Walking a tightrope

The global financial crisis took its toll on SMEs who could be better served by the banks, says **Alexander R. Malaket**, president Opus Advisory Services International. However, he adds several factors have come together to provide SME's with an unprecedented range of trade and business financing options, and even some of the larger global banks are getting in on the act.

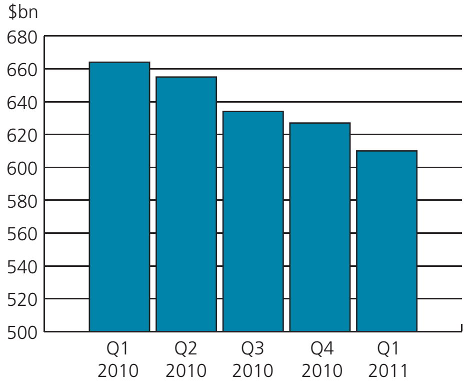
The challenges of establishing, running and sustaining a small business are often written about, frequently discussed, and regularly featured in publications aimed at current or would-be entrepreneurs. In fact, it is difficult for someone who has not attempted such a venture – successfully or otherwise – to appreciate the combination of exhilarating freedom coupled with a heightened awareness of self-reliance and an inescapable sense of 'working without a net'. The circus metaphor is, in many ways, very apt. It should not be surprising then, that there is, almost universally across the globe, a consistent disconnect between small business owners and their bankers. Even the most 'conservative' entrepreneur or small business manager sees the world very differently than the average banker – and rightly so, given that the drivers and objectives of each are quite different.

As the *Wall Street Journal* observed in an article dated 7 February 2011:
"An apparently insoluble conundrum lies at the heart of small-and-medium-sized European companies' attempts to lever themselves out of recession. While SMEs are furious that their growth ambitions are being stymied by their banks' unwillingness to lend, the banks argue that in such deep economic straits, their hands are tied by government pressure to be risk sensitive. SMEs need to find alternative ways to fund growth."

This challenging dynamic can be observed across the Atlantic in the United States, just as it has been consistently identified as an issue in the developing and emerging markets across the globe. Loans to small business (by banks) have been in decline, as noted by the US Small Business Administration (SBA), quoted in *Bloomberg Businessweek*, 10 June 2011:
"Loans outstanding to small businesses continued to decline amid an improving economy. While the rate of decline appeared to slow in the last quarter of 2010, it has turned down slightly in the first quarter of 2011. Remarkably, nominal small business loans outstanding as reported by the Call Reports have declined to levels below those reported in June 2006. Loans by the largest banks, the roughly 35 institutions with at least USD 50 billion in assets, accounted for most of the decline, the SBA reports. Mid-size banks with between USD 10 billion and USD 50 billion in assets increased loans outstanding by 3%, and volumes at smaller lenders remained steady."

The lending gap, or chasm, as some entrepreneurs will likely describe the situation, is not insurmountable, and despite opposing pressures on the banks themselves – the pressure from policymakers to lend to SMEs versus the pressure – very understandable given recent events – to be cautious and relatively risk-averse.

Business loans <$1m outstanding
(Source: Bank call reports, via FFIEC)



Source: Business Week / US Small Business Administration

Small businesses, and in many cases, medium-sized enterprises also, have a couple of fundamental needs:

- Cash, to finance growth, including expansion into international markets
- Advice, particularly, but not exclusively, on financial matters

Banks today, have some key needs that may find their solution in more active engagement in the SME sector – and this includes trade finance and transaction banking units within financial services organisations. Banks are driven by the need, among other things, to:

- Reassure regulators and the market, that they are viable and trustworthy institutions, and that they have taken the lessons of the global crisis to heart
- Go 'back to basics' in terms of their core business activities and the processes, including credit decisioning and risk assessment, which support that business

Is there an overlap of interests and motivations, which, coupled with a bit of innovation and thought leadership, can lead to a resolution of the 'insoluble conundrum'? Small businesses are routinely touted as the 'backbones' of national economies, the keys to international development and anti-poverty measures, and the drivers of progress in market dynamics across the globe. These observations are not without foundation or merit.

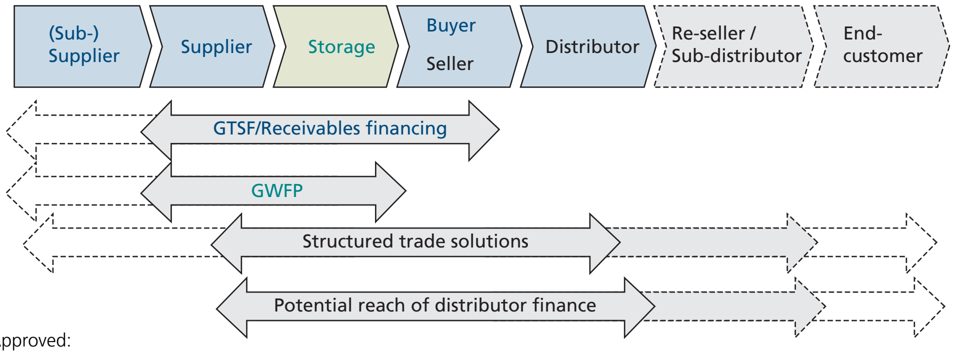
The *Mittelstand*, the small business segment, typically family-owned, has been instrumental in driving a striking export-led recovery in Germany, to the grudging admiration of her neighbours and others who considered such influence and economic power the sole purview of big business. Recently, the German SME sector has even been credited with supporting and maintaining a manufacturing capability in Germany that competes effectively with low-cost manufacturing centres across the globe.

Similarly, small and community-run businesses in the developing world – in particular those created and managed by women – are recognised as critical contributors to the success of development efforts and anti-poverty initiatives. The same is true for larger ventures which fall within the SME segment, and numerous institutions such as the International Trade Centre in Geneva, or the International Finance Corporation (IFC) in Washington, have taken steps to devise effective solutions to the challenges of SME finance – including the provision of trade and supply chain finance solutions for SME's.

Certain banks and financial institutions, and national export credit agencies, have placed significant focus on dialogue around SME finance and trade finance, and a subset of those are demonstrably active in this segment, even as SMEs have understood the importance of identifying and preparing alternate funding sources, in some cases, perhaps surprisingly, through investment finance channels typically reserved for larger enterprises.

Better serving SMEs

Thought leaders in commercial banking have noted attractive margins in the business of trade and more general lending to high-quality SME's,



Approved:

- **GTSF:** Provides affordable working capital financing to Suppliers by taking Buyer payment risk on confirmed payables.
- **GWFP:** Supports increase in banks agribusiness finance portfolio through commdity backed lending against warehouse receipts or collateral management agreements.
- **Structured Trade Finance:** Supports supply chain for commodities to facilitate movement of traded goods within borders and facilitate cross-border trade.

Source: International Finance Corporation (Short Term Finance Presentation, March 2011)

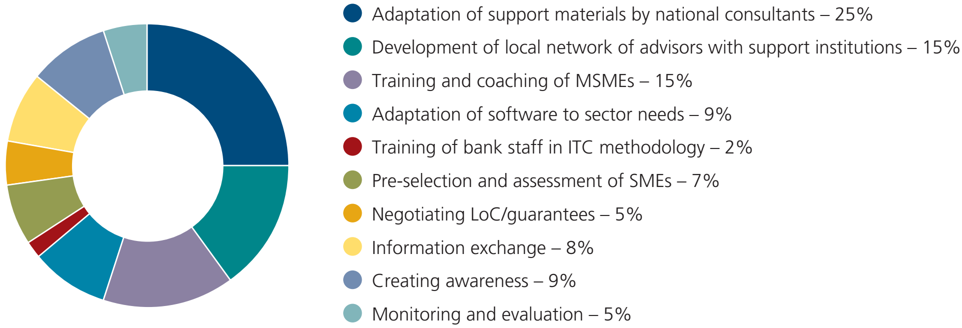
and perhaps more importantly over the long-term, have become aware of the importance of SME's in increasingly complex, increasingly global, supply chains. As supply chain finance evolves and becomes an increasingly integral element of the trade finance value proposition, bankers will naturally be motivated to focus on better serving SME's – including those located in developing and emerging economies, given their important role in the overall trade equation. The motivation will combine considerations related to the profitability and attractiveness of serving the SME sector, but perhaps concurrently, a desire to serve the needs of large clients by responding to the needs of – and thereby assuring the stability of – smaller, but strategically important suppliers.

IFC is a leading provider of trade finance solutions, now active in supply chain finance and has been a critical player in assuring trade finance liquidity over the course of the global crisis. Concurrently, IFC has maintained a disciplined focus on its development-related mandate. The IFC and other regional development banks and institutions designed variety of financing and trade financing solutions and programs aimed at micro-and small/medium-sized enterprises (MSME's). The IFC estimates a financing gap of up to USD 2 trillion in the MSME segment, approximately USD 1.3 trillion of which is related to short-term trade finance.

As the trade and supply chain finance industry overall continues efforts to define supply chain finance and its underlying value proposition, the specialists at IFC have clearly defined their offering along the trade transaction lifecycle, as illustrated above – and have done so in the broader context of the organisation's short-term trade finance solution portfolio. It is worth noting explicitly that the IFC has taken a very partnership-oriented approach, to the benefit of participating institutions and end-clients.

The global crisis has resulted in a significant degree of consolidation and retrenching to domestic markets, particularly among banks in the United States and Europe, and has, by most accounts, had adverse effects on (M)SME's – particularly those based in emerging markets. At the same time, crisis dynamics have driven banks to review value propositions, target client and market segments and strategies related to international presence. Relatedly, most banks engaged in international

Trade finance for SMEs funds allocation share



Source: Trade Finance for SMEs – Roadmap for Implementing the Strategy, ITC

trade finance recognise the importance of strategic alliances, either to extend global footprints, or to enhance knowledge of local markets.

This combination of realities and market dynamics suggests that there are significant – and evolving – motivations and capabilities to better service the (M)SME segment, certainly in the context of global sourcing and supply chains.There are concrete initiatives to facilitate trade and trade finance, and there are, in parallel, policy and commercial efforts to encourage entrepreneurial activity, and specifically, to enable various forms of financing to the SME sector globally, and the MSME sector in developing economies.

"Certainly public and government pressure in the UK for banks to lend more to the SME sector has been strong. The banks have responded by creating the Business Finance Taskforce which arms them with GBP 1.5 billion to ensure better access to finance for SMEs." (The Wall Street Journal, 7 February 2011)

Certain financial institutions have actively positioned themselves to service the SME sector – perhaps surprisingly, including some global institutions that are seeking to engage more significantly in this sector, traditionally the core base of community banks, "Landesbanken" and credit unions. In addition, public sector policy and program development is targeting the sector, as are other international institutions, such as the Geneva-based International Trade Centre. The ITC has recently published a "roadmap" document, related to Trade Finance for SME's.

The ITC program is partnership-based and targets various dimensions, from training of MSME's to the development of partnerships with selected financial institutions.

Program elements and focus are reflected in the chart above. It appears several factors are coming together to suggest an opportunity to create significant business and social value, in the creative financing and trade financing related to micro and SME businesses, across the globe. Thought leadership among providers, coupled with creative strategic alliances, will combine to provide SME's with what may be an unprecedented range of trade and business financing options.

The engagement of entrepreneurs and small business leaders in communicating both their needs, and the existence of emerging solutions, will accelerate the deployment of such solutions, and motivate more banks and other parties to leverage such programs to the benefit of all. SME finance and trade finance: good news at last? ■