

KEY POINTS

- The estimated global trade finance gap is large but stable at \$1.5 trillion.
- Achieving the Sustainable Development Goals is at risk if the persistently large trade finance gap continues to hamper international trade.
- More than 70% of surveyed banks see a shortage in servicing the trade finance needs of the global market.
- More than 40% of trade finance applications rejected by banks were from small and medium-sized enterprises (SMEs).
- Women-owned firms often face additional barriers to access trade finance.
- There is still no evidence showing that technology reduces the trade finance gap, but 86% of banks surveyed say they are preparing to service more SMEs using technology.
- The lack of global digital standards and laws as well as high cost discourage banks and firms from adopting technology.
- Anti-money-laundering measures are an impediment to closing gaps.

The ADB 2019 Trade Finance Gaps, Growth, and Jobs Survey is a joint product of the Private Sector Operations Department and the Regional Cooperation and Integration Division.

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2019 Trade Finance Gaps, Growth, and Jobs Survey

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INTRODUCTION

Our ability to achieve the Sustainable Development Goals (SDGs) can be compromised by insufficient financing available for trade. As trade's ability to drive inclusive growth and poverty reduction is widely recognized, addressing the trade finance gap would help achieve many of the SDGs, including those related to gender equality and economic empowerment of women (SDG 5) and economic growth and jobs (SDG 8) (Figure 1).¹

Nevertheless, this survey, our sixth and the world's leading survey of international trade finance needs, identifies large market gaps for trade finance that make it impossible to exploit the full potential of trade to deliver growth, jobs, and poverty reduction.

The dynamics of international trade are becoming ever more complicated. On the one hand, trade tensions and the imposition of trade barriers, along with softening global economic growth expected in 2019, will adversely impact global trade levels. On the other, emerging technologies such as artificial intelligence (AI) and blockchain, as well as pending new trade arrangements, support future trade growth.

Given the uncertain world economic outlook, it is critical that these and other breakthrough technologies be exploited to create more efficient, stable, and sustainable trade finance channels that will spur global growth and development.

¹ The United Nations Addis Ababa Action Agenda of the Third International Conference on Financing for Development adopted in 2015 recognizes the importance of trade in development and financing trade. It acknowledges that "lack of access to trade finance can limit a country's trading potential, and result in missed opportunities to use trade as an engine for development."

Figure 1: Trade Finance Essential to Sustainable Development Goals



Source: ADB Trade Finance Program, inspired by United Nations. Sustainable Development Goals Knowledge Platform. <https://sustainabledevelopment.un.org>.

The 2019 ADB Trade Finance Gaps, Growth, and Jobs Survey aims to enhance our understanding of the size of the trade finance shortfall and its expected impact. The survey identifies challenges facing efforts to narrow market gaps for trade finance, focusing on the potential role of technology and examining the following aspects of the issue:

- The large market gaps for trade finance persist, which impede the full potential of trade to deliver growth, jobs, and poverty reduction.
- The lack of collateral and “know your customer” (KYC) issues remain among the main reasons why trade finance proposals were rejected.
- As more banks invest in technology to gain efficiencies, we examine digital technology’s unrealized potential to overcome

impediments to narrowing gaps, particularly among small and medium-sized enterprises (SMEs)—and what it will take to realize this potential.

- In addition to banks, we surveyed SMEs—including women-owned firms—to explore how they have (or have not) managed to access finance to support trade-led growth, how fintech and digital finance solutions have helped some firms overcome trade finance shortfalls, and to what extent businesses are digitizing to boost growth and efficiency.
- We also aimed to gauge the perceived effects of trade tensions on the availability of trade finance.

Participants in the 2019 survey included 112 banks from 47 countries, 53 export credit agencies from 17 countries, 39 forfaitors from 20 countries, and 336 firms from 68 countries.²

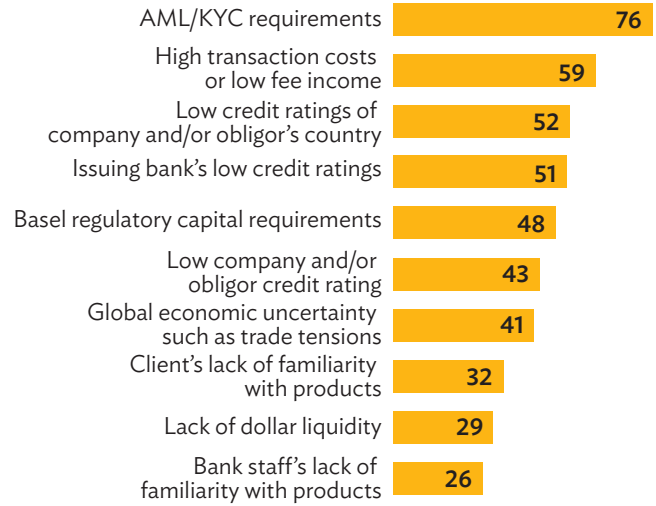
² ADB acknowledges the advice, support, and cooperation of our partner organizations. These include the International Chamber of Commerce (ICC) Banking Commission, the World Trade Organization, the Centre for the Promotion of Imports from developing countries, the International Trade Centre, the Pacific Trade Invest Australia, the Factors Chain International, the International Trade and Forfeiting Association, the Berne Union, the Central Asia Regional Economic Cooperation (CAREC) Program, and the many banks and companies that took time to complete our surveys. This brief benefited from comments from Cyn-Young Park and Marc Auboin. In particular, the 2019 survey would not have been successful without the support of Doina Buruiana, Sanne Boogers, Willem Jansink, Ian Sayers, Yaya Ouattara, Paul Heaney, John Brehcist, Alexia Vella, Cath Cooksley-Little, Dorothea Lazaro, Janet Hyde, Nana Khurodze, Santosh Pokharel, Can Sutken, Maria Clarissa Laysa, Pinky Rose Lustre, John Gerard Larkin, Guy Sacerdoti, and Joseph Manglicmot.

TRADE FINANCE GAPS IN 2018

Using bank-reported rejection rates for trade finance transactions, we estimated that the global trade finance gap remained large and stable at \$1.5 trillion in 2018.³ Despite trade finance transactions being considered a reliable and low-risk asset class, supply has not been sufficient to meet demand.⁴ The persistently large gap coincides with the view by more than 70% of surveyed banks that there is a shortage of financing in servicing global trade finance needs (Figure 2). Furthermore, around 60% of responding banks expect the trade finance gap to increase over the next 2 years (Figure 3). This implies that firms could continue to experience restricted access to trade finance, impeding prospects for economic growth and jobs.

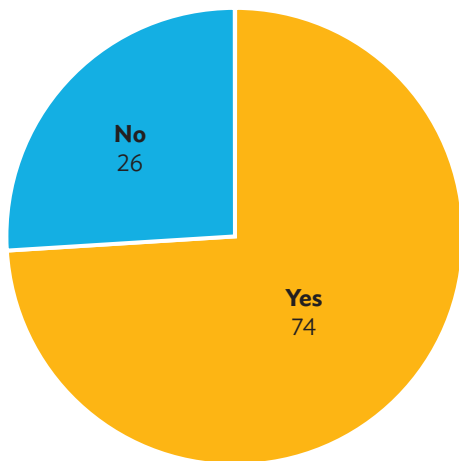
More than three-quarters of surveyed banks (76%) highlighted the requirements on anti-money laundering (AML) and KYC as the largest barrier to expanding trade finance operations. This was followed by high transaction costs and/or low fee income (59%), low credit ratings for the country where a firm is located (52%), as well as low credit ratings of banks in developing countries where they act as intermediaries for trade (51%), and low credit ratings of firms (43%). Rounding out the factors were regulatory capital requirements (48%) and global economic uncertainty such as trade tensions (41%) (Figure 4).

Figure 4: Barriers to trade finance (% of responses)



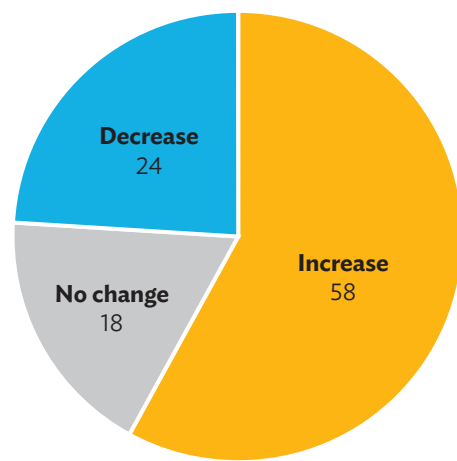
AML = anti-money laundering, KYC = know your customer.
Source: ADB. 2019 Trade Finance Gaps, Growth, and Jobs Survey—Banks.

Figure 2: Do you believe there is a shortage in servicing the trade finance needs of the global market? (% of responses)



Source: ADB. 2019 Trade Finance Gaps, Growth, and Jobs Survey—Banks.

Figure 3: Do you anticipate the unmet demand for trade finance support to increase or decrease over the coming 2 years? (% of responses)



³ In the 2017 Trade Finance Gaps, Growth, and Jobs Survey, Asia and the Pacific accounted for almost half of the global proposals and around 40% of total rejections.

⁴ The 2017 ICC Trade Register reported that default rates for a variety of trade finance products ranged from 0.03% to 0.24%, demonstrating the extremely low level of credit default risk for banks and other financial institutions. <https://iccwbo.org/media-wall/news-speeches/new-icc-report-confirms-trade-export-finance-not-risky-business/>

AML and combating the financing of terrorism (CFT) measures are critical to ensure a robust financial system that does not inadvertently aid crime. That said, unintended consequences of AML/CFT measures impede SMEs and less developed markets from acquiring the financial support they need to grow and prosper to their potential. An extreme example is the Pacific islands where some countries risk being cut off from the global financial system—including trade finance—due to correspondent banks severing relationships with Pacific financial institutions.⁵ Compounding the cost and complexity of conducting KYC/AML due diligence in the Pacific is the issue of “economies of scale” where revenue from correspondent relationships often fail to surpass AML/CFT due diligence costs.

High country risk—represented by low credit ratings—was identified by 52% of respondents as an impediment to providing more trade credit for transactions in developing countries. In fact, most international and regional banks lack country limits to support trade in most ADB developing member countries. Yet the ICC Trade Finance Register, which the ADB Trade Finance Program established in 2010 to generate default and loss statistics on trade finance (on a global industry basis), consistently shows very low default rates of between 0.03% and 0.24%. This suggests that, despite challenging operating environments and correspondingly weak country ratings in many developing countries, trade transactions represent relatively low risk. ADB’s trade finance business, which since 2009 has done over 21,000 transactions valued at \$36 billion—most conducted in Bangladesh, Pakistan, Sri Lanka, and Viet Nam—has never had a default or loss on any transaction.⁶ This again suggests that despite the proven low-risk nature of trade finance, substantial gaps persist.

Given the low risk and high demand, private sector opportunities to fill gaps are significant. Despite expectations of slower global trade growth amid ongoing trade tensions, Asia’s trade finance market prospects are good, with 64% of responding banks expecting Asian demand to increase over the next 2 years (while only about one-third believe demand will increase in other regions). This is because Asia’s strong intraregional trade—at 58% of Asia’s total trade in 2018—provides a buffer, which should grow as Asian governments continue to work on new trade agreements within the region.⁷ Meanwhile, 84% of forfaitors anticipate an increase in receivables financing globally over the next 2 years; and 44% of credit insurance providers expect a rise in short-term insurance demand as opposed to 11% expecting a decline and 44% no change.⁸

SMALL AND MEDIUM-SIZED ENTERPRISES, WOMEN-OWNED FIRMS, AND UNMET DEMAND

Access to trade finance remains disproportionately skewed in favor of large firms. SMEs account for 37% of trade finance demand based on the trade finance proposals received by banks surveyed (51% for banks in Asia and the Pacific). The rejection rate of SME proposals is 45%, higher relative to mid-sized and larger-sized firms (39%) and multinational corporations (17%) (Figure 5a). To mitigate risk on SME borrowers, banks generally require additional collateral, a requirement that is difficult for many SMEs to fulfill (Figure 5b). In the Pacific, for example, the difficulty of using real estate as collateral makes commercial banks reluctant to extend business credit, despite widespread secured transaction reforms in the last decade.⁹ This limited access to finance—coupled with limited access to market and entrepreneurial networks—lowers the economic participation of SMEs and limits their job-creating and growth prospects.

Among SMEs initially rejected that sought alternative financing, 47% were unable to find anything appropriate (Figure 6). A slightly higher percentage of firms use informal (18%) rather than formal financing alternatives (16%), while the take-up of digital finance as an alternative is negligible (below 1%).

Women-owned firms find it even more difficult to access finance. Among women-owned firms surveyed, the average rejection rate of their proposals was 44% compared with 38% for male-owned firms. Once rejected, women-owned firms were less likely to seek alternative finance—whether formal or informal (Figure 7). Ensuring women entrepreneurs have better access to finance could improve firm performance along with economic and social development outcomes.

POTENTIAL OF FINTECH AND DIGITAL SOLUTIONS TO CLOSE THE GAP

There is growing optimism that fintech and digitization are potential solutions to bridge the trade finance gap, particularly among SMEs. Global banks and large firms have collaborated to pilot information technology (IT) solutions to problems such as process inefficiency, costly regulatory compliance, and information asymmetry—all cited in this survey as major contributors to the trade finance gap. The gap can be narrowed by leveraging mobile internet access, cryptography, distributed

⁵ Amid the high cost of compliance with AML/CFT standards, a number of banks have terminated accounts of money or value transfer services in some small states of the Pacific, increasing the cost of remittances which play a key role in most of Pacific island economies. M. Erbenova, et. al. 2016. *The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action. IMF Staff Discussion Note. 16/06.*

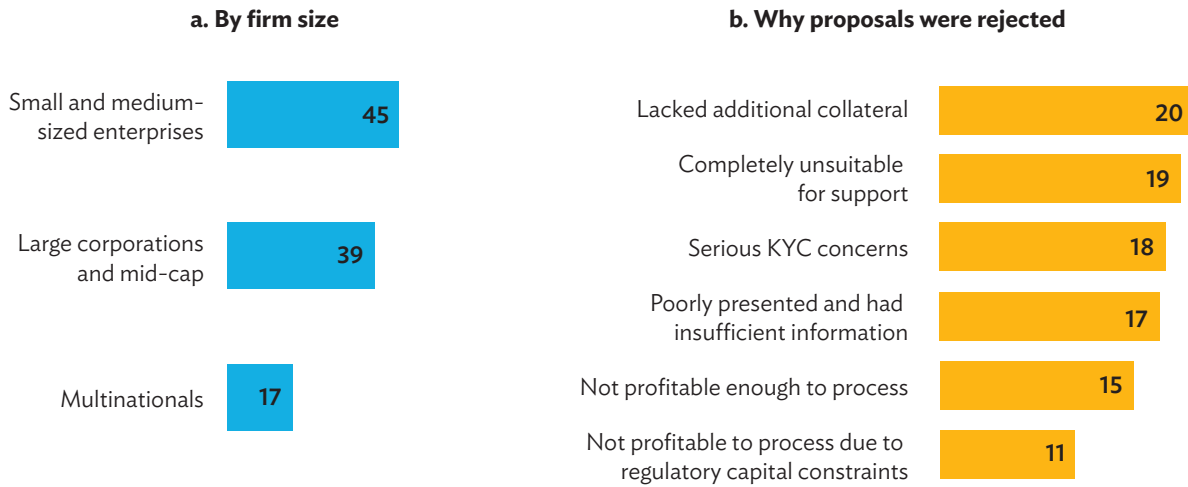
⁶ ADB Trade Finance Program. www.adb.org/tfp.

⁷ For instance, Regional Comprehensive Economic Partnership members—including the Association of Southeast Asian Nations, Australia, India, Japan, New Zealand, the People’s Republic of China, and the Republic of Korea—have reportedly targeted November 2019 to finish negotiations after resolving over two-thirds of market access issues.

⁸ The figures for credit insurance providers do not add up to 100% due to rounding.

⁹ ADB. 2016. *Credit Guarantees: Challenging Their Role in Improving Access to Finance in the Pacific Region.* Manila.

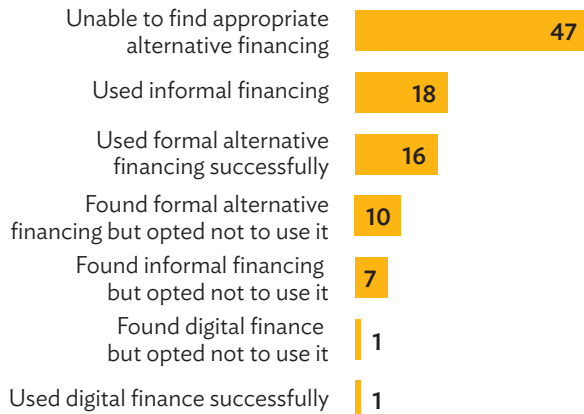
Figure 5: Trade finance rejections (% of applications, average across bank respondents)



KYC = know your customer.

Source: ADB. 2019 Trade Finance Gaps, Growth and Jobs Survey—Banks.

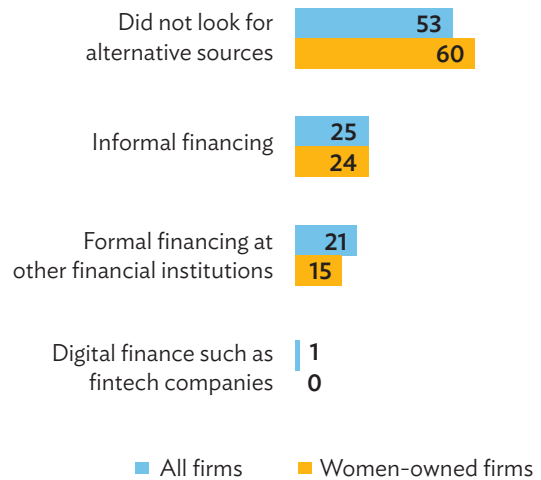
Figure 6: Outcome of efforts to seek alternative sources of trade financing by SMEs (% of responses)



SMEs= small and medium-sized enterprises.

Source: ADB. 2019 Trade Finance Gaps, Growth, and Jobs Survey—Companies.

Figure 7: Alternative financing sources sought (% of responses)



Source: ADB. 2019 Trade Finance Gaps, Growth, and Jobs Survey—Companies.

ledgers, blockchain technology, AI, fintech, digitization, as well as big data, which can improve access and reduce the cost of financial services. Blockchain and AI technology can transform raw data into useful information, helping reduce the number of rejected financing proposals.

A majority of banks surveyed are gearing up to service more SMEs through technology (Figure 8a)—by more efficiently processing KYC (79%), deepening their ability to data-map this market segment (73%), developing new products (70%), and possibly

helping to reduce their rejection rates (46%) (Figure 8b). Many surveyed nonbank players, such as export credit agencies and forfaitors, said digital platforms and solutions can be efficient cost-saving tools to acquire credit information and automate underwriting decisions to enhance support for SMEs.

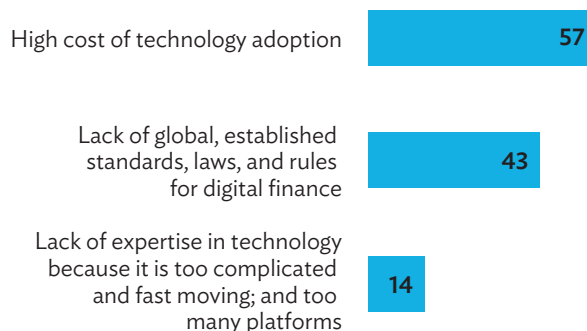
CHALLENGES TO REALIZING TECHNOLOGY’S POTENTIAL

Not all stakeholders agree whether and to what extent technology is transforming trade finance and reducing gaps. The high cost of technology and lack of globally established rules and standards for digital finance were cited as primary constraints (Figure 9). Digitizing operations is daunting and expensive for any firm or bank, especially given the ever-changing technical landscape. A huge IT investment can cause significant disruption, and be suddenly rendered obsolete in a matter of months.

Moreover, implementing IT without interoperability can create problems for clients, supply chains, and financial institutions. The lack of international technical standards and protocols on digitization reduces interoperability and compromises efforts to use technology to narrow the trade finance gap. And insufficient legislation on digitization of commerce—even an e-bill of lading is not legally recognized in most countries—renders digitization in trade virtually meaningless.

Much more work needs to be done to make technology materially relevant in closing gaps. Among firms surveyed that use

Figure 9: Reasons why banks are not using technology (% of responses)



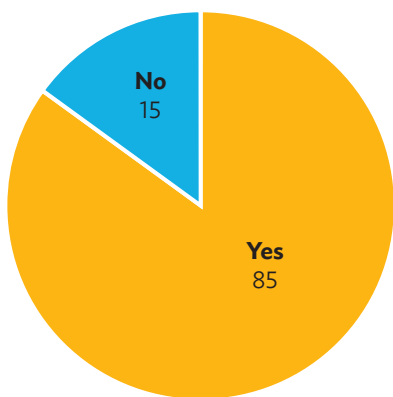
Source: ADB. 2019 Trade Finance Gaps, Growth, and Jobs Survey—Banks.

technology in their operations, the rate of application is limited—less than one-third file documents electronically (26%) and less than one-fifth use e-commerce (15%), cloud computing (14%), analytics (13%), and mobile applications (11%) (Figure 10).

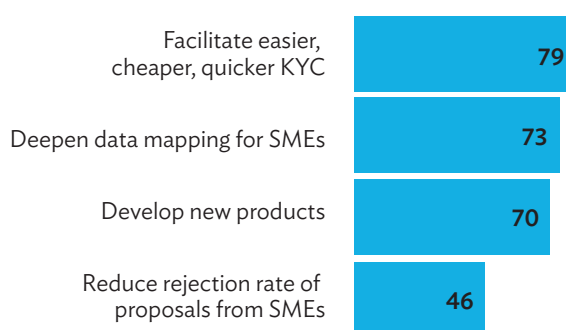
The fintech take-up rate remains low, and survey results suggest a considerable knowledge gap persists about fintech and trade finance. Although invoice financing is relatively well-known and used, on average 60% of responding firms are unaware of alternate tech-related ways of obtaining trade finance (Figure 11). SMEs’ low

Figure 8: Bank’s engagement with SMEs through technology (% of responses)

a. Percentage of banks gearing up to service more SMEs through technology

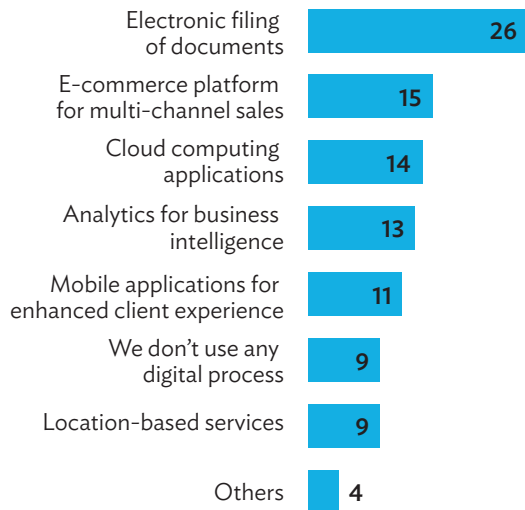


b. How fintech and digitalization can enhance bank engagement with SMEs



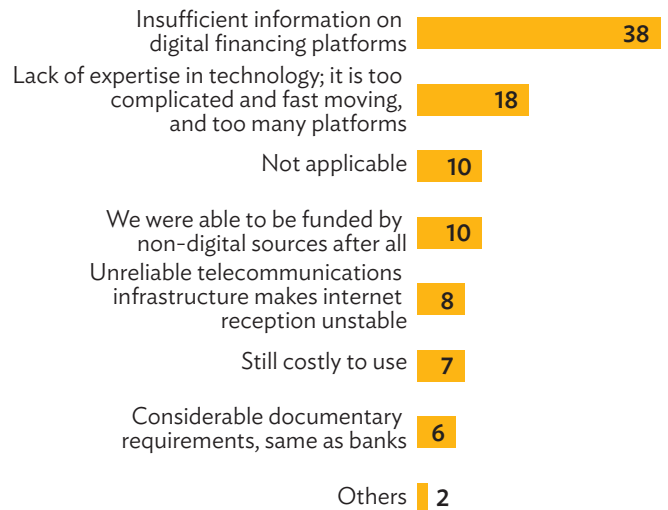
SMEs= small and medium-sized enterprises, KYC = know your customer.
Source: ADB. 2019 Trade Finance Gaps, Growth, and Jobs Survey—Banks.

Figure 10: Application of digital processes in company operations (% of responses)



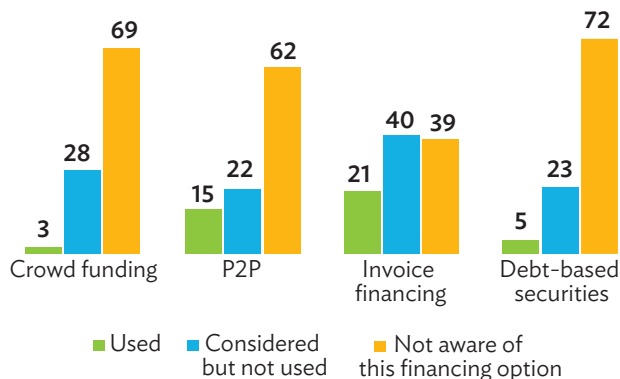
Source: ADB. 2019 Trade Finance Gaps, Growth, and Jobs Survey—Companies.

Figure 12: Why firms don't use digital or web-based platforms (% of responses)



Source: ADB. 2019 Trade Finance Gaps, Growth, and Jobs Survey—Companies.

Figure 11: Firms' knowledge and use of digital or web-based financing instruments (% of responses)



P2P = peer-to-peer.

Source: ADB. 2019 Trade Finance Gaps, Growth, and Jobs Survey—Companies.

FIVE POLICY CONSIDERATIONS

There are five policy considerations derived from this survey.

- (i) Technology's potential to close the trade finance gap is clear. But it will not happen until a basic legal and institutional framework is in place. Governments need to adopt laws—preferably common laws—on digital trade and more broadly e-commerce. The United Nations Commission on International Trade Law (UNCITRAL) has developed model laws that governments should consider and adopt. Until firms and banks have legal grounds to transact digitally, technology will not materially reduce gaps.
- (ii) Global digital trade standards and protocols are needed. This would drive the interoperability between component parts of the trade ecosystem—exporters, shipping, ports, customs, warehousing and logistics, finance, and importers—creating efficiencies never imagined and lowering barriers to access. Seamless trade digitization—with trade transparently conducted—would accumulate the meta-data critical to closing trade finance gaps by providing financiers with information needed to make informed credit and KYC-related decisions. The impact of these digital standards would be transformational on access to finance and inclusion of underserved market segments across the global economy.
- (iii) To make information on individual SMEs accessible in an ocean of meta-data, the Legal Entity Identifier (LEI) should be adopted globally. The LEI, overseen by over 70 financial

level of fintech use in trade finance was also observed in our 2017 survey. Firms' willingness to use digital platforms is encumbered by the lack of information about digital platforms (38%) and their lack of expertise in managing these types of technology (18%) (Figure 12). This implies that more and better training for SMEs can help them take advantage of innovative financing.

regulators worldwide, verifies who is who and who owns whom. This would facilitate the KYC/AML process, also identified in the survey as a major impediment to closing the trade finance gap.

- (iv) To address unintended consequences of AML/CFT measures, more work is needed to find streamlined and efficient ways to exclude criminals and terrorists from the financial system. A focus on materiality and greater technology use could reduce KYC complexity and cost (and increase the likelihood of catching criminals).
- (v) Finally, the annual ICC Trade Finance Register statistics, which demonstrate low default rates on trade finance, have helped entice more private funding to support trade. But more can be done to reduce the gap. When ADB established the Trade Finance Register with the ICC, it intended to produce granular statistics by country, including those with the most challenging operating environments (low country ratings) to demonstrate the low-risk nature of

trade finance. Taking the Trade Finance Register to the next level of granularity could be a powerful way to attract more private resources to help close the trade finance gap in emerging markets. It might also encourage regulators to lower bank regulatory capital requirements for trade finance, which would lower costs and increase the supply of trade finance.

Notes: Bank respondents came from both the ICC Banking Commission as well as banks participating in ADB's Trade Finance Program. The trade finance gap is estimated using the rejected value of proposed trade finance transactions as reported by responding banks. A regional trade finance gap is derived by applying the growth rate of rejected values for the same bank respondents from the current and previous surveys. The global gap is calculated as the total of regional gaps.

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