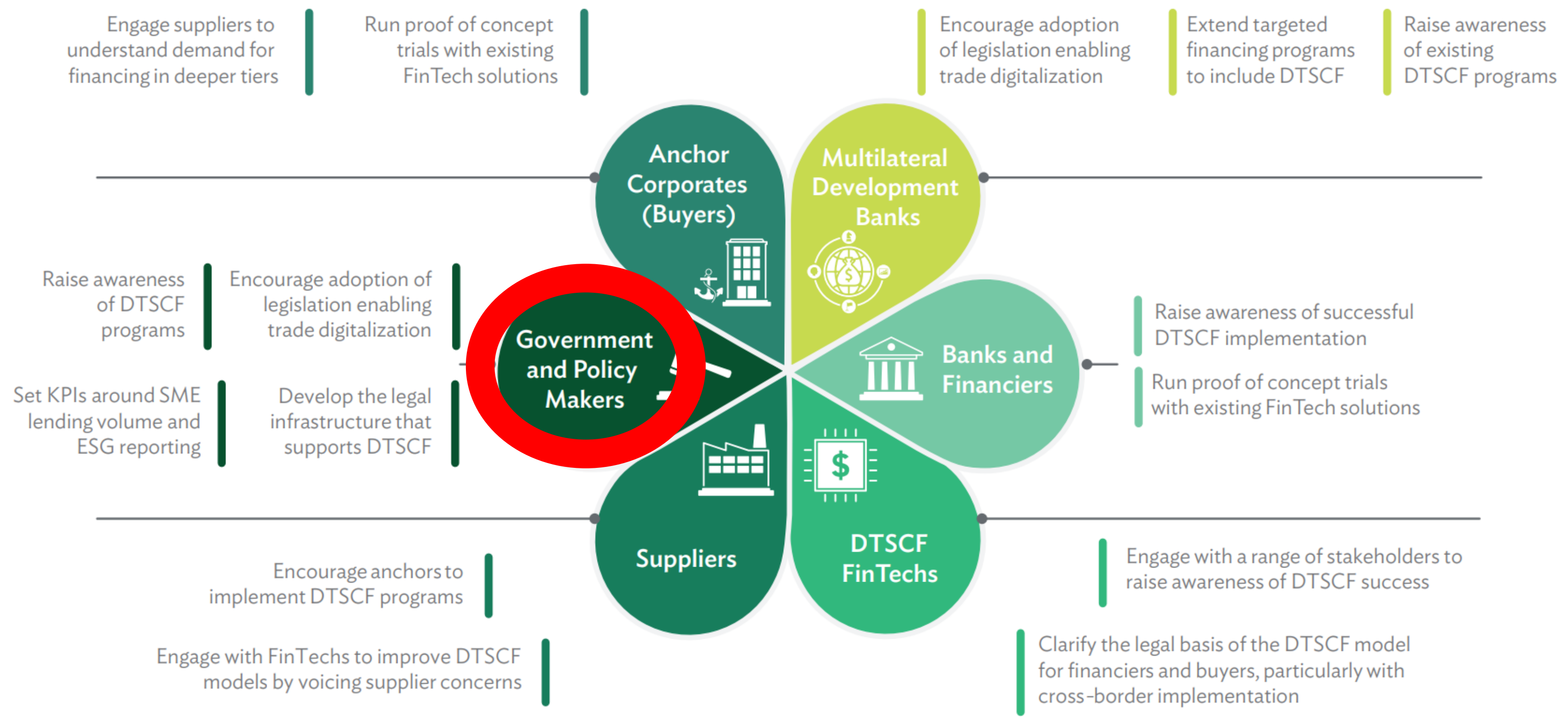


Figure 2: Accelerating the Adoption of Deep-Tier Supply Chain Finance—Action Points for Each Stakeholder



DTSCF = deep-tier supply chain finance; ESG = environmental, social, and governance; FinTech = financial technology; KPI = key performance indicator; SMEs = small and medium-sized enterprises.
Sources: Asian Development Bank; and BCG FinTech Control Tower.

[Deep-Tier Supply Chain Finance (adb.org)]

There are various non-bank variations of solution to reach deeper into global supply chains based on different types of payment undertakings and financial obligations

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3. Innovations like Deep Tier Supply Chain Finance can make a significant contribution to driving liquidity where it is most needed

- Narrowing the Trade Finance Gap is core to TSCFP's mission and mandate in all its dimensions
- The potential economic, development and poverty-reduction impact of addressing the gap is massive, and merits focused, priority attention
- There are policy initiatives that governments can explore, including around the numerous root causes of the gap