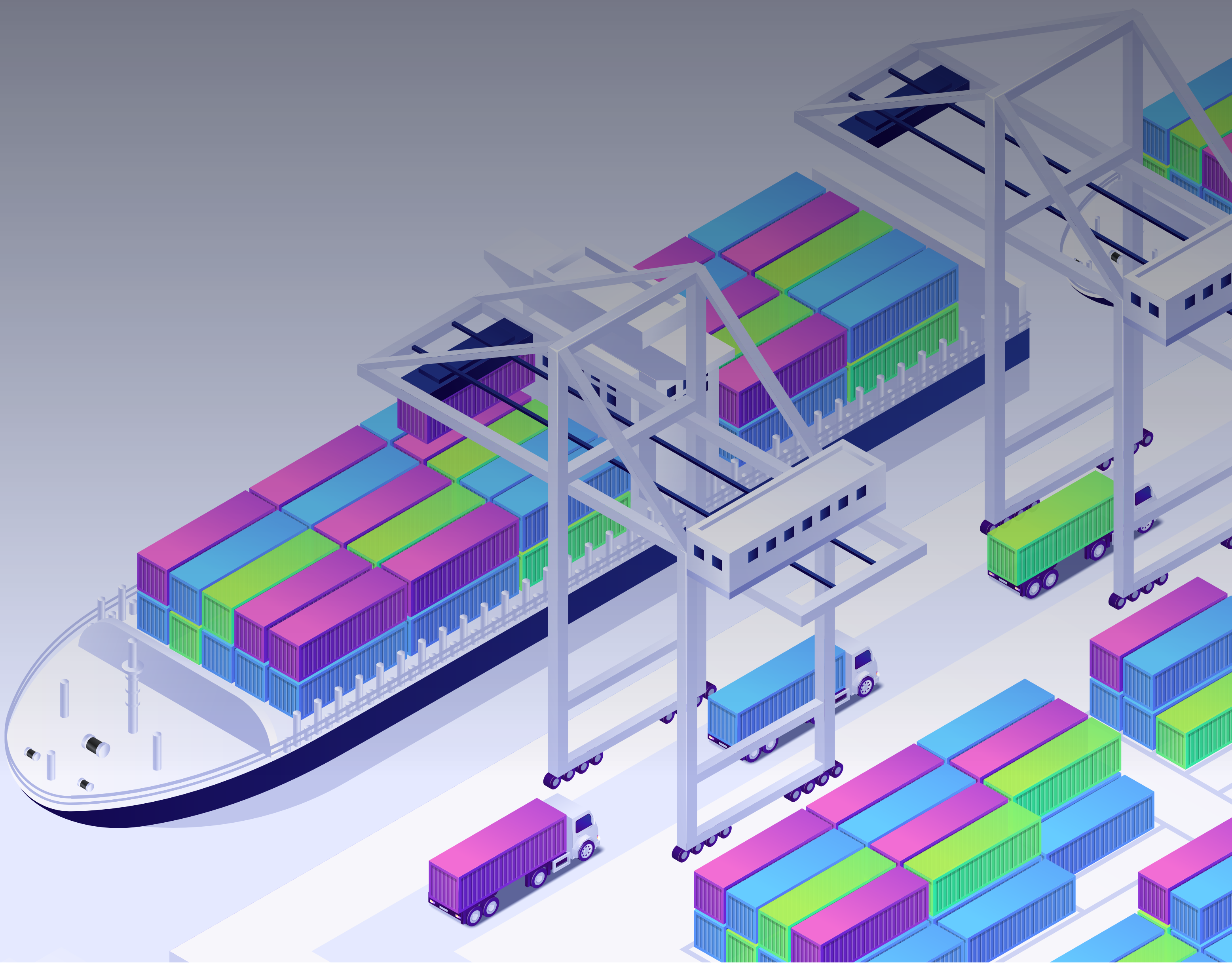
2022

IS SME TRADE FINANCE VIABLE?

A EUROPE OUTLOOK



TRADE FINANCE GLOBAL

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EXECUTIVE SUMMARY

During the current times of high inflation, record energy prices and geopolitical uncertainty, we wanted to take stock on SME attitudes toward trade finance in Europe.

Both funded and unfunded trade finance products are often a lifeline to cross-border SMEs, particularly during economic downturns.

Trade Finance Global (TFG) surveyed firms in the target regions of Belgium, the Netherlands, Germany, and the UK to better understand SMEs' trade finance usage norms and their propensity to pay for new or additional trade finance products and services.

TFG also compared macroeconomic export data, provided by Trade Data Monitor, to assess sentiment towards digital trade finance and export opportunities, by trading partner and commodity type.

The SME survey asked respondents to indicate their interest in trade, inventory, and invoice finance. The survey also investigated the likelihood of SMEs to pay for these services at certain annualised price points.

Based on our independent market analysis and survey data, TFG believes that there is sufficient market demand at the target 4%-8% price point (annualised) for trade finance lending over the next 5 years.

Based on our research and survey data, the beneficiaries of new trade finance products would be for firms that generate $30 million or less in revenue, and hold up to $2 million of inventory.

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INTRODUCTION

According to the World Trade Organization (WTO),[1] 80% to 90% of world trade relies on trade finance.

The tools and instruments that are used to finance the world's trade flows come in many different forms and can be used for a wide array of applications.

Traditionally, the letter of credit (LC) or documentary collection (DC) have been the main instruments used, but in recent decades global forces have increased the volume of open account trade conducted.

[1]https://www.wto.org/english/thewto_e/coher_e/tr_finance_e.htm

Letter of credit:[2] LCs are one of the most secure instruments available to international traders. An LC is a commitment by a bank on behalf of the buyer that payment will be made to the exporter, provided that the terms and conditions stated in the LC have been met, as verified through the presentation of all required documents.

Documentary collection:[3] A DC is a transaction whereby an exporter entrusts the collection of a payment for a sale to its bank (remitting bank), which sends the documents that its buyer needs to the importer's bank (collecting bank), with instructions to release the documents to the buyer for payment.

Open account:[4] An open account transaction is a sale where the goods are shipped and delivered before payment is due, which in international sales is typically in 30, 60, or 90 days.

This report begins with a brief overview of relevant economic and geographic data from the four markets of interest: Belgium, the Netherlands, Germany, and the UK. It will then explore the results of our SME market survey before concluding with our analysis and insights thereof.

[2]https://www.trade.gov/methods-payment
[3]https://www.trade.gov/methods-payment
[4]https://www.trade.gov/methods-payment

1 MARKET OVERVIEW

The following sub-chapters offer an overview of each of the four target markets: Belgium, the Netherlands, Germany, and the UK.

For each country, we have included a brief overview of relevant economic and geographic information, followed by data on the country's international trade activities, SME involvement in that trade, popular financing mechanisms, and an overview of the country's general atmosphere of digital openness.

Where possible, we have used data from the same time periods and collected from the same source(s).

This is intended to help form a comparison between the four markets, and avoid the natural discrepancies that exist between aggregate macroeconomic data.

As best as possible, we have avoided attaching any positive or negative connotations to statements within this section, focusing instead on measurable data points and statistics.

1.1 BELGIUM

The western European country of Belgium is divided into three regions (Brussels-Capital Region, Flanders, and Wallonia) and three primary language groups (Dutch, French, and German).[5]

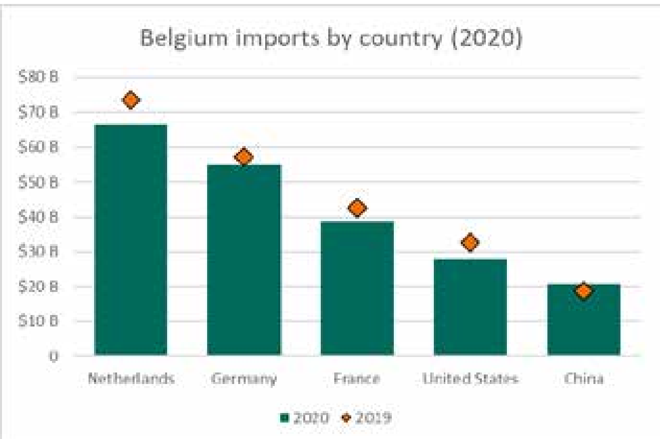
With over 11.5 million inhabitants and a GDP per capita of $44,500 as of 2020, Belgium is considered a small, open economy.[6]

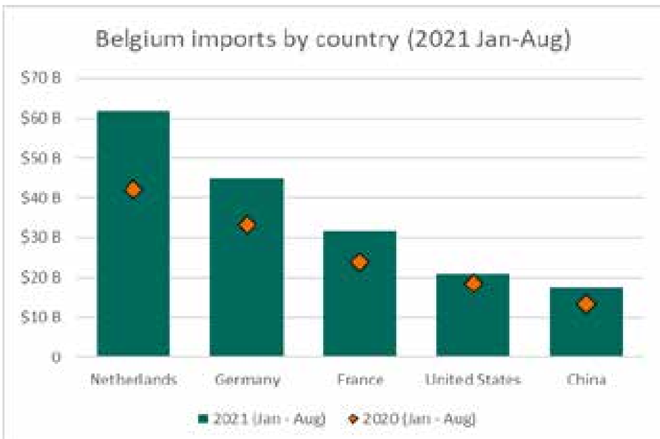
GDP is projected to expand by 4.7% in 2021 and 3.5% in 2022, as uncertainties around the COVID-19 pandemic recede, with GDP expected to reach pre-pandemic levels by mid-2022.[7]

Despite being a relatively small economy, Belgium is deeply involved in international trade. Its 2019 import flows exceeded $426 billion, with imports primarily coming from the Netherlands, Germany, France, USA, and Ireland.[8]

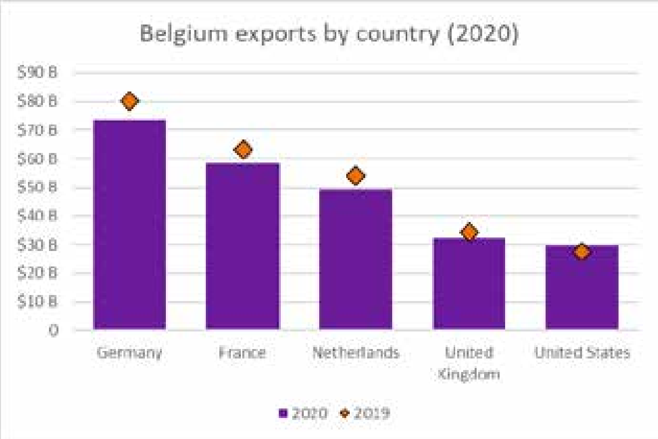
On the export side, the country sent out over $445 billion, primarily to Germany, France, Netherlands, UK, and USA.[9]

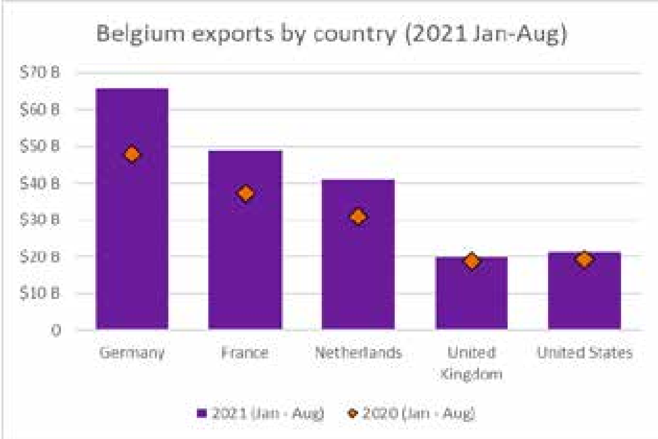
In 2019, four key sectors accounted for over 57% of total Belgian exports. These were chemical products (26%), vehicles and transport equipment (12.7%), machinery and electrical equipment (10.6%), and base metals (8.2%).[10]

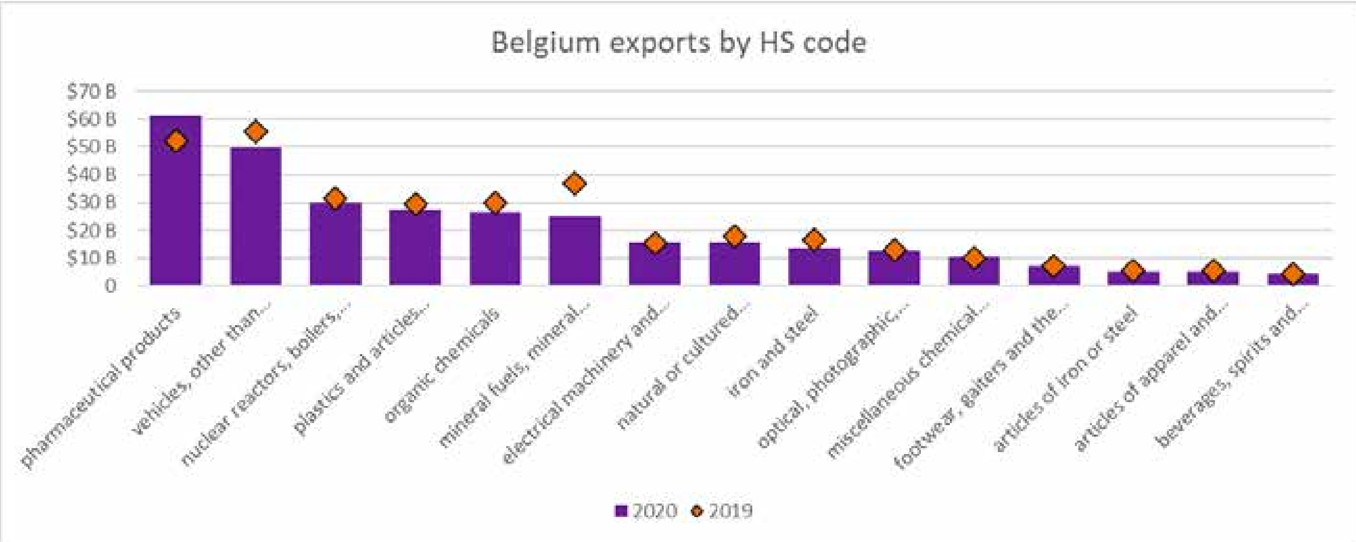




[5]Belgium's Economy in a Nutshell: economic outlook of July 2020. economie
[6]http://datatopics.worldbank.org/world-development-indicators
[7]https://www.oecd.org/economy/belgium-economic-snapshot/
[8]https://wits.worldbank.org/countrysnapshot/en/BEL
[9]https://wits.worldbank.org/countrysnapshot/en/BEL
[10]Belgium's Economy in a Nutshell: economic outlook of July 2020. economie







SMEs play an important role in Belgium's global trade. There were 607,000 SMEs in Belgium in 2020, representing 99.85% of all firms.[11]

Relative to other countries, Belgian SMEs comprise a much larger proportion of the nation's total trade volumes.

Cumulatively, they account for nearly 70% of the country's export value and more than 70% of its import value, compared to an average of around 40% and 50% respectively across all other Organisation for Economic Co-operation and Development (OECD) nations.[12]

Trade finance among Belgian SMES

When conducting business internationally, firms in Belgium have access to a wide and flexible range of loan products offered by the 106 domestic and foreign banks that service the country.[13]

[11]https://read.oecd-ilibrary.org/finance-and-investment/financing-smes-and-entrepreneurs-2020_dd2390a8-en#page12
[12]https://www.oecd.org/industry/smes/SME-Outlook-2021-Country-profiles.pdf
[13]https://www.trade.gov/country-commercial-guides/belgium-trade-financing

Furthermore, over half of all banking transactions in the country are international financial transactions, owing to the volume of international business done.[14]

When it comes to financing international trade, factoring continues to be the method most widely used by firms, and has grown in popularity. In 2018, factoring contributed to 17% of the nation's GDP, growing from a mere 6.3% a decade earlier.[15]

Despite the wide array of available offerings, many Belgian importers feel they have few available sources of inexpensive capital, causing them to push for more lenient credit terms on international transactions.[16]

For a combination of this reason and the strong relations with firms in neighbouring countries, over time, Belgian importers have become accustomed to being offered flexible payment terms, and may be prone to turn down potential new sales contracts if such terms are not present.[17]

Better access to capital may help reverse this trend.

The COVID-19 pandemic has also unveiled a degree of dissatisfaction among Belgian firms with their financial services.

According to data gathered by Ernst & Young,[18] only 38% of Belgian SMEs received support from the government, compared with 51% internationally.

Despite this, only 23% of SMEs borrowed from a bank, much lower than the international average of 45%, while 24% sought alternative methods to meet their financing needs.

In addition, only 29% of SMEs in the country still consider banks as their primary source of business financing - compared to 45% internationally - and 40% are likely to consider switching their main financial provider, with 28% considering switching to a fintech.

This high affinity for fintech services among SMEs is in line with the nation's digitalisation trends.

Data from the OECD[19] indicates that small firms in Belgium are rather ahead of their counterparts, even in other developing countries.

[14]https://www.trade.gov/country-commercial-guides/belgium-trade-financing
[15]https://read.oecd-ilibrary.org/finance-and-investment/financing-smes-and-entrepreneurs-2020_dd2390a8-en#page3
[16]https://www.trade.gov/country-commercial-guides/belgium-trade-financing
[17]https://www.trade.gov/country-commercial-guides/belgium-trade-financing
[18]https://www.ey.com/en_be/financial-services/belgian-banks-must-act-fast-to-redefine-their-relationship-with-smes
[19]https://www.oecd.org/industry/smes/SME-Outlook-2021-Country-profiles.pdf

Consequently, Belgium has maintained a higher level of resilience to the pandemic, with only 62% of Belgian SMEs declaring that COVID-19 has had a negative impact on their operations, compared to 74% for the rest of the world.

This affinity for digitalisation indicates that SMEs in Belgium may be more open to adopting new digital banking solutions than those in other countries.

1.2 NETHERLANDS

With over 17 million inhabitants, the Netherlands is a densely populated nation on the European coast, which lies within 500km of more than one third of the European Union (EU) population.

In addition, the Netherlands is home to the Port of Rotterdam, the largest seaport by container activity outside of East Asia,[20] and Amsterdam Schiphol Airport, the fourth largest airport for cargo in Europe.[21]

This advanced transportation infrastructure has contributed to the relatively small nation's position as the 17th largest global economy, with a GDP per capita of $59,300.[22]

The Dutch economy was able to withstand the challenges of the COVID-19 pandemic well, only shrinking by 3.7% in 2020, which is less than in surrounding countries.[23]

Looking ahead, the Dutch economy is expected to grow by almost 4% in 2021, followed by 3.5% in 2022, reaching pre-pandemic levels near the end of 2021.[24]

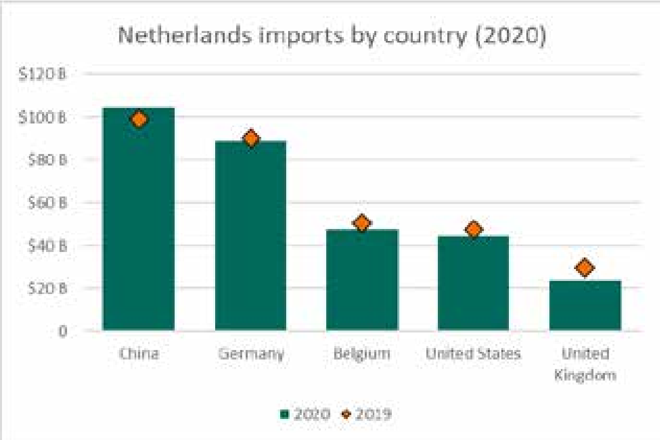
International trade is a critical aspect of the Dutch economy, comprising 77.9% of the nation's GDP.[25]

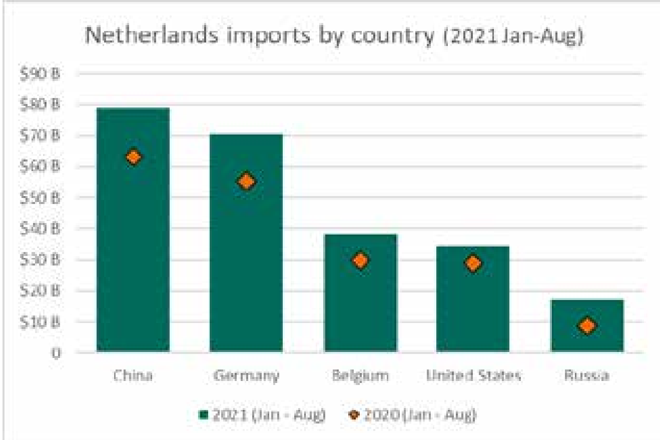
The Netherlands' 2019 import flows exceeded $514 billion, with imports primarily coming from Germany, Belgium, China, USA, and Ireland.[26]

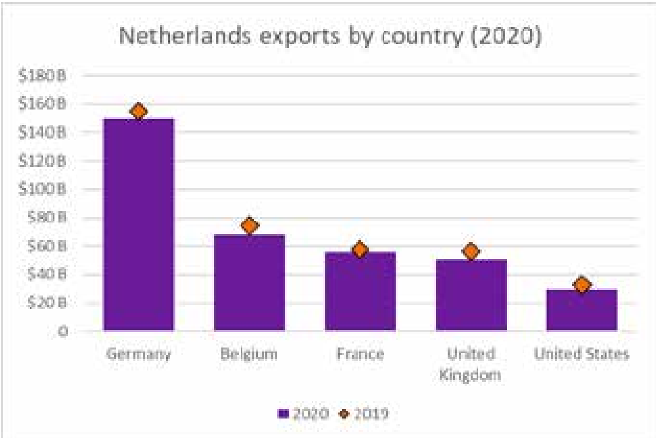
On the export side, the Netherlands sent out over $576 billion, primarily to Germany, Belgium, France, UK, and USA.[27]

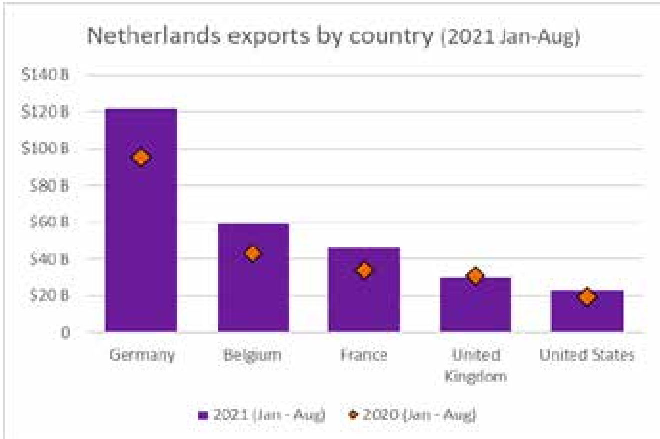
Dutch exports are dominated by a few key categories: machinery and transport equipment (28%), mineral fuels (23%), food (11%), clothing and footwear (10%), and pharmaceuticals (5%).[28]

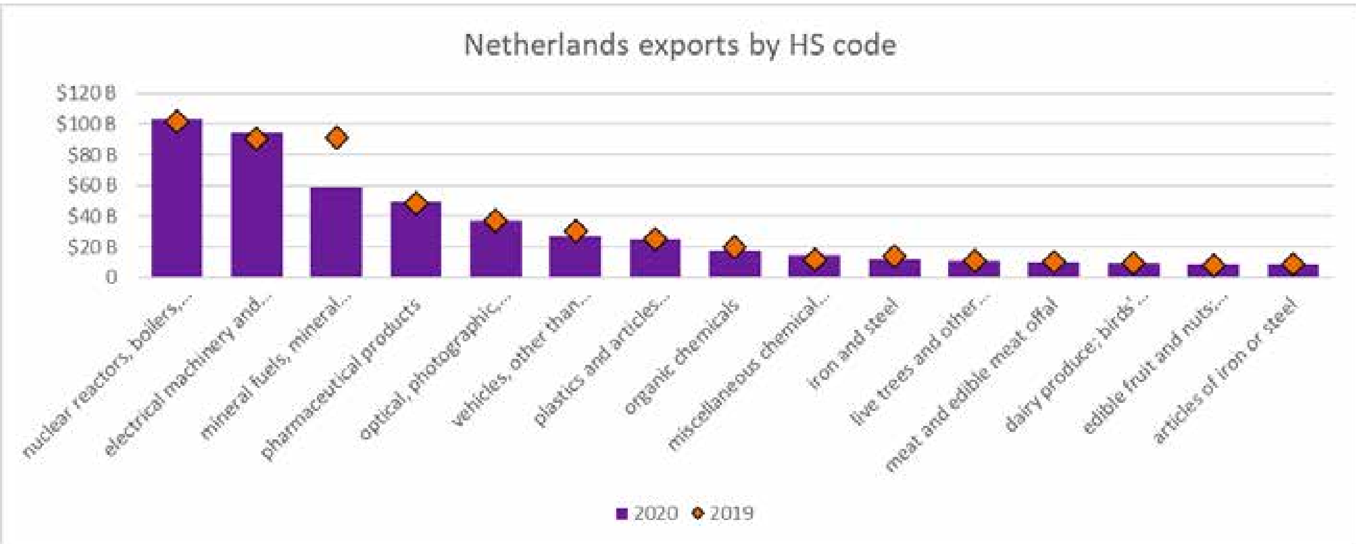
[20]https://www.portofrotterdam.com/en
[21]https://www.trade.gov/country-commercial-guides/netherlands-market-overview
[22]https://data.oecd.org/netherlands.htm
[23]https://www.trade.gov/country-commercial-guides/netherlands-market-overview
[24]https://www.cpb.nl/sites/default/files/omnidownload/CPB-Projections-Macro-Economic-Outlook-MEV-2022.pdf
[25]https://data.oecd.org/netherlands.htm
[26]https://wits.worldbank.org/CountryProfile/en/Country/NLD/Year/2019/SummaryText
[27]https://wits.worldbank.org/CountryProfile/en/Country/NLD/Year/2019/SummaryText
[28]https://tradingeconomics.com/netherlands/exports











While the Netherlands as a whole is heavily involved in international trade, the bulk of trade volume is conducted by the nation's larger firms.

Of the 1.14 million Dutch SMEs, which make up 99.8% of all the country's companies,[29] less than one third are directly involved in international trade.[30]

[29]https://www.oecd-ilibrary.org/sites/21ea1a61-en/index.html?itemId=/content/component/21ea1a61-en
[30]https://www.cbs.nl/-/media/_pdf/2020/45/dutch-trade-in-facts-and-figures-2020.pdf

This SME trade makes up slightly more than 40% of the nation's total exports, and slightly less than 45% of total imports - values that are roughly on par with the OECD averages.[31]

Trade finance among Dutch SMEs

When it comes to financing international trade, Dutch firms display a preference for open account, payment on delivery, documentary collections, letters of credit, and bank guarantees.[32]

In total, the country is served by 93 banks,[33] which offer a wide array of products for business clients.

Generally, however, the interest rates offered by banks to SMEs are 2 percentage points higher than those offered to larger firms.

In the Netherlands, factoring is not a very common method of financing for SMEs, being used by only 2% of the country's small and medium-sized firms.[34]

For most SMEs in the Eurozone, bank loans are the main source of external financing; however, in the Netherlands, this is not the case.

Dutch SMEs apply for 15% fewer loans than their European counterparts, and, of the applications made, 15% fewer are fully granted in the Netherlands compared to the EU aggregate.[35]

The Dutch Centraal Planbureau (CPB)[36] has posited that, in the Netherlands, as opposed to elsewhere in Europe, the expectation of a loan application being rejected is a more important reason for not even applying for one.

In the same report, the CPB also suggests that this could be due simply to the fact that Dutch SMEs tend to make fewer investments, and therefore require less financing.

It seems that other explanations, such as greater reliance on alternative financing sources, do not explain the trend.

[31] https://www.oecd.org/industry/smes/SME-Outlook-2021-Country-profiles.pdf
[32] https://www.trade.gov/country-commercial-guides/netherlands-trade-financing
[33] https://thebanks.eu/banks-by-country/Netherlands
[34] https://www.oecd.org/industry/smes/SME-Outlook-2021-Country-profiles.pdf
[35] https://www.cpb.nl/sites/default/files/omnidownload/Policy%20Brief%20SME%2009072019_0.pdf
[36] https://www.cpb.nl/sites/default/files/omnidownload/Policy%20Brief%20SME%2009072019_0.pdf

Digital readiness in the Netherlands

On the aggregate, the Netherlands appears to be very comfortable with digitalisation and the notion of digital banking.

SMEs in the Netherlands rank in the upper range of their OECD counterparts on all aspects of digital readiness.[37]

The Netherlands also ranked fifth in Europe in 2020 for online banking penetration, with 89% of Dutch respondents aged 16-74 accessing online banking sites.[38]

The combination of these metrics suggests that Dutch firms would be open to the idea of financial technology.

[37] https://www.oecd.org/industry/smes/SME-Outlook-2021-Country-profiles.pdf
[38] https://www.statista.com/statistics/222286/online-banking-penetration-in-leading-european-countries/

1.3 GERMANY

With a population of 83.2 million[39] and a GDP per capita of $46,200,[40] Germany has the fourth largest economy in the world.

The western European behemoth was responsible for nearly one quarter of the entire EU's GDP in 2020.[41]

Directly bordering nine European nations and housing the port of Hamburg, the world's third largest seaport,[42] Germany is strategically positioned for strong international activities.

Like most countries around the world, the German economy was impacted by the COVID-19 pandemic, retracting by 5% over the course of 2020.[43]

Forecasts predict that the German economy will grow 3.3% in 2021 and 4.4% in 2022, reaching pre-pandemic levels sometime in 2022.[44]

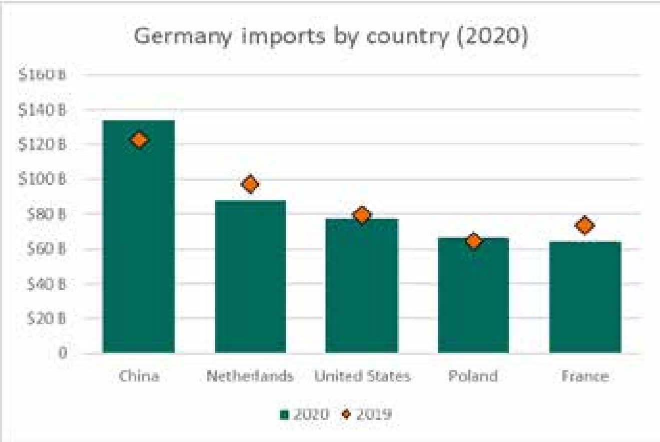
Germany is the third largest exporter in the world,[45] with international trade accounting for nearly 45% of the country's GDP.

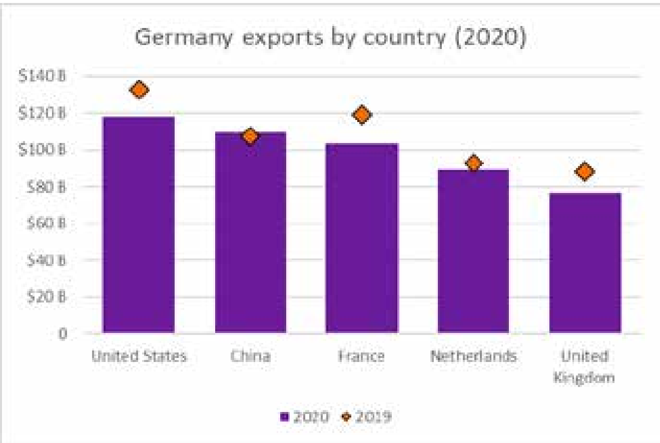
Its 2019 import flows were nearly $1.2 trillion, with imports primarily coming from China, Netherlands, USA, France, and Poland.[46]

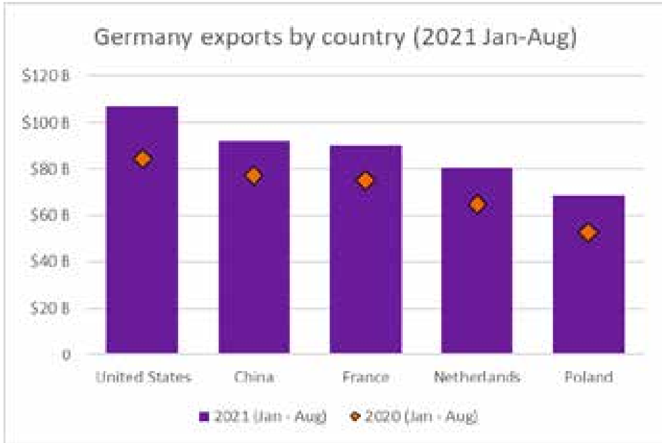
On the export side, Germany sent out over $1.5 trillion, primarily to the USA, France, China, Netherlands, and UK.[47]

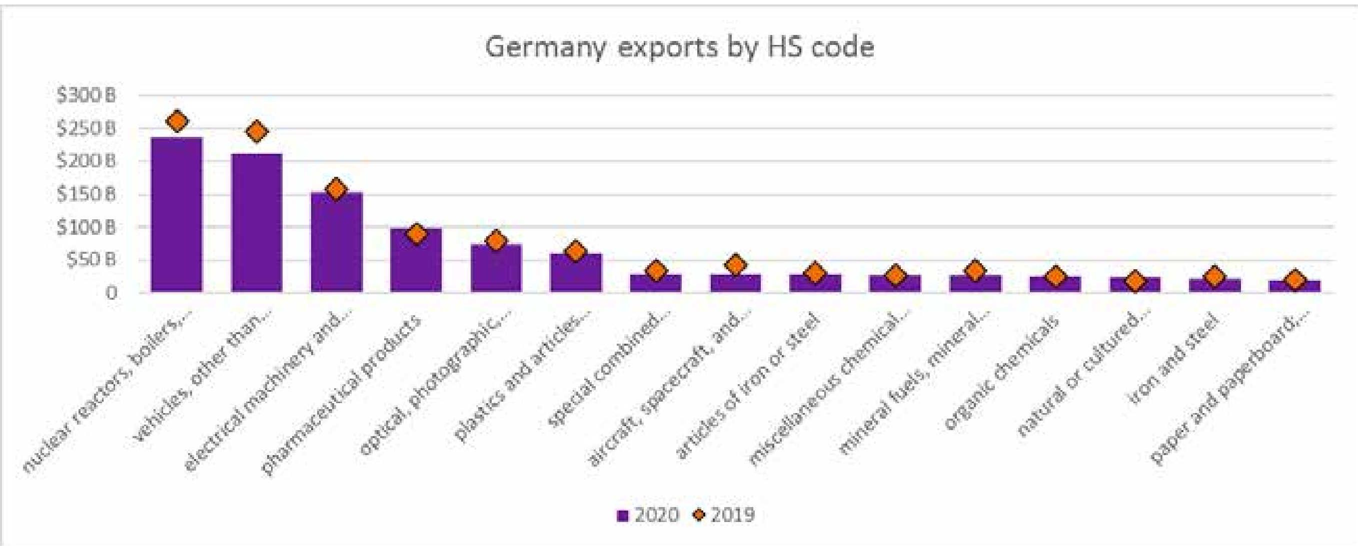
German exports are dominated by a few key categories: motor vehicles, trailers, and semi-trailers (18%); machinery and equipment (14%); chemicals and chemical products (9%); and computer, electronic, and optical products (9%).[48]

[39] https://data.worldbank.org/indicator/SP.POP.TOTL?locations=DE
[40] https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=DE
[41] https://www.trade.gov/knowledge-product/germany-market-overview
[42] https://www.hafen-hamburg.de/en/statistics/
[43] https://www.imf.org/en/News/Articles/2021/01/15/na011921-germanys-post-covid19-recovery-in-five-charts
[44] https://www.oecd.org/economy/germany-economic-snapshot/
[45] https://tradingeconomics.com/germany/exports
[46] https://wits.worldbank.org/CountryProfile/en/Country/DEU/Year/2019/SummaryText
[47] https://wits.worldbank.org/CountryProfile/en/Country/DEU/Year/2019/SummaryText
[48] https://tradingeconomics.com/germany/exports









The 2.52 million[49] German SMEs, a group dubbed the 'mittelstand' [middle class][50] to which over 99% of all firms in the country belong,[51] play a defining role in the nation's economy.

Around 44% of the country's firms are involved in exporting activities, and, on average, small German firms generate over 20% of their turnover from exports.[52]

[49]https://www.statista.com/statistics/818691/small-and-medium-sized-enterprises-germany/
[50]https://www.trade.gov/country-commercial-guides/germany-trade-financing
[51]https://www.bmwi.de/Redaktion/EN/Dossier/sme-policy.html
[52]https://www.bmwi.de/Redaktion/EN/Dossier/sme-policy.html

However, German SMEs comprise a much smaller proportion of the nation's total trade volumes than that of their counterparts in other developed nations.

On the export side, German SMEs generate less than 20% of the country's total trade value, much less than the 40% generated by the average OECD SME class.[53]

German SME imports come in around 27% of total trade value, compared to the OECD average of nearly 47%.[54]

These smaller percentages of SME contribution to the total national trade values may underestimate the actual exposure of German SMEs to international trade.[55]

Particularly in larger economies, like Germany, many SMEs play a significant role in indirect exports as suppliers to internationally operating firms.[56]

In these instances, supply chain finance instruments like factoring and pre-shipment finance may be able to play a key role.[57]

A few German industry sectors still use letters of credit or bills of exchange, but these antiquated mechanisms are much less common than in the past, and only cover a small portion of total imports.[58]

Germany's direct import transactions most often involve seller-buyer terms or payment against documents.[59]

German banks and digital readiness

German banks still hold a dominant position in the country's financial system, with bank loans serving as the predominant form of funding for firms, particularly SMEs.[60]

With over 1,600 banks operating in the country - nearly 1,000 more than any other European nation[61] - Germany is considered overbanked, leading to ongoing consolidation and low profit margins.[62]

[53] https://www.oecd.org/industry/smes/SME-Outlook-2021-Country-profiles.pdf
[54] https://www.oecd.org/industry/smes/SME-Outlook-2021-Country-profiles.pdf
[55] https://www.oecd.org/cfe/smes/Trade%20finance%20for%20SMEs%20in%20the%20digital%20era.pdf
[56] https://www.oecd.org/cfe/smes/Trade%20finance%20for%20SMEs%20in%20the%20digital%20era.pdf
[57] https://www.oecd.org/cfe/smes/Trade%20finance%20for%20SMEs%20in%20the%20digital%20era.pdf
[58] https://www.trade.gov/country-commercial-guides/germany-trade-financing
[59] https://www.trade.gov/country-commercial-guides/germany-trade-financing
[60] https://www.trade.gov/country-commercial-guides/germany-trade-financing
[61] https://www.statista.com/statistics/940867/number-of-banks-in-europe-by-country/
[62] https://www.trade.gov/country-commercial-guides/germany-trade-financing

The profitability of German banks is increasingly under pressure due to very low interest rates, high cost structures, increased competition from fintechs, and increased regulatory expenses.[63]

There is also an overall lack of digital adoption within the German economy. German SMEs in particular lag behind their OECD peers on all levels of digital readiness.[64]

Regarding digital integration in working processes, Germany performed worse than the European average in 2020.[65]

Experts argue that this lag may be due to cultural barriers in Germany whereby most people are wary of the use of information technology and its adaptation into daily work processes.[66]

Data indicate that even if digital infrastructure was available, German citizens would remain hesitant to use it for digital management and administration purposes.[67]

[63]https://www.trade.gov/country-commercial-guides/germany-trade-financing
[64]https://www.oecd.org/industry/smes/SME-Outlook-2021-Country-profiles.pdf
[65]https://ec.europa.eu/digital-single-market/sites/digital-agenda/files/desi_2020_desi_country_fiche_de.png
[66]https://www.hertie-school.org/en/content/detail/content/germany-is-lagging-behind-on-digital-transformation-digital-adaptation-is-a-matter-of-culture
[67]https://joinup.ec.europa.eu/sites/default/files/inline-files/Digital_Government_Factsheets_Germany_2019.pdf

1.4 UK

With a total GDP of more than $2.7 trillion,[68] the UK's 67.2 million inhabitants[69] comprise the world's fifth largest economy.[70]

The UK's 2016 decision to leave the EU gave it the freedom to pursue its own trade deals with countries around the globe.

At the time the UK left, the EU had about 40 trade deals covering more than 70 countries.[71] Since leaving, the UK has signed trade agreements and agreements in principle with 69 countries, including one with the EU.[72]

Some experts argue that leaving the EU will reduce the UK's potential GDP by about 4% in the long-term, a decrease that has only been compounded by the COVID-19 pandemic.[73]

As the island nation rebounds from the pandemic, however, it is expected to see strong GDP growth of 7.2% in 2021 followed by 5.5% in 2022, with GDP expected to return to pre-pandemic levels in early 2022.[74]

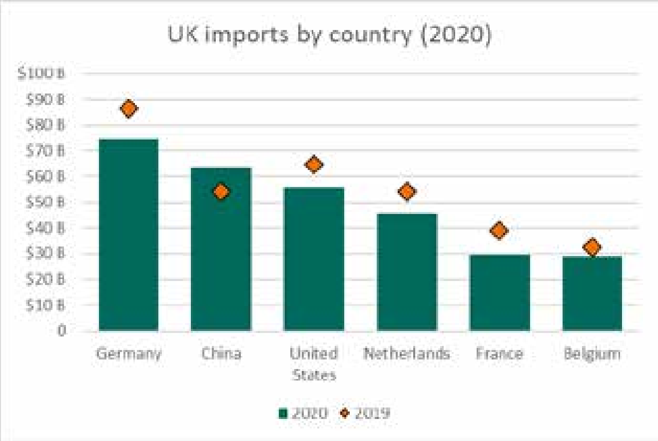
The UK is a major international trading power,[75] with international trade accounting for 28% of the country's GDP.

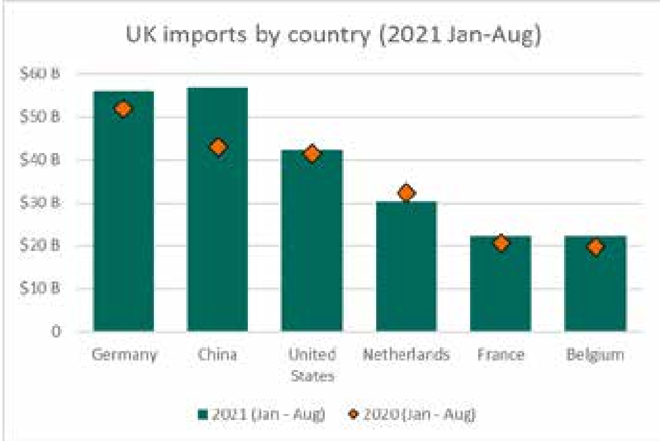
Its 2019 import flows were nearly $692 billion, with imports primarily coming from Germany, the USA, China, Netherlands, and France.[76]

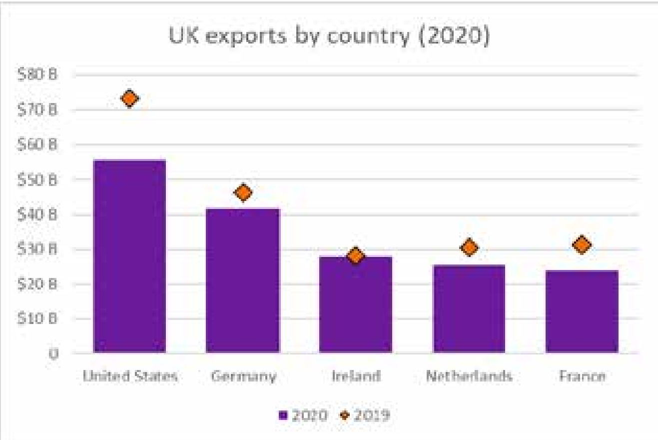
On the export side, the UK sent out over $468 billion, primarily to the USA, Germany, France, Netherlands, and China.[77]

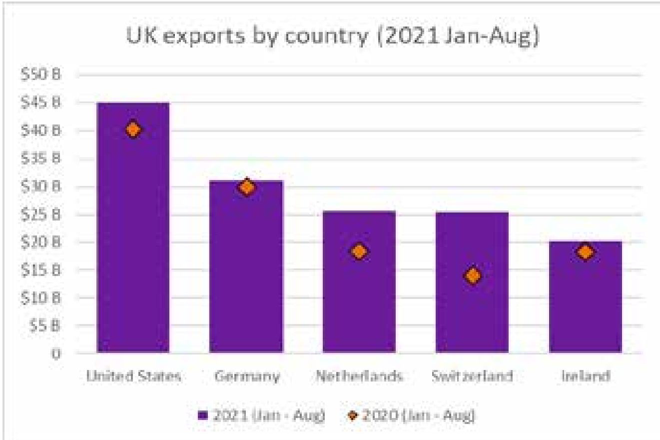
The majority of British exports are from a few key categories, namely mechanical machinery (14%); cars (10%); electrical machinery (8%); medicinal and pharmaceutical products (8%); crude oil (6%); and aircraft (5%).[78]

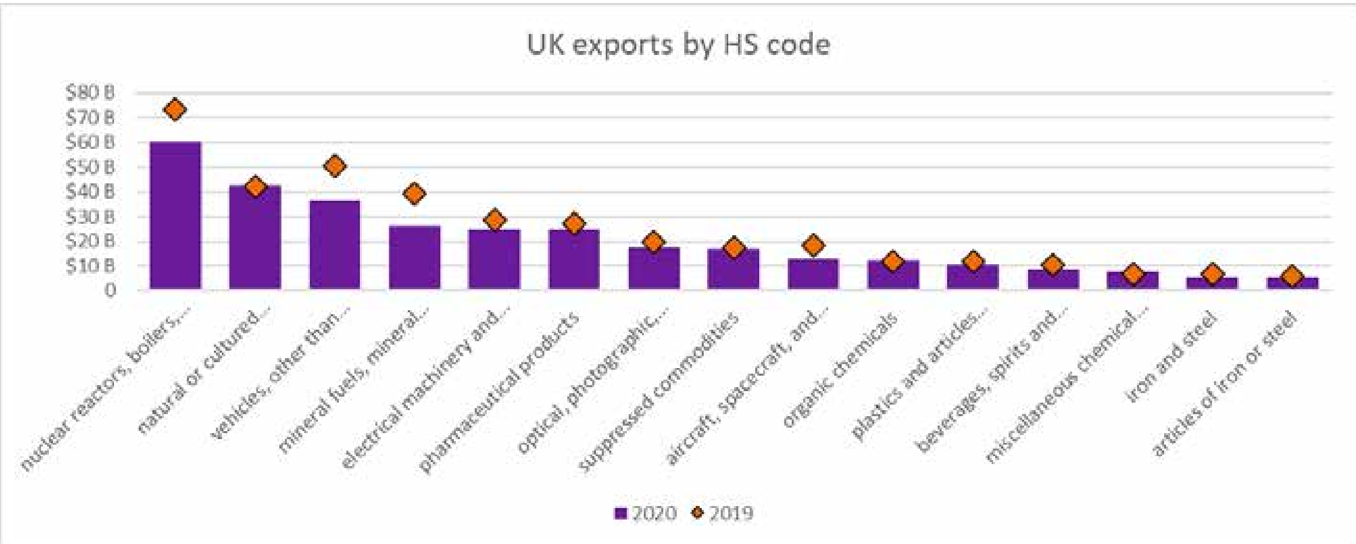
[68] https://databank.worldbank.org/data/download/GDP.pdf
[69] https://data.worldbank.org/indicator/SP.POP.TOTL?locations=GB
[70] https://databank.worldbank.org/data/download/GDP.pdf
[71] https://www.bbc.com/news/uk-47213842
[72] https://www.bbc.com/news/uk-47213842
[73] https://www.bbc.com/news/business-59070020
[74] https://www.oecd.org/economy/united-kingdom-economic-snapshot/
[75] https://www.trade.gov/knowledge-product/united-kingdom-market-overview
[76] https://wits.worldbank.org/CountryProfile/en/Country/GBR/Year/2019/SummaryText
[77] https://wits.worldbank.org/CountryProfile/en/Country/GBR/Year/2019/SummaryText
[78] https://tradingeconomics.com/united-kingdom/exports











Upwards of 99.9% of all businesses in the UK, or 5.6 million firms, are classified as SMEs.[79] The SME share of total UK exports has been decreasing on average since 2009, when nearly 60% of exports were from small and medium-sized firms.[80]

Today SME trade in the UK comprises around 33% of the nation's total exports, and slightly less than 45% of total imports.[81]

[79] https://www.fsb.org.uk/uk-small-business-statistics.html

[80] https://www.british-business-bank.co.uk/wp-content/uploads/2020/02/UK-SME-Exporting-FINAL-VERSION.pdf

[81] https://www.oecd.org/industry/smes/SME-Outlook-2021-Country-profiles.pdf

While these values are much lower than the UK's own historic amounts, they are still only slightly below the OECD averages.[82]

Trade finance among UK exporters

In the UK, exporters typically make payment on open account, payment in advance, letter of credit, documentary draft, or consignment.[83]

However, many smaller firms in the UK show a reluctance towards using external financing.

In 2018, for example, just 36% of exporting UK SMEs reported using external finance[84] - a sharp drop from the 44% reported in 2012.[85]

A 2020 OECD report[86] speculates that the drop can be attributed to recent increases in the region's political and economic uncertainty.

While the majority of SMEs still aspire to grow,[87] 74% indicate that they would be willing to accept a slower growth rate in order to avoid external financing.[88]

Some UK SME exporters believe that they don't need external financing, and so do not use it.

Approximately 74% of SMEs who do not use external finance do not recognise a need for it, with a further 16% indicating that they have access to expanded internal cash reserves.[89]

SMEs do not identify financing as a particular challenge at any stage of the export process. When asked at which stage finance was the greatest challenge, over two thirds of SMEs responded that no stage was the most challenging.[90]

In general, individuals in the UK seem open to digitalisation, even for financial products.

Online banking penetration in the UK has grown steadily over the past decade, reaching 76% in 2020.[91]

Specifically looking at SMEs, those in the UK are generally ahead of their OECD peers on most levels of digital readiness, but still lag behind on a few key metrics, such as access to high-speed broadband.

[82] https://www.oecd.org/industry/smes/SME-Outlook-2021-Country-profiles.pdf
[83] https://www.trade.gov/country-commercial-guides/united-kingdom-trade-financing
[84] https://www.british-business-bank.co.uk/wp-content/uploads/2020/02/UK-SME-Exporting-FINAL-VERSION.pdf
[85] https://read.oecd-ilibrary.org/finance-and-investment/financing-smes-and-entrepreneurs-2020_cbcf56e7-en#page1
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[88] https://www.british-business-bank.co.uk/wp-content/uploads/2020/02/UK-SME-Exporting-FINAL-VERSION.pdf
[89] https://www.british-business-bank.co.uk/wp-content/uploads/2020/02/UK-SME-Exporting-FINAL-VERSION.pdf
[90] https://www.british-business-bank.co.uk/wp-content/uploads/2020/02/UK-SME-Exporting-FINAL-VERSION.pdf
[91] https://www.statista.com/statistics/286273/internet-banking-penetration-in-great-britain/

1.5 THE TRADE FINANCE GAP

The world's trade finance gap is growing. According to the Asian Development Bank (ADB), the global trade finance gap hit a record $1.7 trillion in 2020, up 15% from a previous high of $1.5 trillion in 2018.[92]

Other estimates from the UK All-Party Parliamentary Groups (APPG) on trade finance put the current gap as high as $3 trillion to $5 trillion.[93]

Regardless of the exact size of the gap today, there is no debate that it disproportionately impacts micro, small, and medium enterprises (MSME).

On the aggregate, most banks only reject a small percentage of trade finance applications, with 62% of reporting banks rejecting between 0%-10% of applications in 2019.[94]

More than half of the applications submitted by MSMEs, however, were rejected.[95]

The COVID-19 pandemic only increased this, with the likelihood of trade finance applications being rejected rising significantly over the course of 2020.[96]

While default rates for trade finance products did experience a modest increase due to the pandemic, trade finance products still represent an inherently low-risk asset class, suggesting that there are other factors influencing financing decisions.[97]

Regardless of the reasons, banks and MSMEs agree that access to trade finance is a major barrier that must be addressed in order for firms to recover from the economic impact of the pandemic.[98]

Understanding the reasons for such high rates of MSME rejection is a crucial step on the path to closing the gap.

According to the ADB survey,[99] the most commonly cited reason (72.4%) for MSME rejection is the stringent anti-money laundering (AML) and know your customer (KYC) requirements in place today.

[92] ADB 2021 Trade Finance Gaps, Growth and Jobs Survey
[93] APPG Review of UK Trade Finance
[94] APPG Review of UK Trade Finance
[95] APPG Review of UK Trade Finance
[96] ADB 2021 Trade Finance Gaps, Growth and Jobs Survey
[97] ICC Trade Register Report
[98] ADB 2021 Trade Finance Gaps, Growth and Jobs Survey
[99] ADB 2021 Trade Finance Gaps, Growth and Jobs Survey

Another factor may be the impact of time-consuming and manual onboarding processes on the profit that banks are able to make from MSME clients.

APPG reports[100] that banks now face onboarding costs as high as $80,000 for MSME clients due to this cumbersome, redundant, and mostly manual bureaucracy.

Digitalising the trade ecosystem is widely seen as a key enabler to help streamline efficiency in the industry and close the trade finance gap.

As digital advocates increasingly promulgate the potential benefits, many financial providers are exploring ways to incorporate digital workflows into their operations.

The Boston Consulting Group (BCG) predicts that, by 2025, 10%-15% of trade finance and 20%-25% of SME trade finance will be conducted via digital platforms.[101]

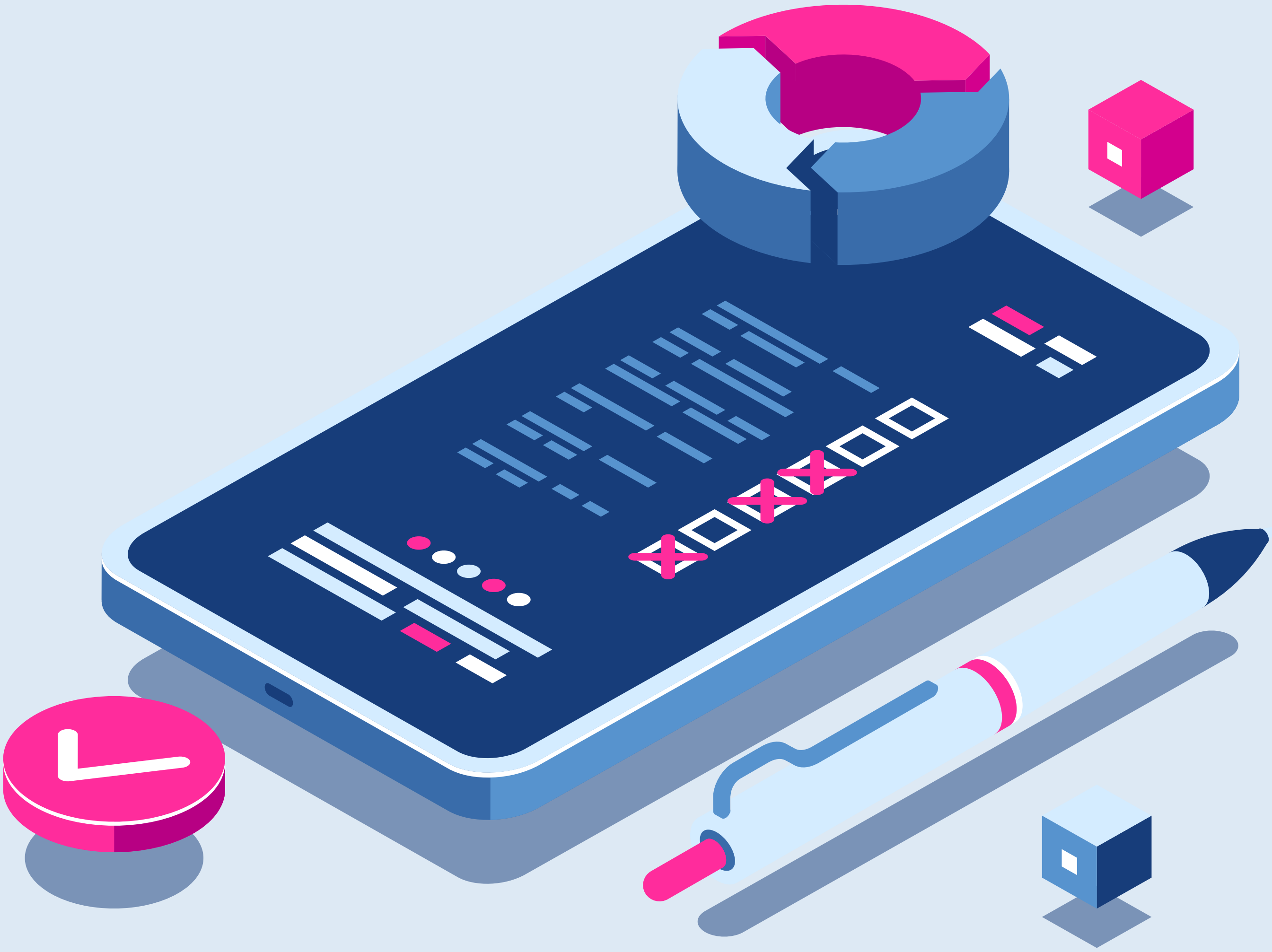
Around 55% of respondents to an APPG survey[102] said they are currently positioning themselves to service more MSMEs with tech solutions.

Despite the promised gains and wide potential for growth, however, the use of fintech and digital solutions seems to be limited and concentrated only in certain functions and by certain types of firms.[103]

Smaller local banks, for example, tend not to engage with digital solutions to the same extent as their larger and more global counterparts.[104]

This may pose a challenge for MSMEs, since these are the types of banks that typically service smaller firms.[105]

[100] APPG Review of UK Trade Finance
[101] https://image-src.bcg.com/Images/BCG_Digital_Ecosystems_in_Trade_Finance_tcm38-229964.pdf
[102] APPG Review of UK Trade Finance
[103] ADB 2021 Trade Finance Gaps, Growth and Jobs Survey
[104] APPG Review of UK Trade Finance
[105] APPG Review of UK Trade Finance



2 SME SURVEY ANALYSIS

To acquire the data presented in this analysis, Trade Finance Global (TFG) surveyed firms in the target regions to gain a better understanding of SMEs' trade finance usage norms and their propensity to pay for new or additional trade finance products and services.

The survey was designed to gain insight into firms based on numerous factors, including business type, operating location, annual revenue, use of third-party financing, average inventory levels, current number of lenders, current debt utilisation, current cost of debt financing, and letter of credit use.

The survey asked respondents to indicate their level of interest in a hypothetical new market entrant seeking to provide trade, inventory, and invoice finance. The survey also investigated the likelihood of SMEs to pay for these services at a 4%-8% per annum price point.

The survey was distributed between 22nd October 2021 and 17th November 2021 to firms that operate in the UK, Germany, the Netherlands, and Belgium.

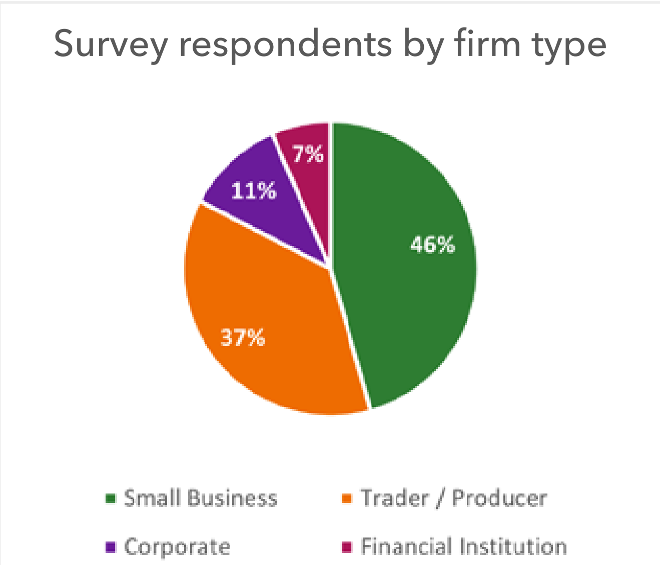
The full list of survey questions can be found in Appendix 4.1.

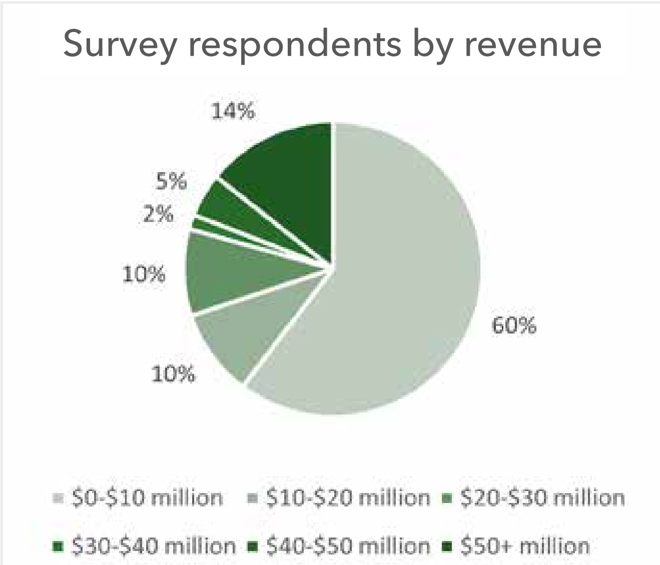
2.1 RESPONDENT DEMOGRAPHICS

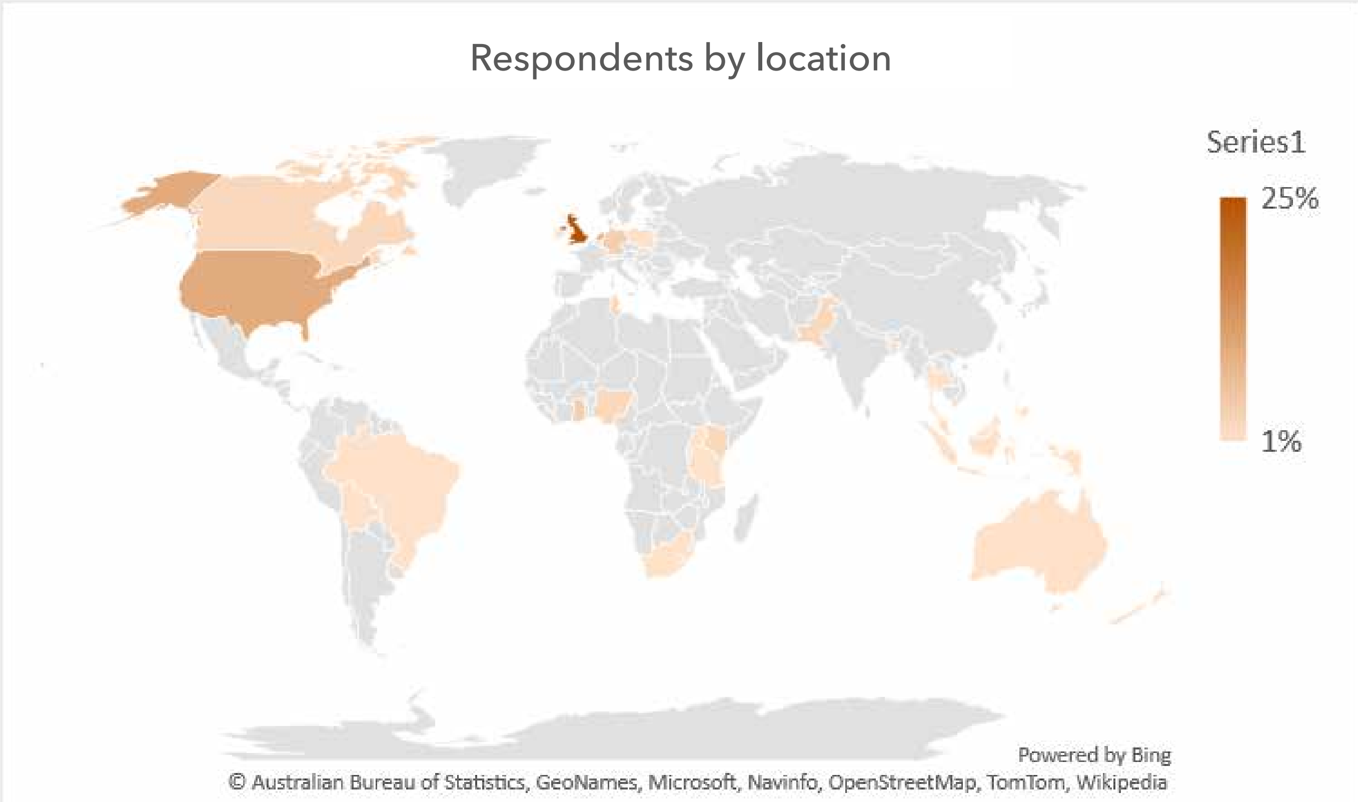
A total of 64 firms with operations in the four target markets responded to the survey. Overall, these firms operate in 31 countries altogether.

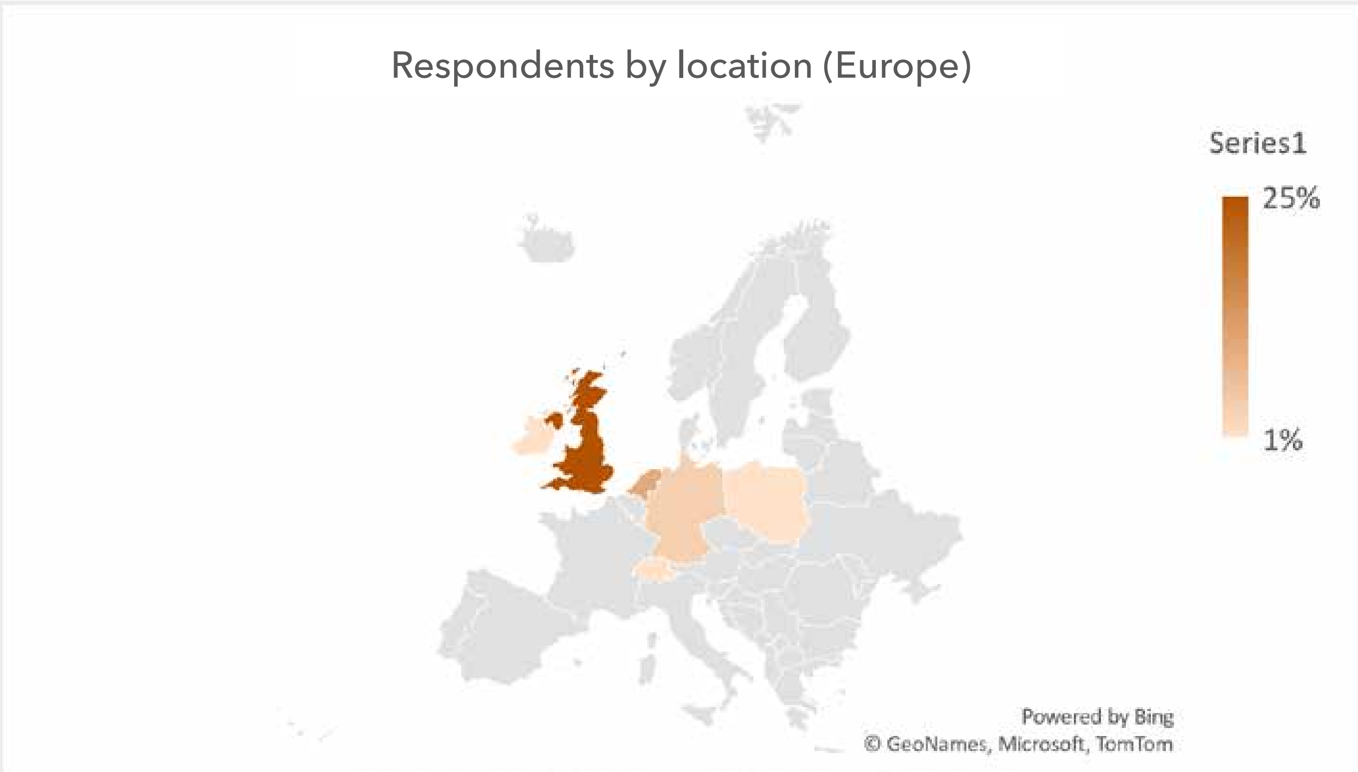
Over 80% of the firms surveyed self-identified as either small businesses, traders, or producers, and less than 20% self-identified as corporates or financial institutions.

The majority (60%) reported annual revenues between $0-$10 million, while 14% reported an annual revenue of $50 million or more.





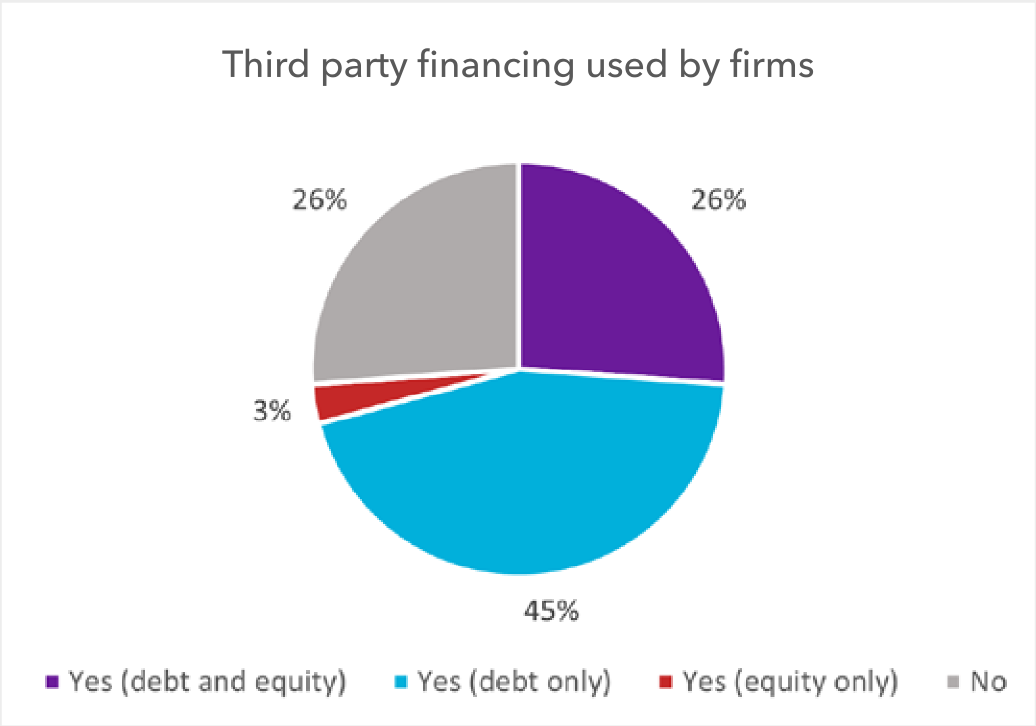

Respondents by location
Series1
25%
1%
Powered by Bing
© Australian Bureau of Statistics, GeoNames, Microsoft, Navinfo, OpenStreetMap, TomTom, Wikipedia

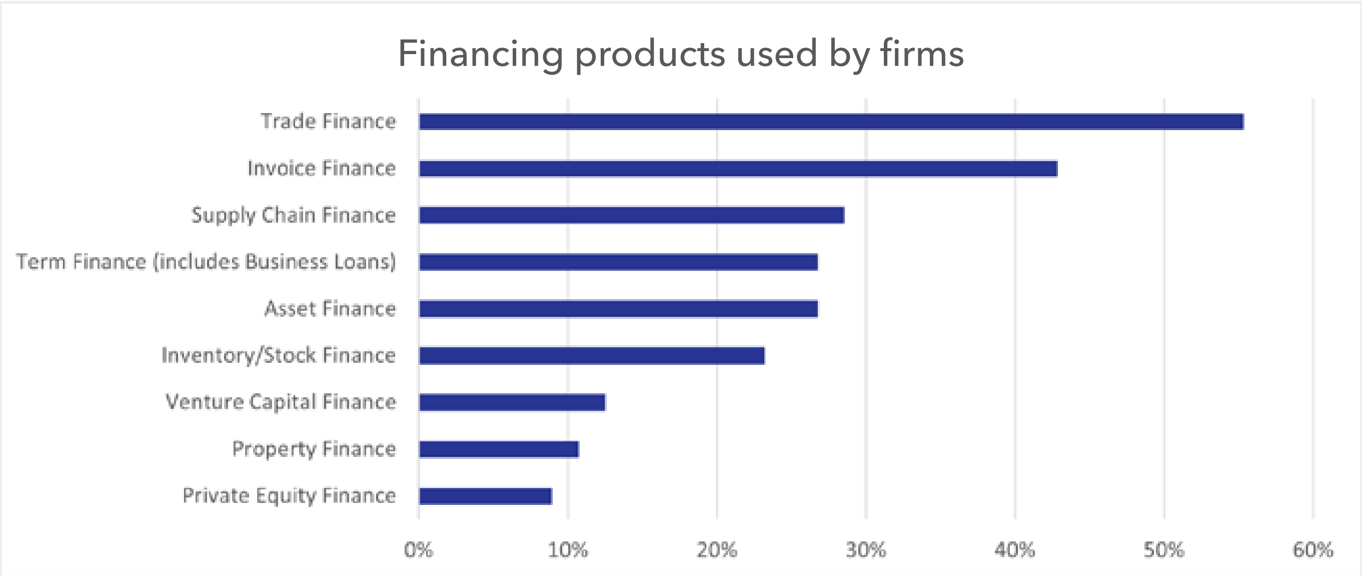

Respondents by location (Europe)
Series1
25%
1%
Powered by Bing
© GeoNames, Microsoft, TomTom

2.1.1 FINANCING USE AMONG RESPONDENTS

Nearly three quarters of all respondents use third-party financing of some sort: 26% use both debt and equity financing, 45% use only debt financing, and 3% use only equity financing.

Of the financing products used by respondents, trade finance is the most popular: 55% use trade finance, 43% use invoice finance, 29% use supply chain finance, and 27% use term finance and asset finance respectively.



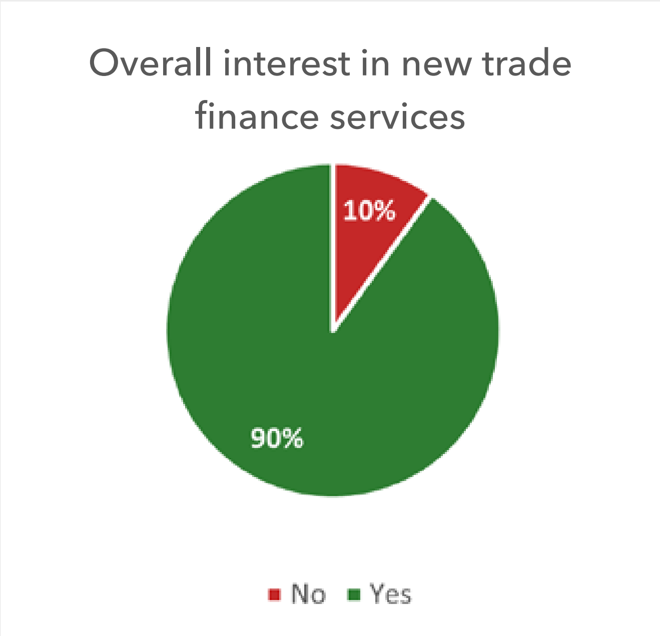


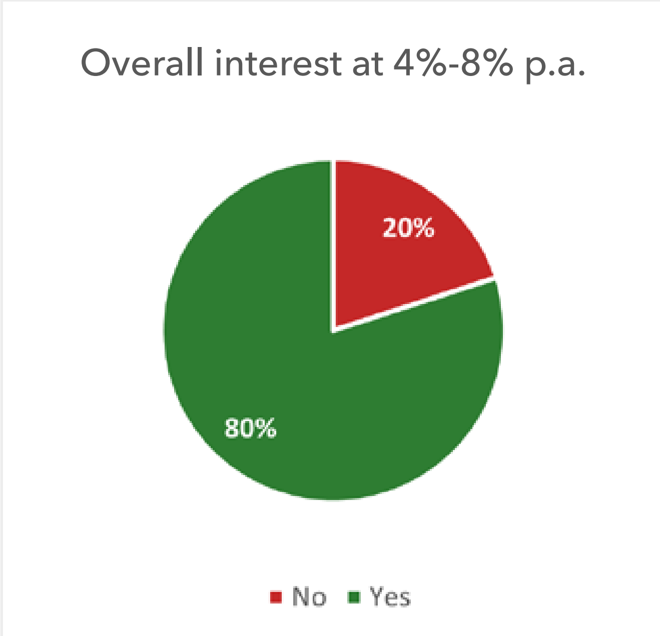

BALANC

2.2 WHAT IS THE APPETITE FOR SME TRADE FINANCE?

In order to guage the market gaps for trade finance, TFG asked respondents whether a specific SME trade finance lending product would be of interest. 90% of respondents showed interest, as it would facilitate financing to pay suppliers and to hold stocks, as well as be useful for invoice finance purposes.

However, when provided with the specific price point of 4%-8% per annum for these services, interest dropped to 80%.





2.2.1 IMPACT OF CURRENT FINANCING COSTS ON PROPENSITY TO PAY

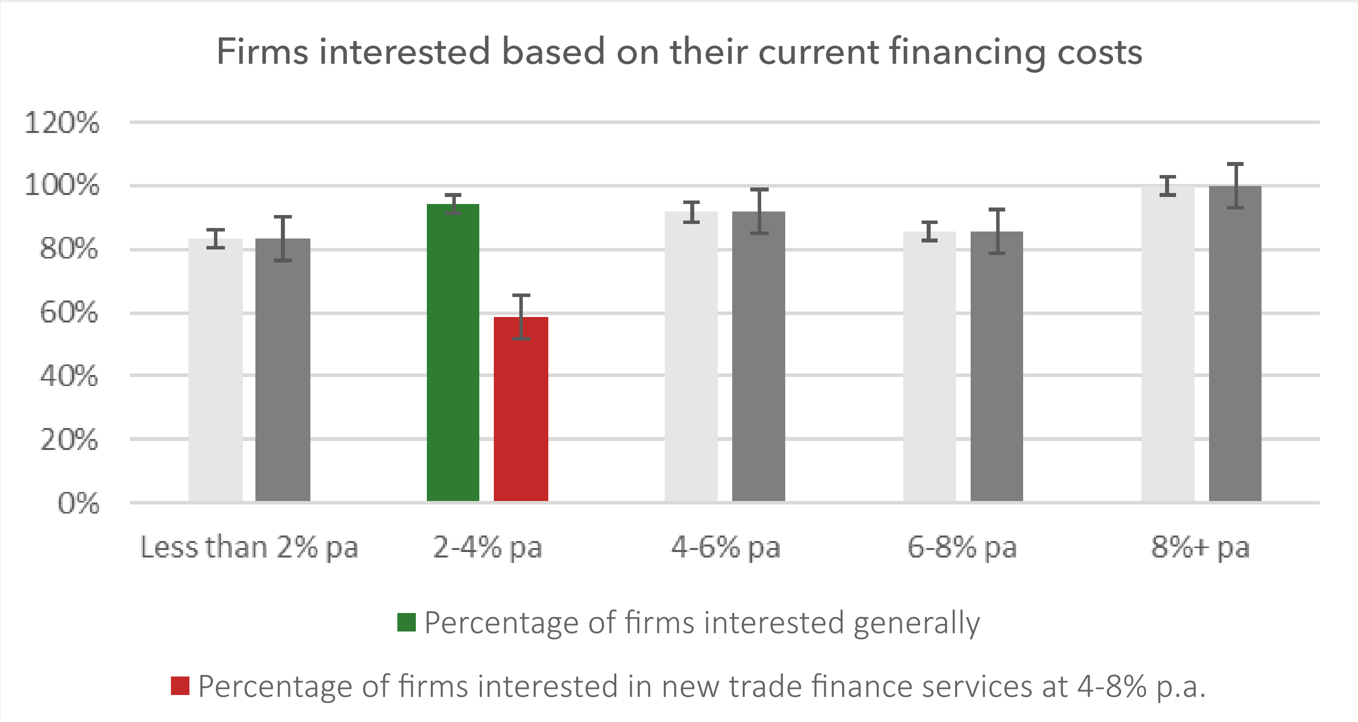
The largest overall drop in interest at the stated price point came from those firms that are already paying 2%-4% per annum.

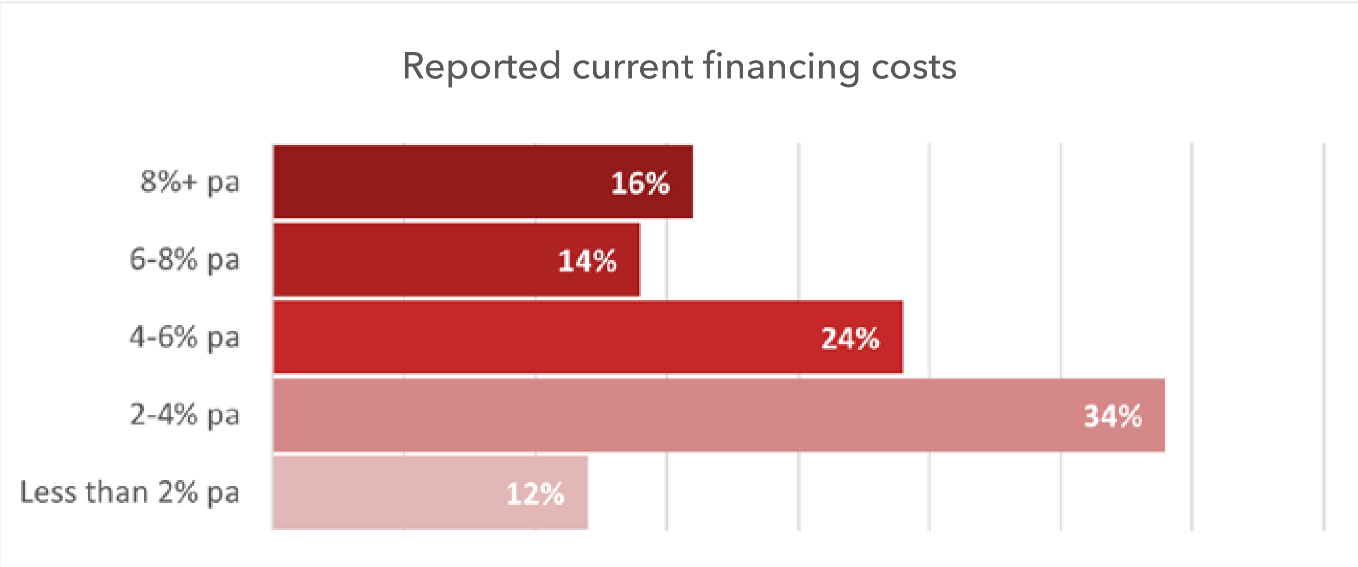
In general, 94% of firms that said they pay 2%-4% for their current financing indicated an interest, but that figure dropped to 59% at the 4%-8% price point.

This decline in interest among firms that currently pay 2%-4% is notable, as this group contains one third of the total respondents, which is the largest of any price point.

Interestingly, the 12% of respondents that currently pay less than 2% for financing did not seem any less interested at 4%-8%.

It is also important to note that every firm currently paying 8% or more for financing was interested in new trade finance services. In total, 16% of respondents currently pay 8% or more for financing.





2.2.2 IMPACT OF FIRM REVENUE ON PROPENSITY TO PAY

A firm's annual revenue also appears to have an impact on the price that it would be willing to pay for trade finance services.

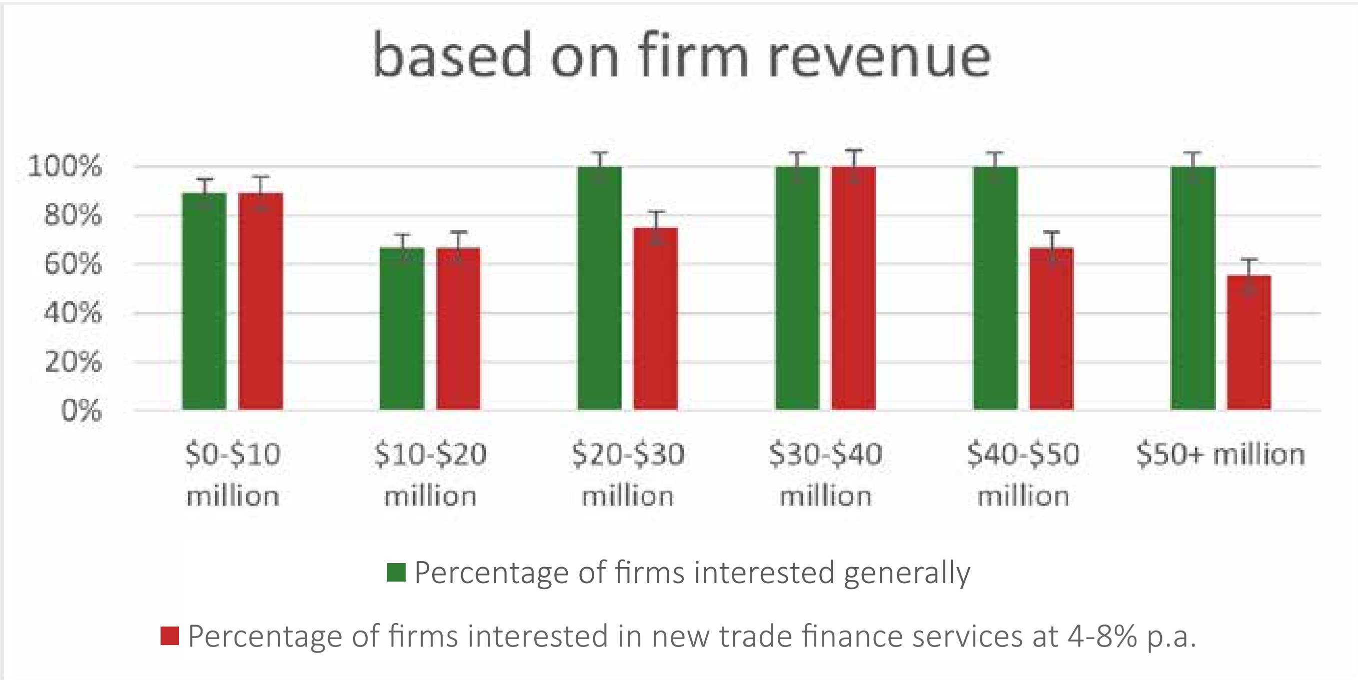
Companies that make $50 million per year or more in revenue tend to be much more price-conscious, with their level of interest dropping from 100% to 56% at the 4%-8% price point.

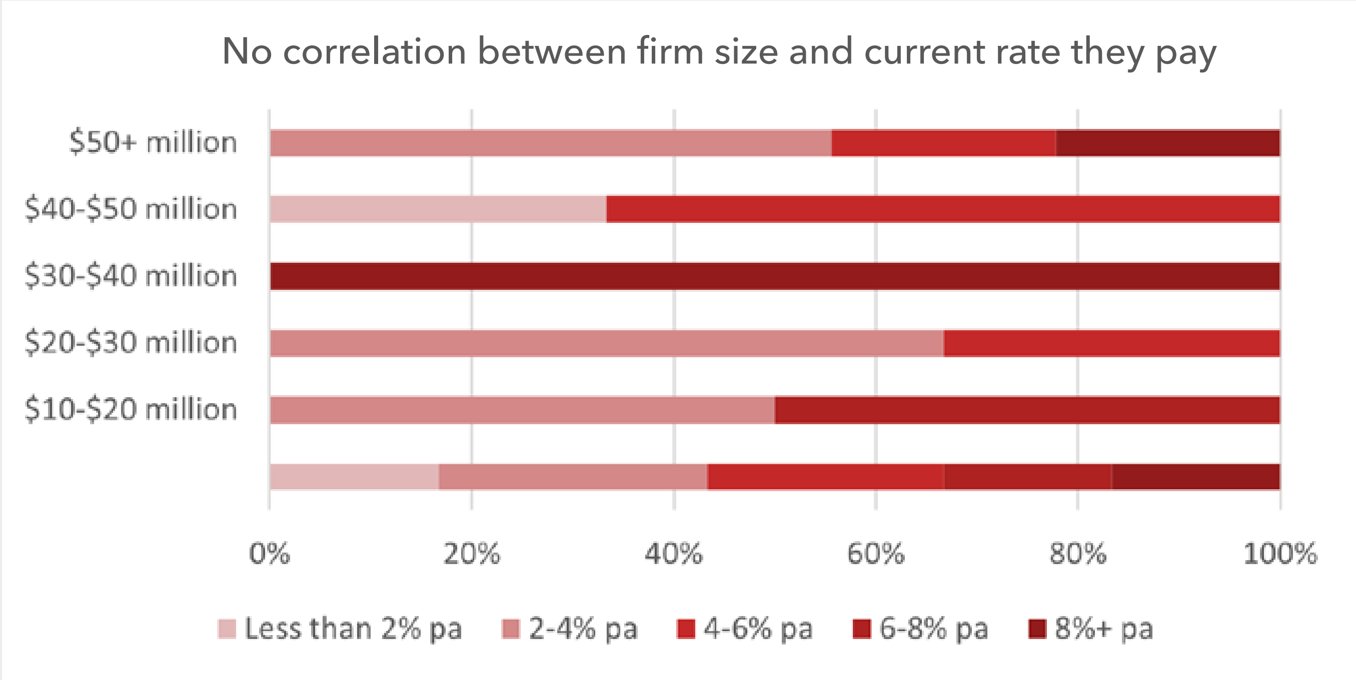
There was a similar decline among firms in the $40 million to $50 million annual revenue category, with interest dropping from 100% to 67% at the 4%-8% price point.

Among firms that earn less than $10 million per year, however, there was no decline in interest at the 4%-8% price point.

Interestingly, there is no correlation between a firm's annual revenue and the current rate that they pay for financing.

This suggests that the increased price-consciousness of firms with higher revenue is not related to the ability of these firms to obtain lower prices for financing products.





2.2.3 PROPENSITY TO PAY BASED ON INVENTORY LEVELS

In general, interest in new trade finance services increased alongside the level of inventory that a firm holds.

Firms that do not hold any inventory showed the lowest interest overall, whereas all firms that hold more than $2 million in inventory said they would generally be interested in new trade finance services.

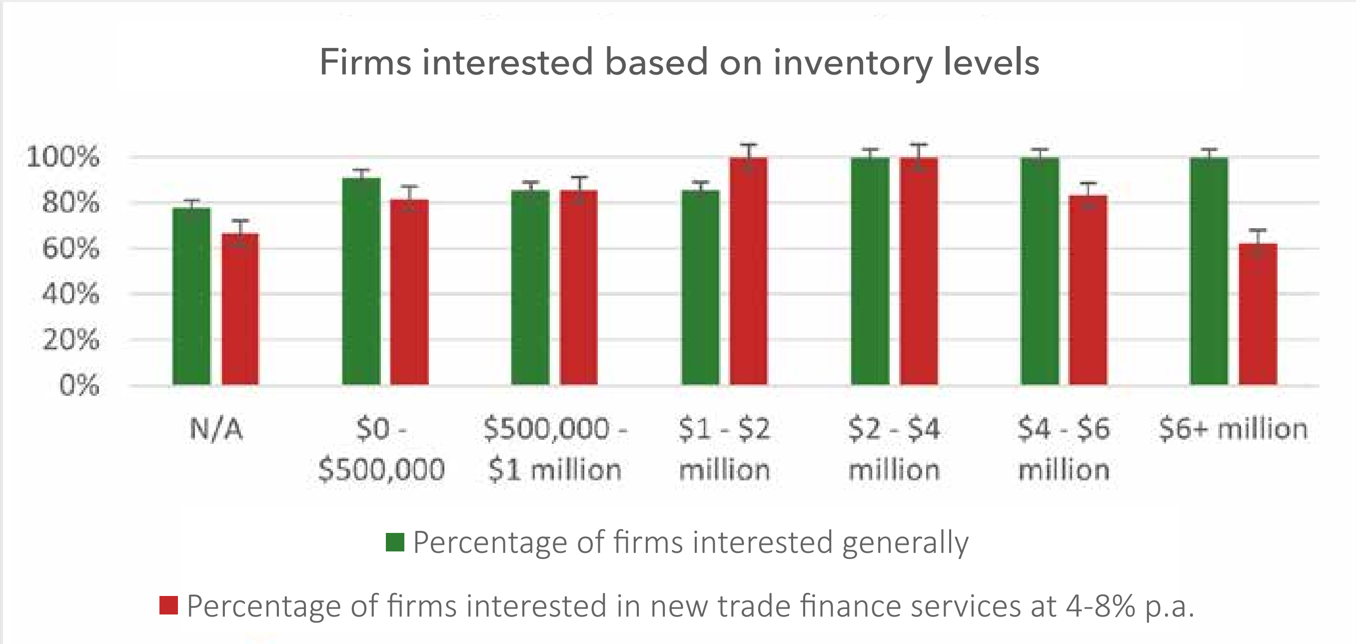
This seems to indicate that the more inventory a company holds, the more they are interested in the means of acquiring financing for that inventory.

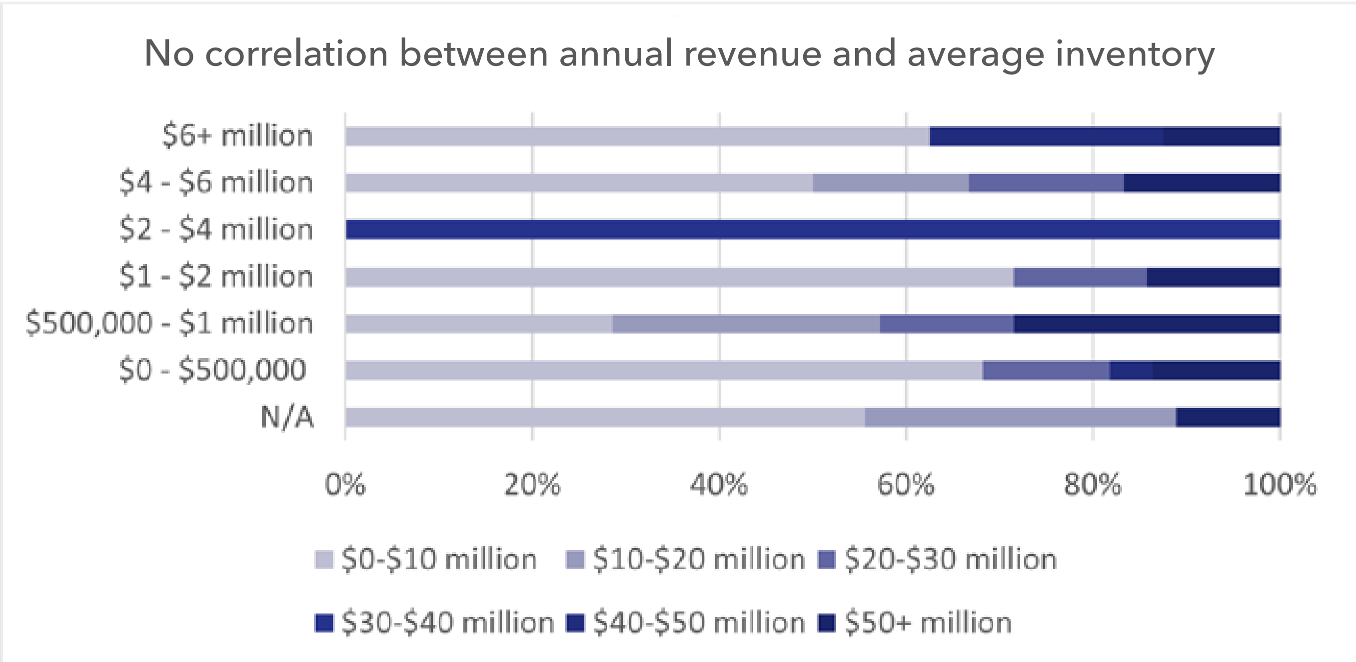
Firms that hold over $4 million in inventory on average lost significant interest in any new trade finance services when offered at the 4%-8% price point, despite being interested when no specific price point was specified.

This seems to indicate that, while firms that hold significant amounts of inventory do see the importance of new financing methods, they are not willing to pay higher prices for it.

It is also important to note that there is no correlation among respondents between their annual revenue and their average inventory (R2=0.0074).

This suggests that the aversion to higher prices among firms with larger annual revenues is unique to those with larger annual inventories.


Firms interested based on inventory levels
100%
80%
60%
40%
20%
0%
N/A
$0 - $500,000
$500,000 - $1 million
$1 - $2 million
$2 - $4 million
$4 - $6 million
$6+ million
Percentage of firms interested generally
Percentage of firms interested in new trade finance services at 4-8% p.a.


No correlation between annual revenue and average inventory
$6+ million
$4 - $6 million
$2 - $4 million
$1 - $2 million
$500,000 - $1 million
$0 - $500,000
N/A
0%
20%
40%
60%
80%
100%
$0-$10 million
$10-$20 million
$20-$30 million
$30-$40 million
$40-$50 million
$50+ million

2.2.4 CURRENT DEBT UTILISATION

In total, one third of all respondents maintain a current debt utilisation level of between 0% and 24%.

A further one third maintain a current debt utilisation level of between 75% and 99%, and 7% of firms maintain a 100% debt utilisation level.

Among the remaining respondents, debt utilisation levels vary from 25% to 74%.

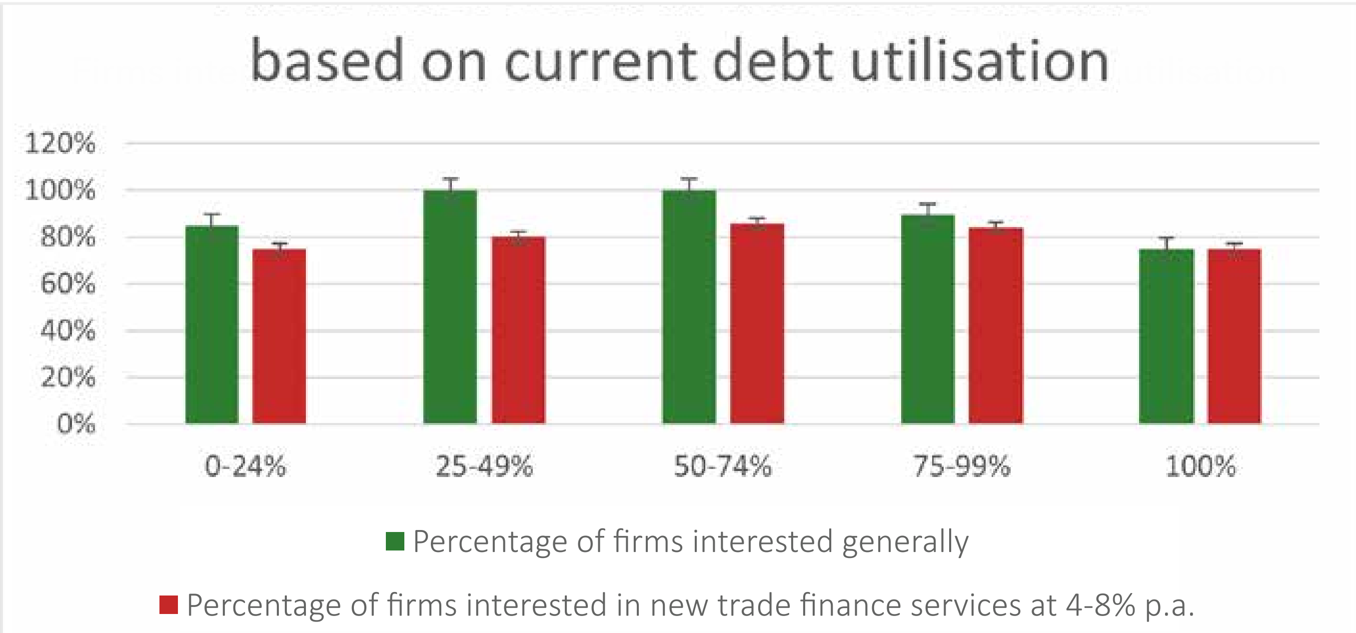
Interest was highest among firms in both the 25% to 49% and the 50% to 74% current debt utilisation ranges.

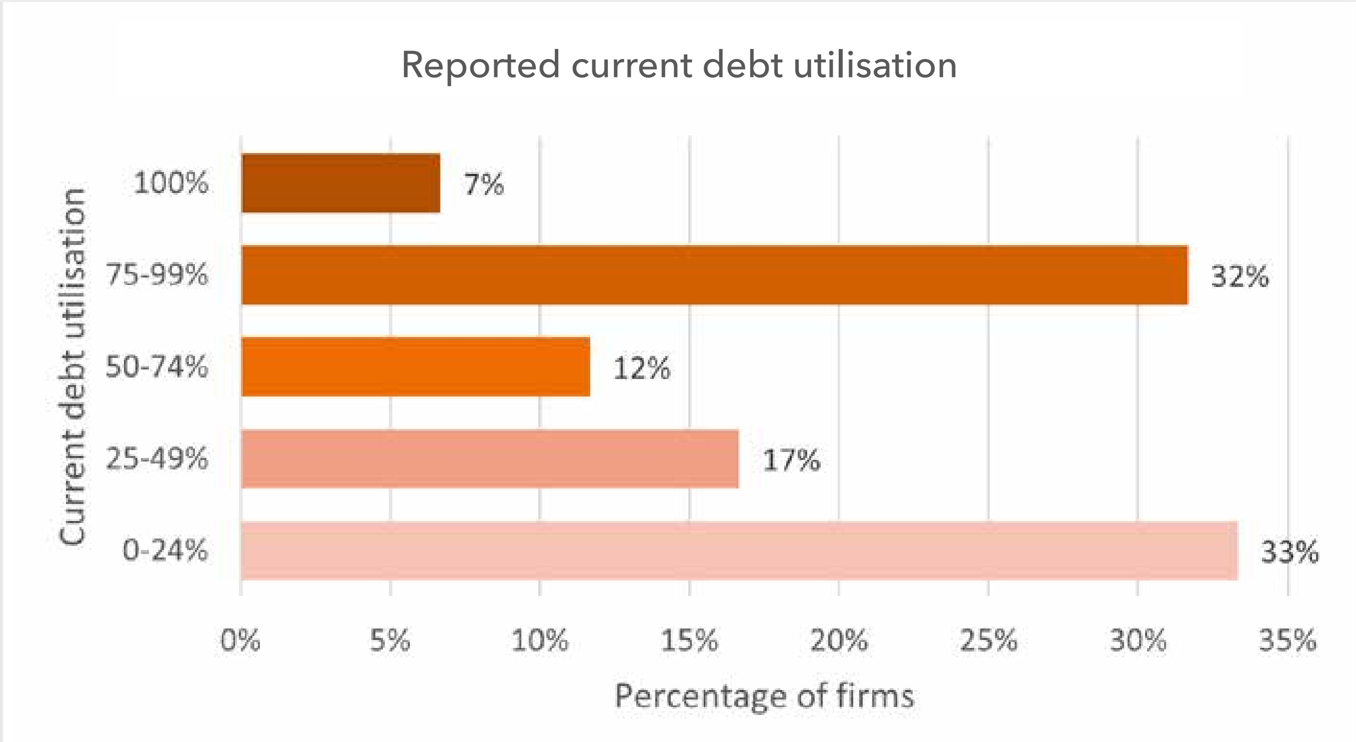
The lowest level of overall interest came from those firms that have 100% debt utilisation; however, the propensity of these firms to pay did not decline at the 4%-8% price point.

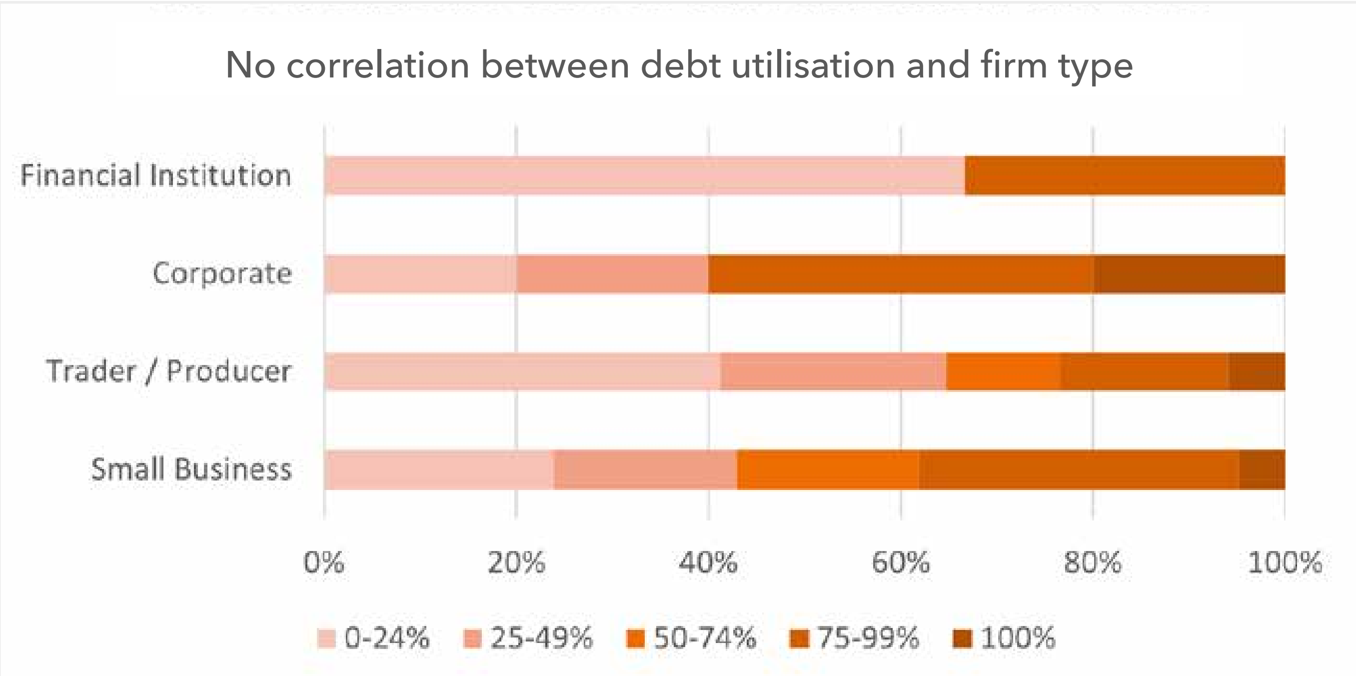
Firms with 0% to 24% utilisation also showed lower than average levels of interest, and their interest decreased even further at the 4%-8% price point.

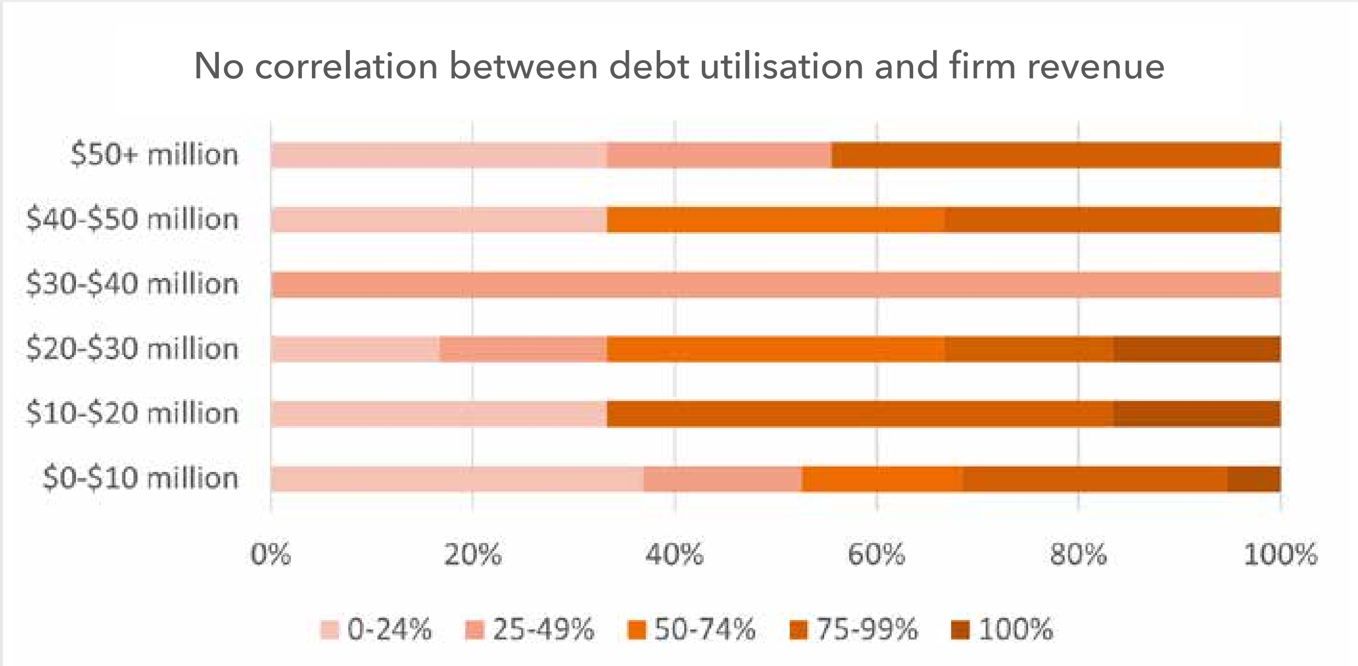
This suggests that firms at this lower debt utilisation level tend to avoid taking on additional debt unless prices are justifiably low.

It is also interesting to note that there is no apparent correlation between debt utilisation and firm type or annual revenue.




Reported current debt utilisation
Current debt utilisation
100%
75-99%
50-74%
25-49%
0-24%
7%
32%
12%
17%
33%
0%
5%
10%
15%
20%
25%
30%
35%
Percentage of firms


No correlation between debt utilisation and firm type
Financial Institution
Corporate
Trader / Producer
Small Business
0%
20%
40%
60%
80%
100%
0-24%
25-49%
50-74%
75-99%
100%



2.2.5 NUMBER OF LENDERS

Over 80% of respondents use three or fewer lenders, for their debt, while 36% use only a single lender, and 13% use five or more lenders.

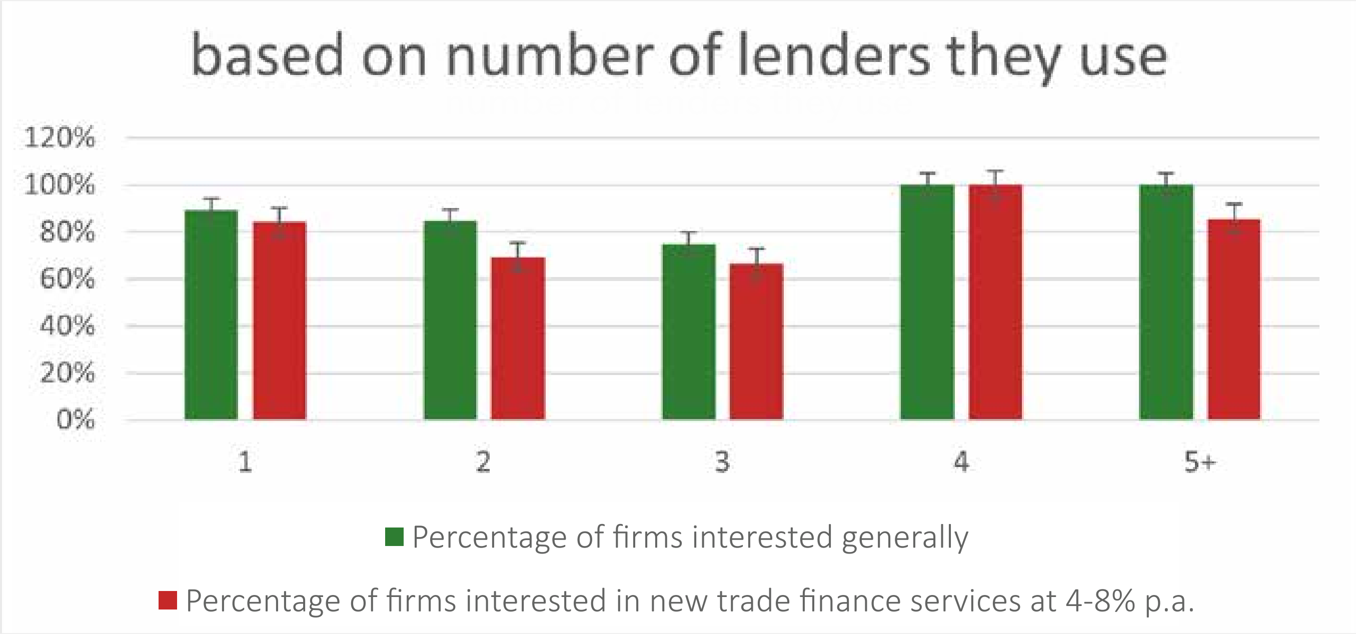
Firms that use only a single lender, and firms that use five lenders or more, are the two groups that showed the greatest interest in new trade finance services.

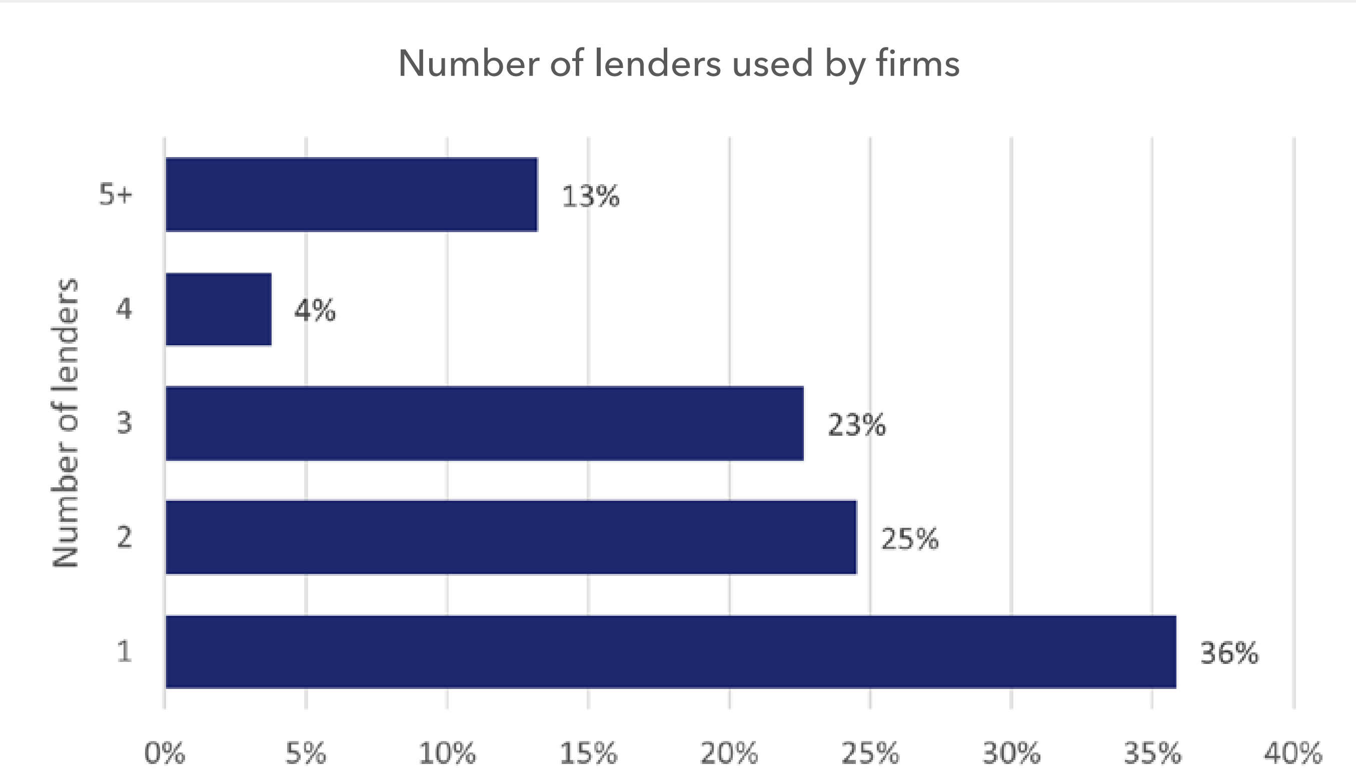
On the contrary, firms that use two or three lenders indicated lower levels of interest.

This suggests that firms without a diversified lender base are interested in adding new lenders.

Moreover, firms that already exhibit strong levels of diversification also appear to be interested in adding new lenders to further diversify.

Conversely, the firms in between these two poles - who have already achieved some degree of diversification by using two or three lenders - were the least interested in acquiring new lenders.


based on number of lenders they use
120%
100%
80%
60%
40%
20%
0%
1
2
3
4
5+
Percentage of firms interested generally
Percentage of firms interested in new trade finance services at 4-8% p.a.


Number of lenders used by firms
Number of lenders
5+
4
3
2
1
13%
4%
23%
25%
36%
0%
5%
10%
15%
20%
25%
30%
35%
40%

2.2.6 PERCENTAGE OF TOTAL DEBT LINES AS BANK FINANCING

In total, 60% of respondents use bank financing for between 0%-24% of their total debt lines.

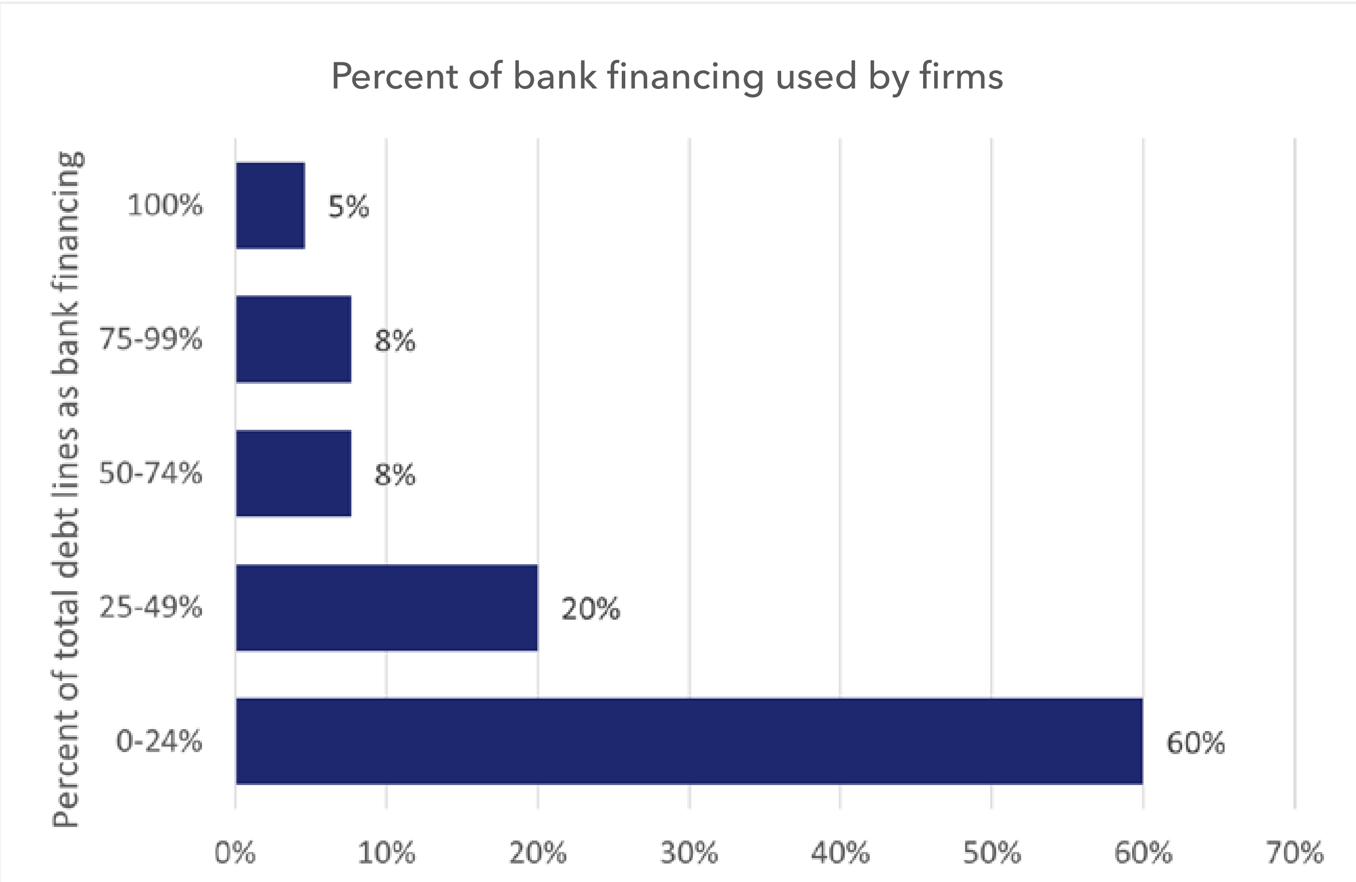
The number of respondents that use bank financing continually dropped as the number of total debt lines increased.

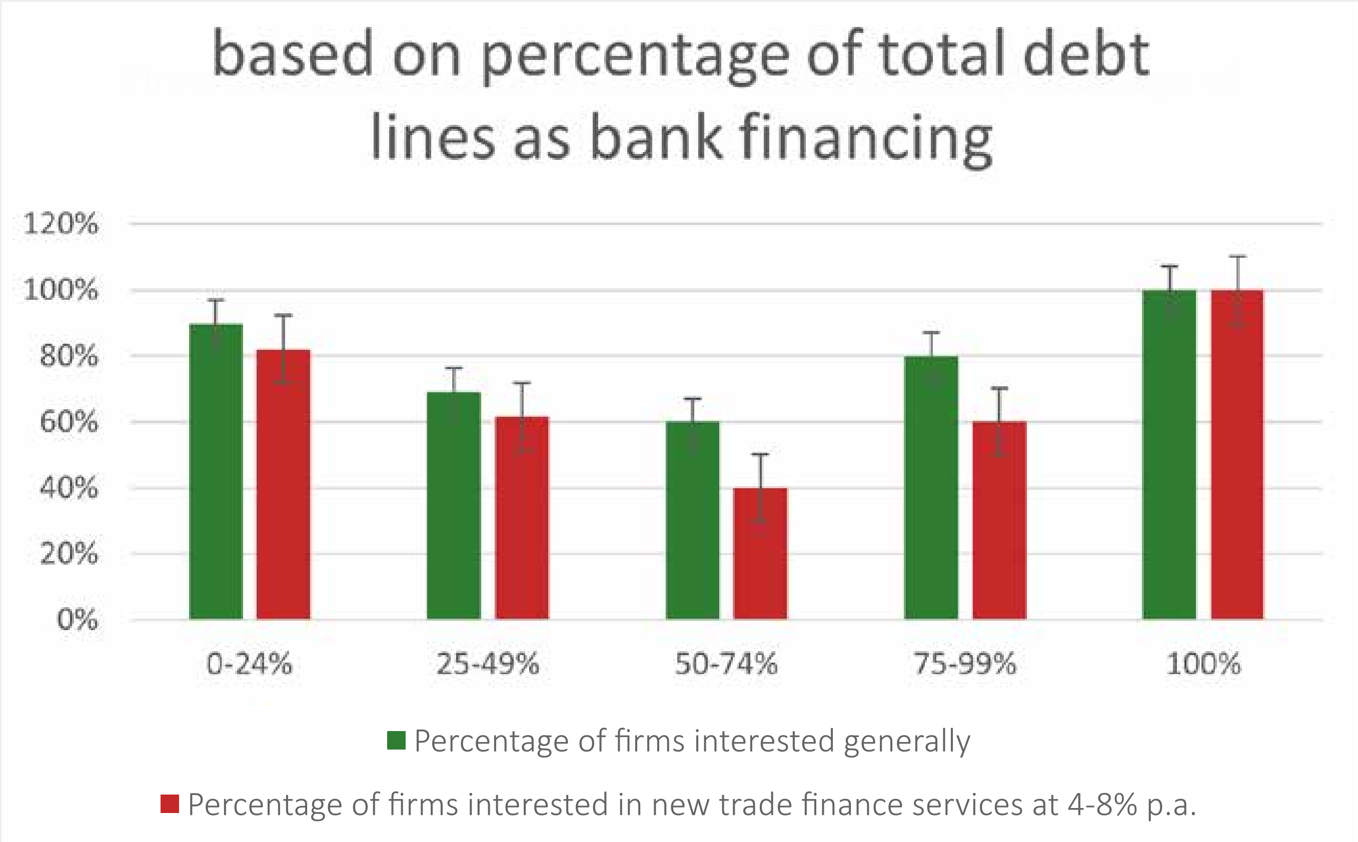
For example, only 20% of respondents use bank financing for 25% to 49% of their total debt lines, 8% use bank financing for 50% to 74% and 75% to 99% of their total debt lines respectively, and only 5% use bank financing for 100% of their total debt lines.

The level of interest in new trade finance services was highest among firms with the smallest amount of bank debt as a proportion of their total debt lines, and among firms with the largest amount of bank debt as a proportion of their total debt lines.

Conversely, interest was lowest among firms in the 25% to 74% range.

As suggested in 2.2.5, this pattern indicates that both the least and the most diversified firms are more interested in taking advantage of new offerings, but those firms that are already somewhat diversified are less interested.




based on percentage of total debt lines as bank financing
120%
100%
80%
60%
40%
20%
0%
0-24%
25-49%
50-74%
75-99%
100%
Percentage of firms interested generally
Percentage of firms interested in new trade finance services at 4-8% p.a.

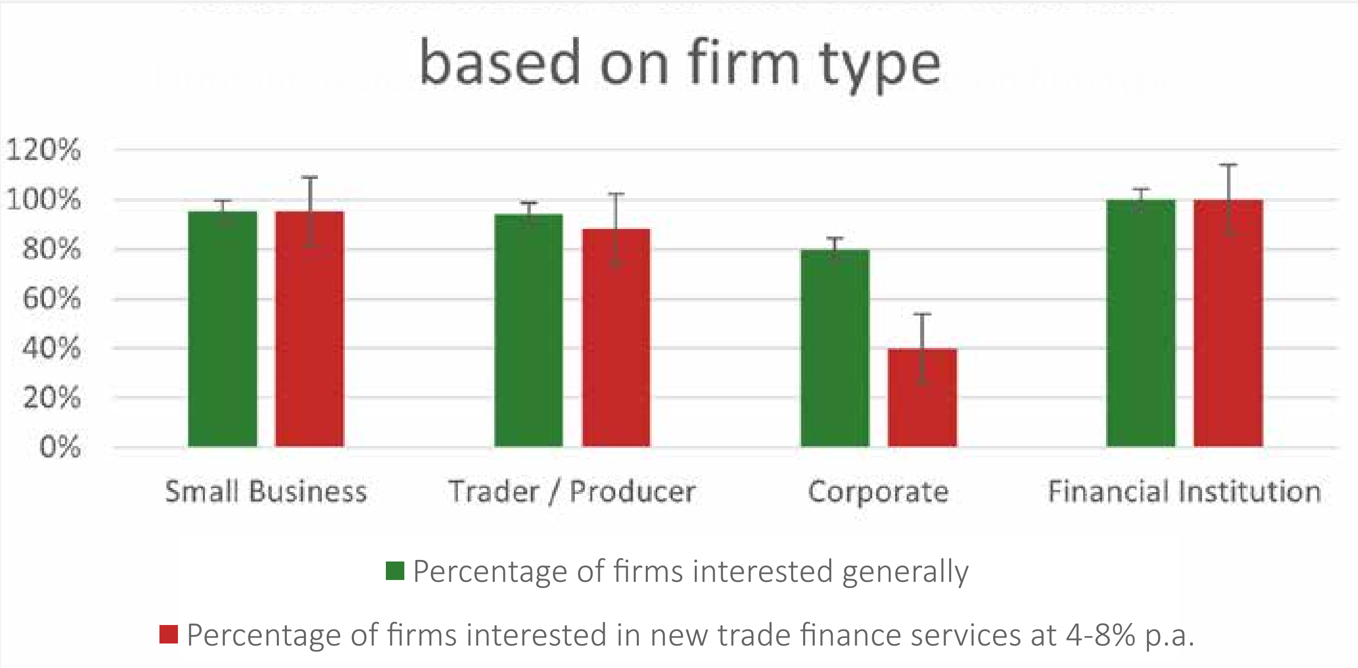
2.2.7 PROPENSITY TO PAY BASED ON FIRM TYPE

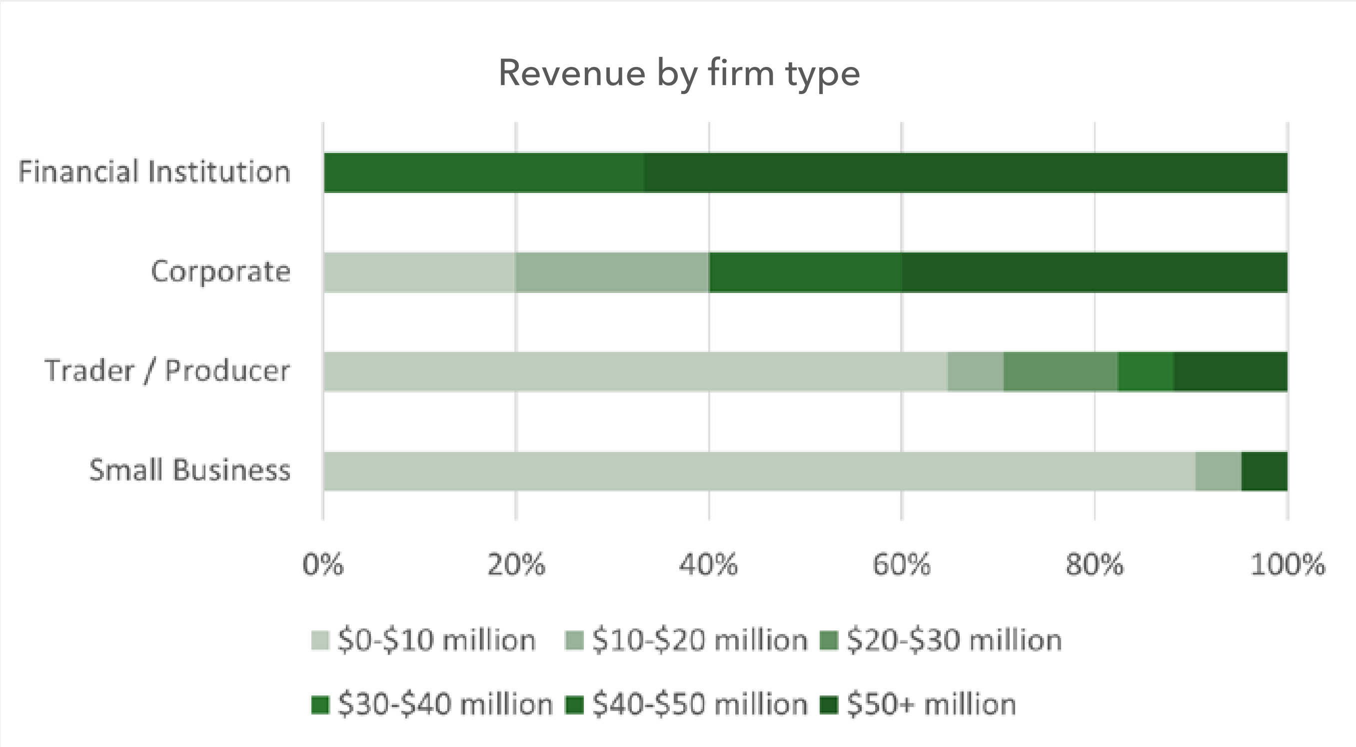
In general, small businesses, traders, and producers were highly interested in trade finance services, even at the 4%-8% price point.

Corporates showed the lowest interest overall, and that interest dropped considerably at the 4%-8% price point.

In general, respondents that self-identify as corporations or financial institutions earn significantly more annual revenue than do small businesses, trader, or producer respondents.

Based on this observation - and the data discussed in 2.2.2 - it is difficult to determine whether these trends ought to be attributed to differences in firm type or to differences in revenue.




Revenue by firm type
Financial Institution
Corporate
Trader / Producer
Small Business
0%
20%
40%
60%
80%
100%
$0-$10 million
$10-$20 million
$20-$30 million
$30-$40 million
$40-$50 million
$50+ million

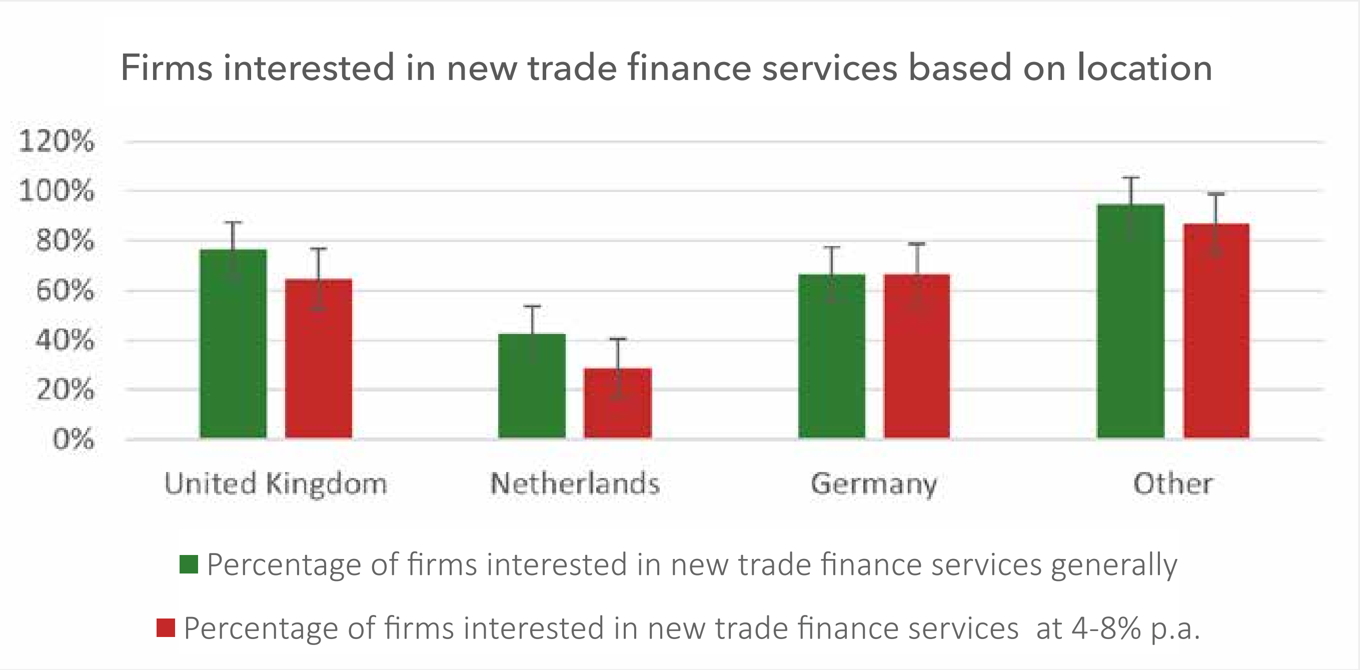
2.2.8 PROPENSITY TO PAY BASED ON LOCATION

To examine the respondents' propensity to pay based on operating location, we grouped them into four categories: those based in the UK, those based in the Netherlands, those based in Germany, and those based in any other region of the world.

Firms based in the UK, Netherlands, and Germany indicated lower levels of interest overall compared to firms based elsewhere in the world.

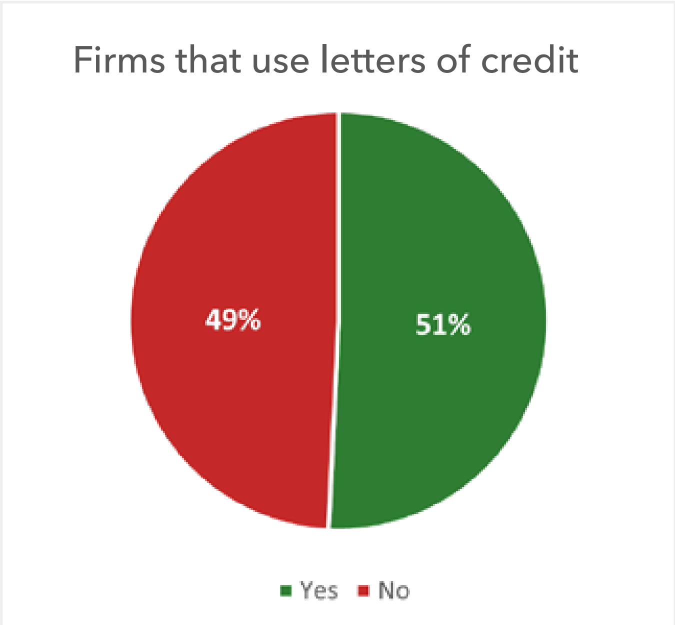
Notably, firms based in the Netherlands indicated the lowest interest overall, at 43%, and that figure dropped to 29% at the 4%-8% price point.

Among firms based in the UK, interest also dropped with the 4%-8% at price point, falling from 76% to 65%.



2.3 LETTER OF CREDIT USAGE

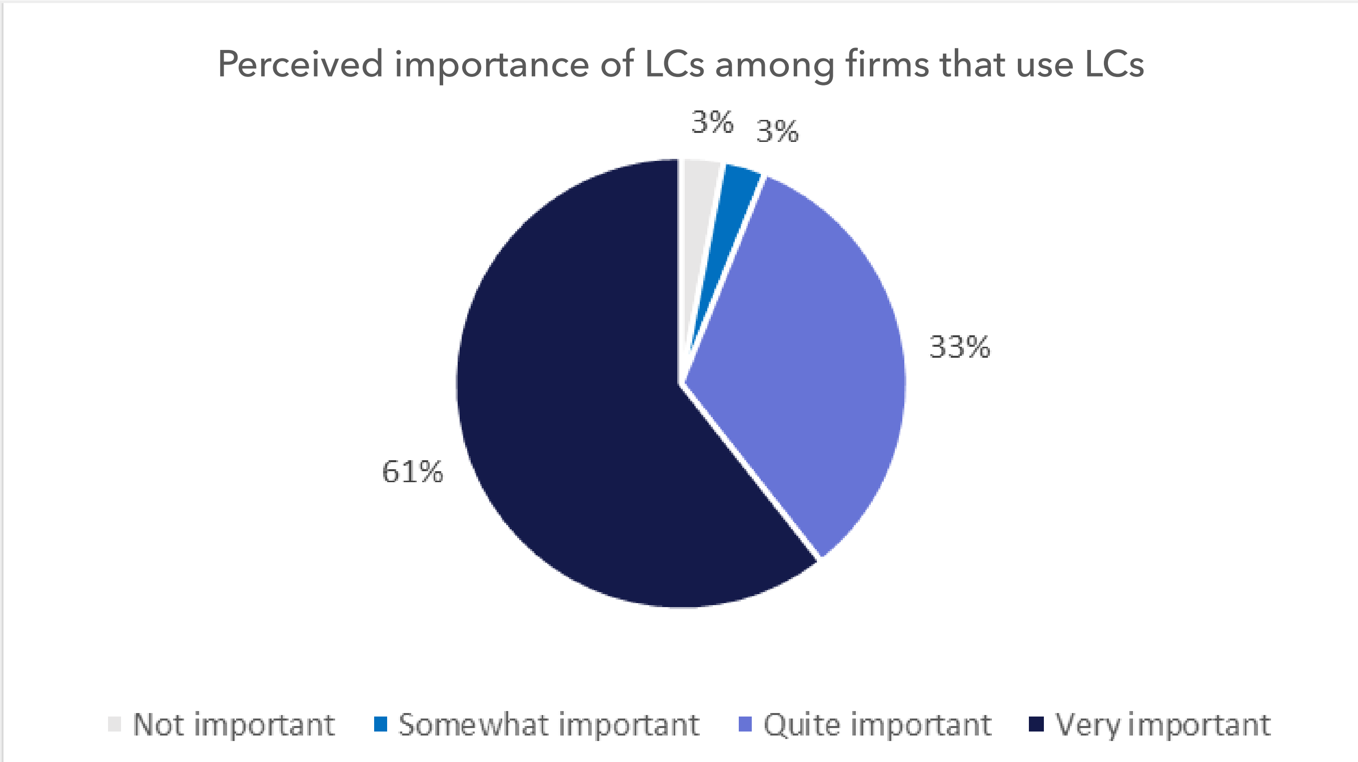
Among all respondents, there was a near-equal split between those that use and those that do not use letters of credit (LCs).



Among those that use LCs, nearly all consider them to be of significant importance to their operations.

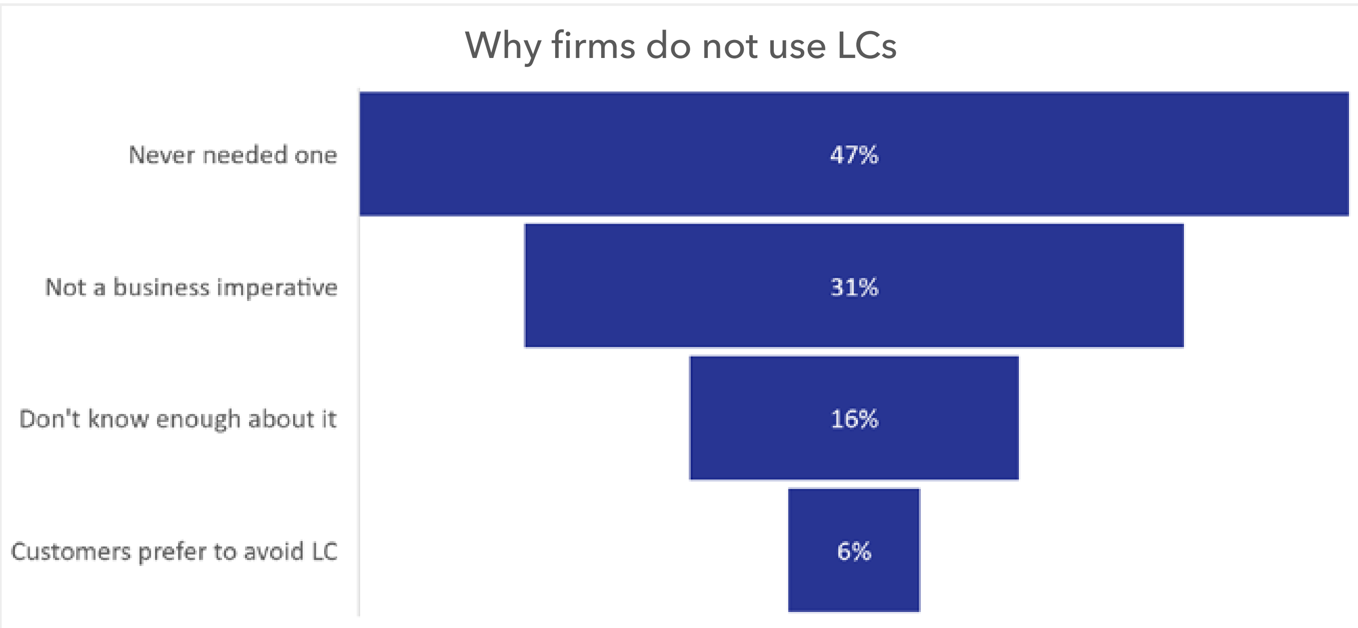
Some 61% said LCs are “very important” to their operations, and 33% said LCs are “quite important” to their operations.

Only 6% of firms that use LCs consider them to be “not important” or “somewhat important”.



Of the firms that do not use LCs, 47% said they have never needed to use one, and 31% said they do not consider them a business imperative.

Only 16% of respondents that do not use LCs cited a lack of knowledge as the reason why, and 6% said they avoid using LCs because their customers prefer to avoid them.



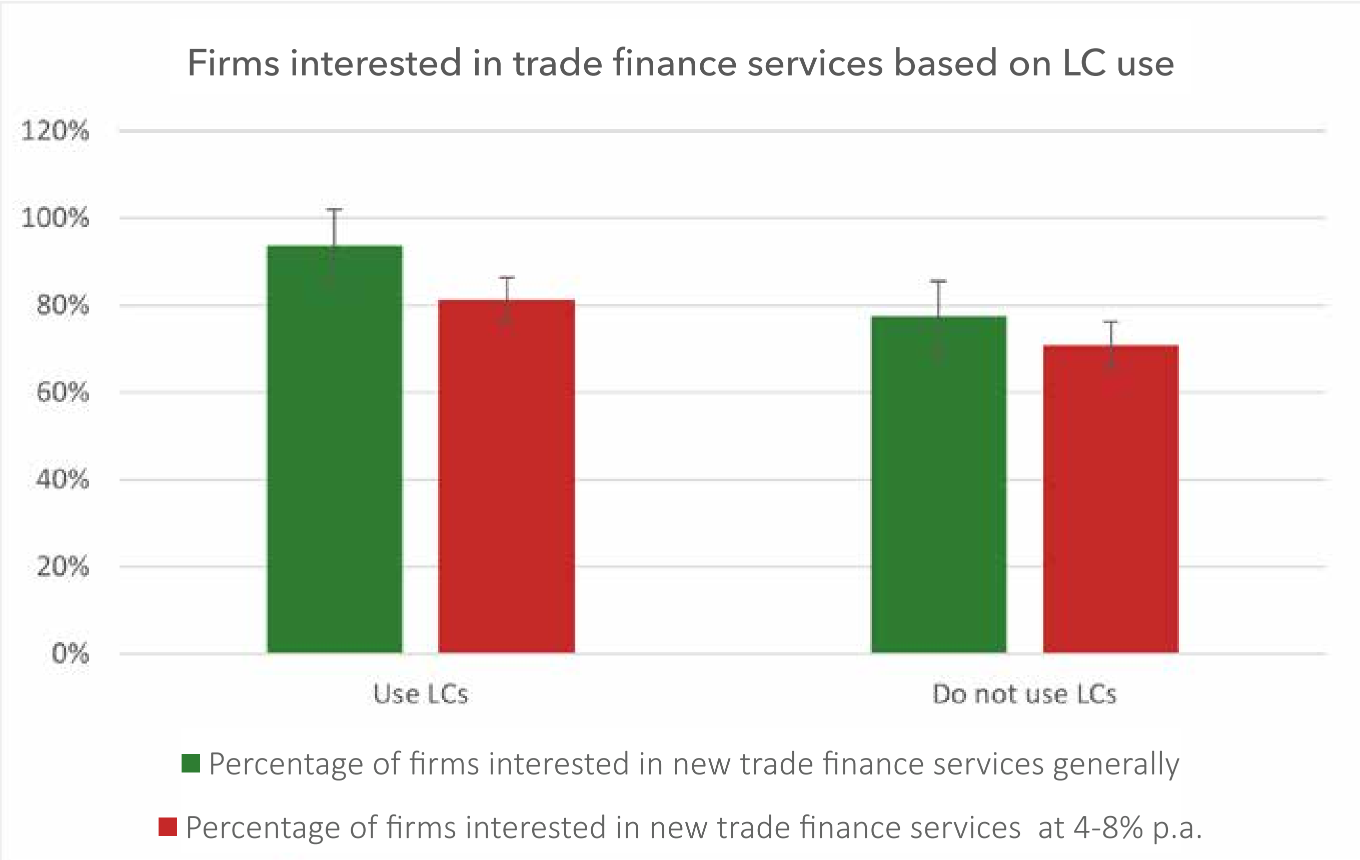
2.3.1 PROPENSITY TO PAY BASED ON LC USAGE

Firms that use LCs showed a higher interest in new trade finance services than those that do not use LCs.

Even at the 4%-8% price point, 81% of firms that currently use LCs said that they would be interested in new trade finance services.

This is significantly higher than the 77% of firms not using LCs that said they would be generally interested in new trade finance services.

This is also higher than the 71% that said they would be interested at the 4%-8% price point.




PROFILE
CREDIT CARD
1 2 3 4 5 6 7 8

3 TRADE FINANCE GAPS

Following the results from this survey, there are clearly some gaps and opportunities for the development of trade finance in these European regions.

This report will now explore market appetite for letters of credit and documentary collections as part of a lending proposition, concluding with an overview of the general market proposition, with specific notes on entering each of the four target markets.

3.1 OFFERING LETTERS OF CREDIT AND DOCUMENTARY COLLECTIONS

Slightly more than half of all respondents use LCs in some capacity, and more than 95% of those consider them to be an important part of their business operations.

Consequently, it is clear that LCs and DCs still hold a prominent position in trade finance for SMEs.

That being said, firms that do use LCs reported a significantly higher propensity to pay for trade, inventory, and invoice facility services than those firms that do not.

This suggests that there is a willingness for firms that use LCs to transition to a new alternative financing opportunity, if it is able to effectively replicate the characteristics of an LC, which these firms consider as very important for their business.

For many traders, the ultimate value proposition of an LC is that it can provide reliable and familiar financing for trade anywhere in the world.

Based on the fact that the overwhelming majority of respondents that do not use LCs indicated that they do not need them or do not consider them a business imperative, other methods of financing should be deemed suitable and made available.

As such, offering alternative instruments such as LCs and DCs as a complimentary service could help increase market share in the short-term.

However, it may not necessarily be the case that firms want these instruments: it could be that they see little other option than to use them for their operations.

Based on these observations, we recommend not offering letters of credit and documentary collections at this time.

Incorporating these offerings will consume resources and may detract from the lender's core offerings.

3.2 MARKET PROPOSITION

This research and survey data highlights a trade finance demand for firms generating $30 million or less in revenue and holding up to $2 million of inventory.

Firms that generate less than $30 million in revenue make up 80% of the respondents to our survey.

This group also expressed a high degree of interest in the services offered, and they had the least aversion to the 4%-8% price point.

Firms that hold less than $2 million of inventory make up 60% of the total respondents, and these firms showed some of the highest propensity to pay 4%-8% for new trade finance services.

INDIVIDUAL MARKET ANALYSES

In each market, we recommend tailoring the core marketing message to meet the conditions that are specific to firms operating in that country

In Belgium, for example, it will be useful to highlight the shortcomings of existing financial providers to meet the needs of SMEs in light of the pandemic.

Emphasising that the lender's new offering will provide a digital and user-friendly means of accessing financing will appeal to this audience, as these are aspects of financial service that are in high demand but low supply among Belgian SMEs.

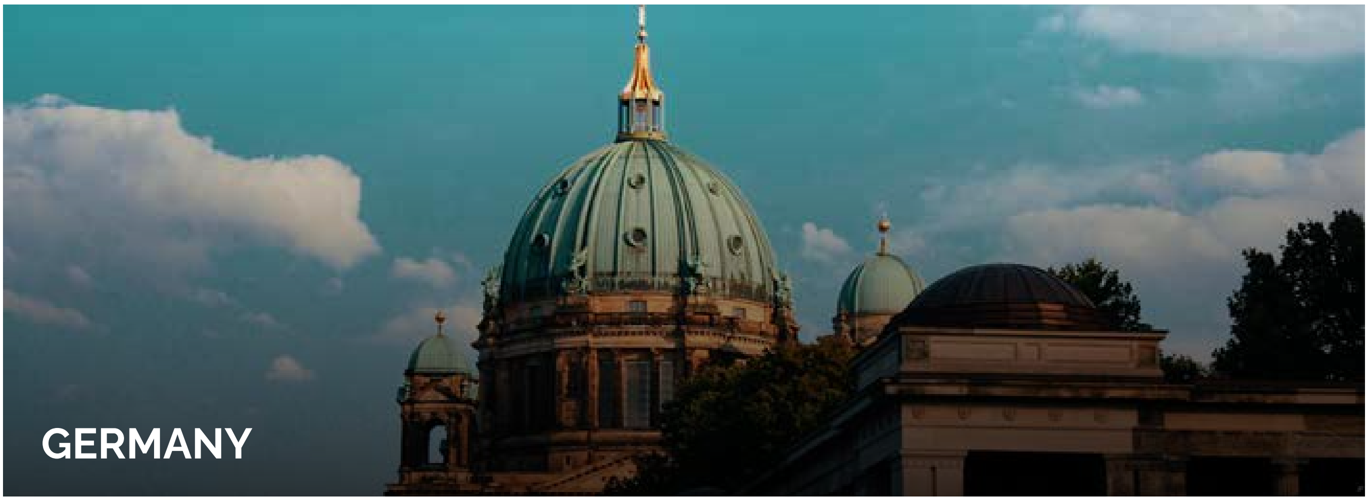
Many SMEs in the UK exhibit a reluctance towards using external financing. To combat this hesitancy, it will be important to tailor messaging to help small firms feel comfortable with taking on external financing for their exporting needs and to acquire the growth that they reportedly desire.

One possible way to achieve this would be to highlight the idea that the region's recent political and economic uncertainty need not necessitate an aversion to external financing as growth capital.

NETHERLANDS

In the Netherlands, our evidence indicates that many small firms do not apply for external financing because they believe that their application will be rejected.

Messaging focused on this touchpoint could inspire more SMEs in the Netherlands market to take steps towards applying for financing.



GERMANY

Germany may pose unique challenges, given its high degree of competition in the banking sector.

However, Germany presents an opportunity to be an early-mover in terms of financial digitalisation.

While German consumers tend to shy away from technology, the pressures of the pandemic have necessitated many digital adaptations, and these may catalyse individuals and firms into being more comfortable with digital offerings - something that incumbent providers may be unable to deliver effectively.

3.3 CLOSING REMARKS

Following the events of the pandemic and the Russia-Ukraine conflict, we at TFG have observed several phenomena at play in the macroeconomic environment, ranging from skyrocketing inflation to plummeting food availability.

These factors mean that any financing programme from the lender that targets SMEs and the mid-market could also be open to larger clients.

Some mid-market and corporate clients may be willing to accept a higher cost of capital in order to increase their trade volumes.

In the current environment, we see demand from many mid-market corporates and SMEs, which are looking for additional flexibility from their trade, inventory, and receivables finance partners - across structures, their asset base, and terms.

We have seen the same demand for liquidity increasing in the corporate space, coupled with a shortage of expertise from the trade finance industry.

Therefore, a bank offering that allows flexibility for the client, where there is a modest compromise on pricing, is an appealing offering as it sits in between clearing banks and alternative finance options.

Offering other trade services as part of the product set, should assist clients to develop their cross-border business.

4 APPENDIX

4.1 SMES QUESTIONNAIRE

What best describes your organisation?

Mark only one oval

- ⬭ Small Business
- ⬭ Corporate
- ⬭ Trader / Producer
- ⬭ Financial Institution
- ⬭ Other ______________________

A) Basic Information

1. What is your revenue/turnover bracket for the last 12 months?

Mark only one oval

- ⬭ $0-$10 million USD
- ⬭ $10-$20 million USD
- ⬭ $20-$30 million USD
- ⬭ $30-$40 million USD
- ⬭ $40-$50 million USD
- ⬭ $50+ million USD

B) Financing Arrangements

2. Do you use any third-party financing (e.g. bank, non-bank lenders)?

Mark only one oval

- ⬭ Yes (debt and equity)
- ⬭ Yes (debt only)
- ⬭ Yes (equity only)
- ⬭ No

3. What financing products do you use?

Check all that apply

- [ ] Trade Finance
- [ ] Supply Chain Finance
- [ ] Inventory/Stock Finance
- [ ] Invoice Finance
- [ ] Term Finance (includes Business Loans)
- [ ] Asset Finance
- [ ] Property Finance
- [ ] Private Equity Finance
- [ ] Venture Capital Finance
- [ ] Other ______________________

4. Do you buy and/or hold stock (i.e. goods)?

Mark only one oval

- ⬭ Yes
- ⬭ No

5. Which financial products would you be interested in using more?

Check all that apply

- [ ] Trade Finance
- [ ] Inventory/Stock Finance
- [ ] Invoice Finance
- [ ] Term Finance (includes Business Loans)
- [ ] Asset Finance
- [ ] Property Finance
- [ ] Private Equity Finance
- [ ] Venture Capital Finance
- [ ] Other ______________________

6. How many lenders do you use (i.e. banks financiers only)?

Mark only one oval

- ◯ 0
- ◯ 1
- ◯ 2
- ◯ 3
- ◯ 4
- ◯ 5+

7. What percentage of your total debt lines is bank financing?

Mark only one oval

- ◯ 0-24%
- ◯ 25-49%
- ◯ 50-74%
- ◯ 75-99%
- ◯ 100%

C) Trade Finance Product Utilisation

8. Do you use Letters of Credit?

Check all that apply

- Yes
- No

Letters of Credit - Usage (Yes)

8. a) How important are Letters of Credit to your business?

Mark only one oval

- Very important
- Quite important
- Somewhat important
- Not important
- Other ______________________________

8. b) Why are Letters of Credit important for your business?

____

____

____

____

Skip to question 14

Letters of Credit - Usage (No)

8. c) Why do you not use Letters of Credit?

Mark only one oval

- ◯ I don't consider it a business imperative
- ◯ I don't know enough about it
- ◯ I've never needed one
- ◯ Other ____________________

8. d) Would you consider providing guarantees or Letters of Credit to your suppliers in the future?

Mark only one oval

- ◯ Yes
- ◯ No
- ◯ Other ____________________

Skip to Question 14

Final Section

9. What do you pay for debt financing per annum (pa)?

Mark only one oval

- ◯ Less than 2% pa
- ◯ 2-4% pa
- ◯ 4-6% pa
- ◯ 6-8% pa
- ◯ 8%+ pa
- ◯ Other
- ◯ N/A
- ◯ Other ____________________

10. A new market entrant is coming in, and providing trade, inventory and invoice finance. Would this be of interest to you (vs your current facilities)? This would allow financing to pay suppliers, to hold stocks, and also invoice finance.

Mark only one oval

- Yes
- No

11. If this new trade, inventory/stock and invoice facility was priced at 4-8% pa, would this be of interest to you?

Mark only one oval

- Yes
- No

12. What features of a trade, inventory and receivables finance facility do you think are important?

Check all that apply

- [ ] Pricing
- [ ] Flexibility
- [ ] Financing wide range of assets
- [ ] Wider countries that stock could be held in
- [ ] Wider countries of sale/customers could be incorporated in
- [ ] Time
- [ ] Other ______________________

13. How much stock do you hold at any one time?

Mark only one oval

- ⬭ $0 - $500,000 USD
- ⬭ $500,000 - $1 million USD
- ⬭ $1 million - $2 million USD
- ⬭ $2 million - $4 million USD
- ⬭ $4 million - $6 million USD
- ⬭ $6+ million USD
- ⬭ N/A
- ⬭ Other ______________________

14. What percentage on average (in terms of average drawn amount/utilisation) do you use your debt facilities?

Mark only one oval

- ⬭ 0-24%
- ⬭ 25-49%
- ⬭ 50-74%
- ⬭ 75-99%
- ⬭ 100%

15. What country is your company based?

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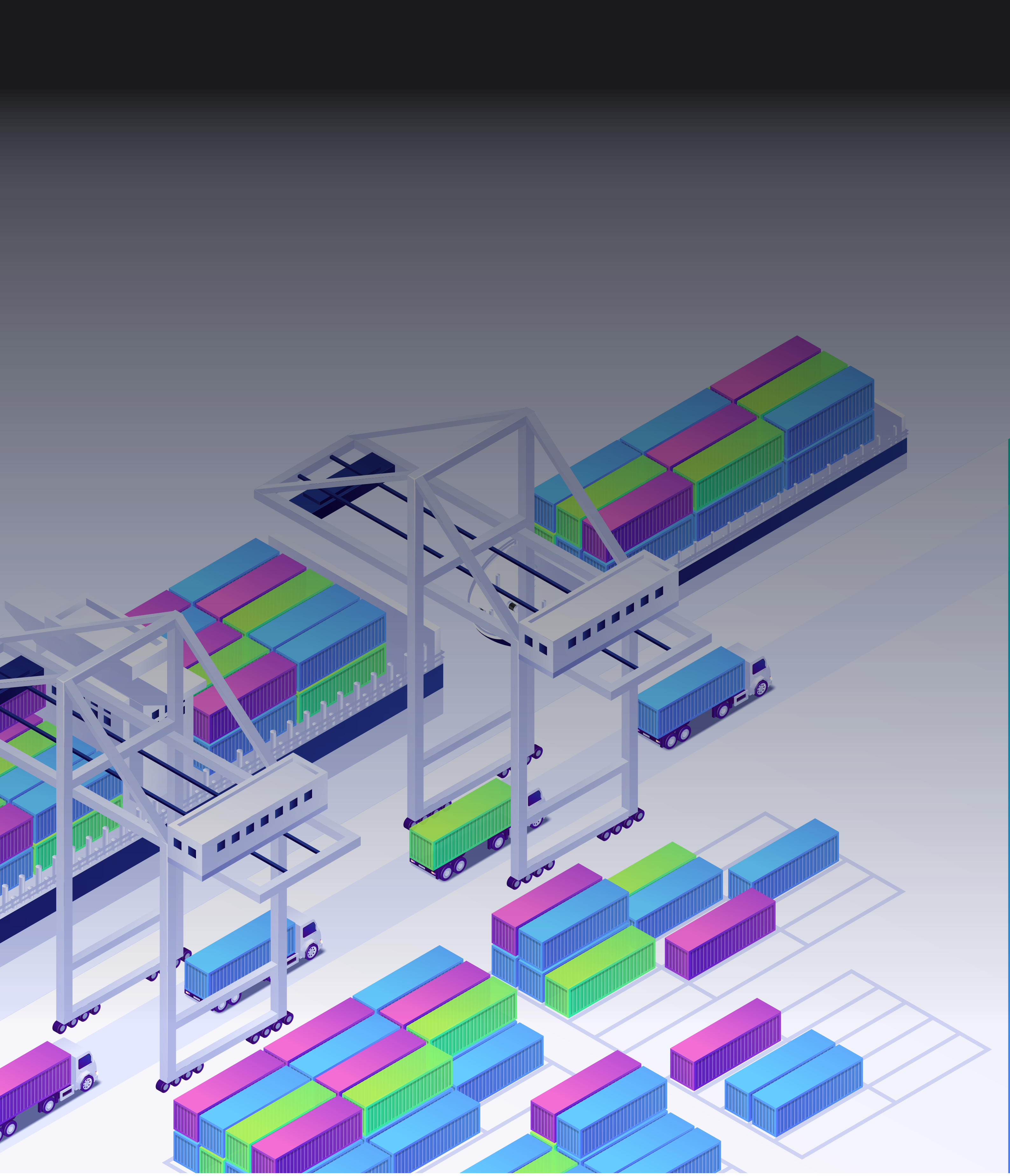
ABOUT TRADE FINANCE GLOBAL

TRADE FINANCE WITHOUT BARRIERS

Trade Finance Global (TFG) is the leading B2B fintech in trade finance. TFG's data-led origination platform connects companies with innovative trade and receivables finance solutions from over 300 financial institutions.

This is combined with TFG's award-winning content, informing a global audience of 160k monthly readers (6.2m impressions) – across app, podcasts, videos, magazines and research.



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