International Banking: A Myth? —

Access Gap in Cross-border Trade Finance

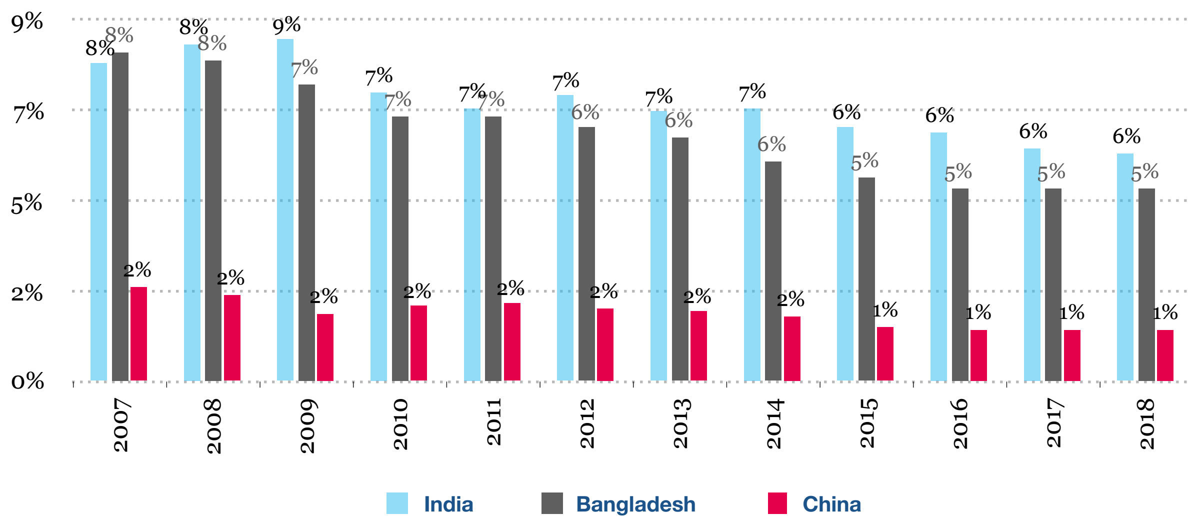
by Shruti Sood | interlinkages.online

April 06, 2019

Local vs Global Banking

World's local bank – is there such a thing? It would seem not, or so suggests the data. Foreign banks share of banking sector assets is abysmally low especially so for large emerging market countries. Apart from the asset size of foreign banks, participation in cross border settlements is low as well. Growth of emerging economies, that have deeper roots and larger credit appetites, are typically supported by domestic banks - as the chart shows for China and India, which are 2nd and 6th largest economies in the world. To be fair, there is also the case of regulatory advantage which is sometimes skewed in favour of domestic banks and supporting the local currency. The chart clearly depicts that for access gaps to be plugged, especially for the small and medium enterprises (SME) in emerging countries, the delivery channel needs to include domestic banks.

Chart 1: Foreign banks share of banking sector assets



Source: Reserve Bank of India. Statista.com, ceicdata.com, India data updated till 2018, Bangladesh till 2016 and China till 2017

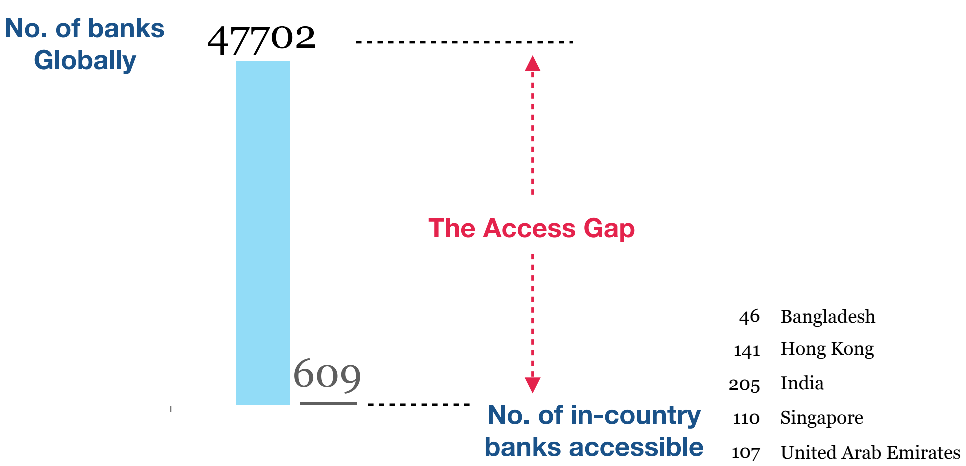
The Bank Gap: A Reality

The next level of analysis is to see how spread out this access to foreign financial institutions actually is. According a report published by the New York Fed in 2014, which focuses primarily on US exports, while US banks provide trade finance to most countries, the business is highly concentrated with 90% of the market being covered by the top 5 banks. Considering the US of A has 4687 commercial banks, as a foreign trade counterpart one is accessing only the tip of the iceberg when it comes to banks that could potentially provide trade finance.

The other important point to note is that these top 5 banks in fact work on an originate-to-distribute model. This means that they further distribute the emerging market deal originations to other banks. A hold-to-maturity bank is one that keeps the risk on its book and this could be a regional bank, a community bank or even possibly an emerging country bank. So even though there are many more banks with an appetite to hold emerging market trade risk, corporates end up paying opaque intermediation fees to a select few because of lack of access.

The chart below shows there is a big gap in terms of international banking reach especially so for emerging market countries such as Bangladesh and India.

Chart 2: The Access Gap



Source: S&P Capital IQ

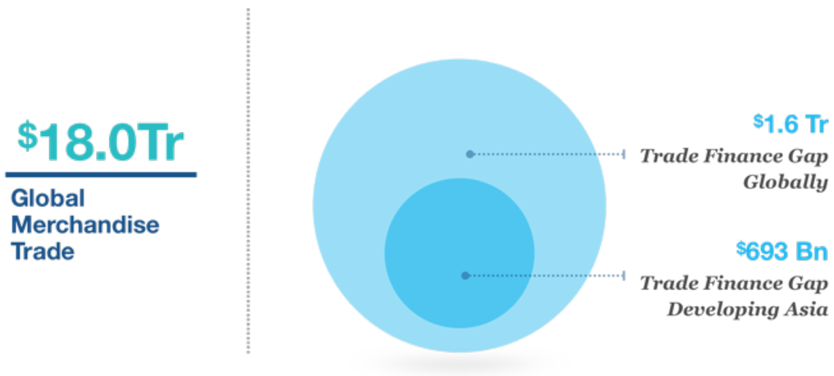
Case Study: Germany - India trade corridor

Germany is India's 6th largest trade partner with a total trade of USD 20.33bn (2017-18). While the number of banks in Germany stand at over 650, there is only 1 German bank in India with a full branch license and ability to transact in the specific trade corridor. The other four German Banks only have representative offices in India. And these banks typically do not deal with the small, and medium-sized enterprises. Thus, SME trade finance requirements continue to be funded by local banks in INR or USD. As local cost of funding applies, this option becomes quite an expensive proposition and leads to lack of competitiveness.

The Access Gap Quantified

As per the International Chamber of Commerce (ICC) survey, MSMEs across the world are the hardest hit due to the gaps in cross border trade finance, estimated at US$ 1.6 trillion globally and US$ 693 billion in Developing Asia. The cross-border trade finance market, which is estimated to be approximately USD 18.3 trillion, is beset with problems typically associated with a brick and mortar model one of which is lack of access especially for MSMEs. As per a survey conducted by the Asian Development Bank in 2017, 74% of rejected trade finance transactions come from SMEs and midcap firms.

Chart 3: Gap in Trade Finance



Source: 2017 Trade Finance Gaps, Growth, and Jobs Survey, Asian Development Bank

Reasons for poor access

MSMEs in emerging countries lack access to efficient and cost-effective trade finance products for the following reasons –

- their reach is limited to the banks present in their country and typically to their relationship banks
- lack of information on other banks (local or global) who might have appetite on their markets
- small ticket SME transactions end up being commercially unviable for traditional banking channels to finance on a stand-alone basis
- lack of structuring expertise around credit wraps and insurance covers that help in making the risk distributable and bring down the financing cost. Multilateral agencies who have such mandates lack access to corporates who can use these facilities

Trade Finance and Financial Inclusion

As per ADB's 2017 Trade Finance Gaps, Growth, and Jobs Survey:

- At least 36% of rejected trade finance may be fundable by other financial institutions.
- A 10% increase in trade finance could boost employment by 1%.
- 80% of banks report digitization will cut costs, yet no evidence that savings translate to additional trade finance capacity.

Improving cross border trade finance access for MSMEs, enhancing efficiency and providing cheaper foreign currency financing to bridge access gaps is necessary to enable growth and sustained employment generation. While digitization seems an obvious answer to the problems faced by MSMEs in accessing trade finance solutions a lot needs to be done to raise awareness amongst MSMEs and bridge the knowledge gap.

About the Author

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Shruti Sood is the Cofounder and Director of Interlinkages Online, a Trade Finance Marketplace. Shruti has 15 years of experience in Global Banking and Markets in Research and Sales roles across geographies covering asset classes including FX, credit and rates. Shruti has worked with large International banks across London, India and Hong Kong before cofounding Interlinkages. Shruti holds a Post graduation in Management studies from Indian Institute of Management, Ahmedabad.

About Interlinkages

Interlinkages Online (www.interlinkages.online) is the first online platform which facilitates Importers and Exporters in accessing Trade Finance from banks around the world for their Letter of Credit backed imports or exports. The platform has a transparent deal matching mechanism which endeavours to make inaccessible banks accessible through a click of a button and provides seamless cross-border Trade Finance experience. Interlinkages delivers faster financing quotes and cost savings hassle free, for its clients through its online platform. Interlinkages team helps their clients be more profitable and grow their business by providing optimum solutions like Suppliers Credit, Usance Payable at Sight, LC Confirmations and Reimbursement Finance through its online platform. Interest cost savings for Interlinkages clients ranges from 0.20% - 1.50% per annum.

Interlinkages is headquartered in Hong Kong and has clients in India, Hong Kong, Singapore, Dubai and Bangladesh and has closed more than 200 transactions across 22 trade corridors

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