Supply Chain Finance: A Value Proposition Evolves

- The realities of the global economy, including trade and investment, are focusing attention on the small business sector and on higher-growth developing and emerging markets.
- For large corporates, there are a growing number of reasons to advocate the small and medium enterprise (SME) sector.
- Political and commercial support are improving SME access to trade finance; the sector also benefits from a renewed interest in emerging markets and commodity trade.
- Banks and trade financiers are assisting corporate clients by devising solutions aimed at providing liquidity to "strategic-supplier" SMEs and to the wider supply chain.

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"Cash is king" – a familiar expression that has been a part of business and finance in any part of the world where commercial ventures are driven by free market or quasi-free market dynamics, across segments from small and medium enterprises (SMEs) to large corporates.

The global financial crisis, and the related constriction of credit facilities and liquidity across the globe, brought certain fundamentals back into sharp focus, such as the importance of cash flow and working capital management. This renewed attention has been particularly timely, given the increasingly strategic role evolving for finance and treasury executives under current conditions.

Whether in the context of small businesses, or larger corporate enterprises, the role of the finance and treasury function has necessarily become more central to the effective management of an enterprise, given the relative scarcity of financial resources, and the additional disciplines of regulation and reporting imposed on finance executives – either directly, or indirectly as business executives work with their bankers and financiers to respond to increasingly stringent demands for transparency, to which banks and other financial institutions have been, quite rightly, required to respond.

Reasons to Advocate Small Business

The textbook concern about crises, and the adverse impact upon small businesses and developing/emerging economies, appears to have played out exactly as most commentators had predicted: constricted credit and crisis-driven selectiveness related to client relationships and core markets, resulting in a magnified crisis among SMEs, and even more among SMEs based in developing or higher-risk markets.

There is, however, room for optimism for advocates of small business, and for those who support the notion that trade is important to international development and the evolution of developing/emerging economies.

We perceive several reasons for optimism, which, taken together, suggest that the crisis may generate long-term and sustainable benefits for SMEs and developing economies, despite the short-term pain. The following observations support this sentiment:

- The crisis has facilitated a change in market dynamics, likely to endure for some time, where public sector intervention is not only welcomed, but recognised as invaluable.
- The political rhetoric about the importance of small business to economic growth has intensified, both among national leaders and among heads of international organisations.
- Commodity trade and global sourcing patterns are evolving, involving a complex network of small suppliers across the world, including in isolated corners of the planet.
- International institutions such as the International Finance Corporation (IFC), the International Trade Centre and others have devised a rich set of programmes aimed at supporting small and micro-enterprises in developing economies.
- Banks, having reverted to fundamentals in lending, credit adjudication and risk analysis, have also shown greater interest in the SME segment as a client base.
- Trade finance has evolved into the open account and supply chain finance space.

What does this all mean for an entrepreneur, or a manager or finance executive in an SME, including such enterprises located in developing or emerging markets?

SME Access to Trade Finance

The political and commercial dynamics are aligning to offer some new opportunities for small businesses to access business and trade finance, in a variety of markets including developing and emerging economies.

The cost of trade finance for smaller businesses, in higher-risk economies especially, continues to be higher than for mid-market or corporate customers, yet the combination of factors at play, together with banks' decided desire to regain favour and the now more attractive margins to be earned from SME business, combine to create a set of conditions where business and trade finance ought to be more readily available. Trade finance, in particular, continues to reinforce its position as an asset class with very low loan-loss history, and therefore, one can expect the "bankability" of trade finance to be viewed positively among providers of trade finance – particularly those that know the SME segment, and that are active in developing and emerging economies.

In addition to the contextual factors, the development of integrated programmes around supply chain finance is a critical element that contributes further to the expansion of trade financing options for SMEs and for developing and emerging market based businesses.

As banks have sought to remain engaged in trade finance beyond traditional product offerings and in the context of supply chain activity, solutions have evolved from standalone products – even some long-existing mechanisms simply repackaged as supply chain finance – to sophisticated and comprehensive programmes aimed at supporting complex, geographically disparate global supply chains.

As with traditional trade finance, certain financial institutions have been quicker and more innovative in embracing and devising value-added solutions in global supply chain finance, and those leading institutions have devised programmes of various flavours – some of which look at the supply chain ecosystem on an end-to-end basis, and explicitly seek to devise solutions for smaller suppliers in the supply chain, even as these banks service the large corporate buyer/importer, for example, around which the supplier ecosystem revolves.

Support for Strategic Suppliers

Several events and tragedies over the course of the past year or more, have illustrated the adverse commercial consequences related to the disruption of global supply chains through the inability of suppliers to deliver even minor-seeming components, without which, it turns out, entire product lines cannot be delivered to end-consumers. This notion of a "strategic supplier" is an emerging element of focus on the context of global supply chain finance, and is one concrete illustration of the way in which a small business can better access financing and trade financing, under global supply chain finance programmes.

To be specific, banks and trade financiers have identified an opportunity to assist large corporate clients by devising trade and supply chain finance solutions aimed at providing liquidity to strategic suppliers, and to the extent viable, to the wider supply chain. Accordingly, it may be feasible, and attractive from a financing cost point of view, for small businesses to secure financing on the "strength" of a large buyer: whether that be in terms of financial strength and ability to borrow, or whether that be on the basis of the strength of a banking relationship, which then provides the source of funding.

Other programmes also exist, where large suppliers serve to "anchor" a supply chain finance solution, through which smaller buyers can access funding, including relatively cost-effective trade and supply chain finance.

In addition to the commercial initiatives launched by banks and other financial sector trade finance providers, SMEs have been targeted specifically as a client segment, by boutique firms whose services include significant amounts of advisory and transaction-level support – an area where larger institutions have also decided to better engage as a result of current market dynamics.

Arguments once used to justify under-serving the SME sector are less and less valid today, and while a single small business still rarely exercises meaningful leverage on a financial institution, the segment overall is deemed more attractive – to the point that even global financial institutions profess an interest in devising interesting product and solution offerings for small business clients. This reality can suggest that sector-level championing of SME interests and needs, both with financial sector providers and with public sector authorities, has the potential to be particularly effective.

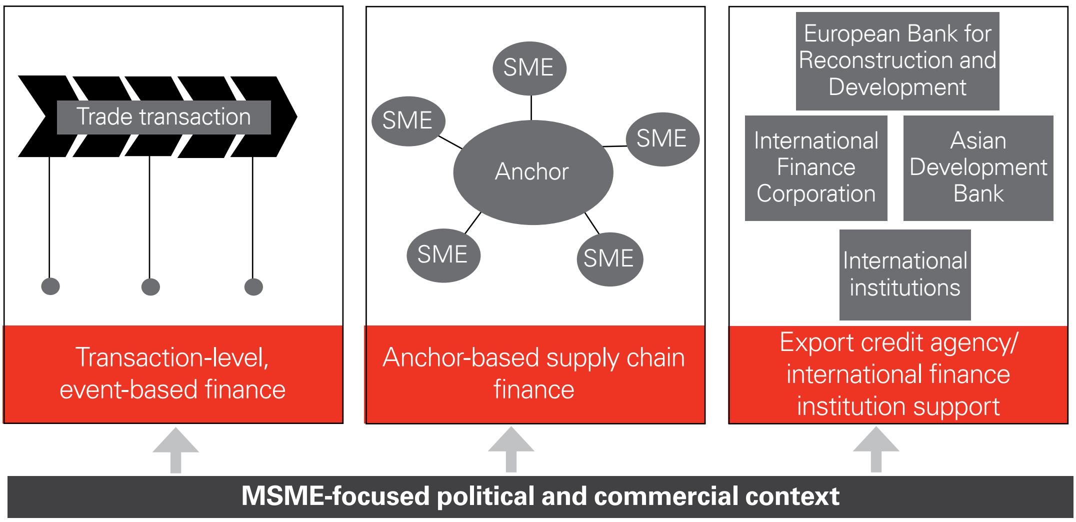
Spotlight on SME Sector, Emerging Markets

Those financial institutions still sufficiently robust to pursue a meaningful international strategy are taking note of the realities of the post-crisis world, with near-default in the US and sovereign risk issues in Europe, contrasting attractive growth rates in China, India, Brazil, coupled with interesting opportunities in Vietnam, Indonesia, parts of Africa and Latin America.

The realities of the global economy and the context of international trade and investment are focusing attention on the small business sector, and on higher-growth developing and emerging markets. At the same time, public policy and the mandates of public sector and international institutions are focusing significantly on the SME sector, and on developing economies.

The IFC, a member of the World Bank Group, as well as the International Trade Centre in Geneva, the Asian Development Bank and others, have either developed or are beginning to devise solutions aimed at enabling micro, small and medium enterprises (MSMEs) in developing economies to access trade and supply chain finance at various stages in a trade transaction.

Figure 1: Focus on Micro, Small and Medium Enterprises (MSMEs)



Source: OPUS Advisory Services International

Despite long-standing empirical and largely industry-driven arguments to the contrary, it is clear (certainly in the crisis and post-crisis reality) that there is in fact a market gap in trade finance: a shortage of timely and fairly priced financing, especially relative to the needs of small businesses and emerging economies. By extension, it has become clear that public sector export credit agencies and international institutions have an important role to play in filling that gap, either providing financing directly, or working in partnership with local and international banks, to facilitate the provision of financing options through various guarantee schemes.

Opportunities Outscore Challenges

Entrepreneurs and financial managers in small businesses will be well served to take a fresh approach to identifying and engaging with potential providers of financing and trade finance. The universe of potential suppliers of trade and supply chain finance to SMEs is now significantly broader than perhaps was the case in a pre-crisis, cash-rich business environment.

Small businesses can quite credibly and legitimately approach large, even global financial institutions, either on a standalone basis (particularly those institutions positioning to serve the SME segment), or in the context of an existing supply chain relationship hinged on a large trading partner, which may be a value bank client. Smaller financial institutions, such as second-tier banks or credit unions may be quite receptive to facilitating dialogue for their SME clients seeking access to the expertise and resources of a regional or global institution.

Concurrently, SMEs ought to take the initiative to become intimately acquainted with the various programmes available through export credit agencies and international agencies such as IFC and others. To the extent that certain banks or other trade finance providers may not be fully versed in the options available through international institutions, a small business manager or entrepreneur seeking opportunities in international markets can usefully take a proactive role in informing their house banks about potentially valuable trade financing options.

Small businesses in developing and emerging markets will continue to face challenges related to the risk profiles (perceived and actual) of the markets in which they are based. They will also, however, benefit from renewed interest in emerging markets trade, commodity trade, and the SME sector as a driver of growth in developing economies, and as enablers of poverty reduction efforts.

Traditional trade finance products and solutions, offered over the lifecycle of a trade transaction such as pre-shipment finance to post-settlement funding, supply chain, anchor-client based financing solutions, export credit agency (ECA)/international finance institution (IFI) provided solutions driven by public policy and development imperatives (as opposed to purely commercial considerations) are all options potentially helpful to, and now available to, SMEs and micro enterprises in the current global business environment.

An educated choice related to effective trade finance solutions, and the selection of a well-matched partner, will be invaluable to the international success of a small business. Trade finance is, once again, a competitive advantage in the business of international trade, and it appears that SMEs – including those based in developing economies – may benefit from a confluence of positive circumstances, particularly if the leaders of these enterprises engage actively in shaping their circumstances in the trade and supply chain finance space.