

TRADE FINANCE IN THE DIGITAL ERA

THE POSITION OF GUARANTEE ACTORS

(Note that rare counter examples can exist for some of the following assertions, which still are, in our opinion, representing the majority of cases)

Guarantee organizations face many obstacles when trying to develop an offer on specific financial instruments answering the need of enterprises engaging in international activities.

Consequently, in spite of public authorities' intentions, few dedicated guarantee funds exist for such financial tools.

- Guarantees can technically and in theory share risks on short-term trade financing (and sometimes long-term financing for investments).

Counter guarantees are offered to banks delivering letters of credit, document-based credit, performance bonds, bonds related to advance payments made to the exporter, and bonds ensuring a satisfactory technical accomplishment to the final buyer.

- Risk analysis is difficult: beyond data on national actor, access data on foreign party data, when SMEs are concerned, is limited or costly. Asymmetry of information is increased.

International credit insurance schemes exist in several countries (institutions such as COFACE in France), but is covering mostly the "country risk", or environmental risk linked to political or social events in the foreign country.

For the risk of default of the buyer, or the risk of non-performance of the supplier, large foreign corporate enterprises (and sometimes the larger SMEs) can also be analysed, allowing risk rating and a good definition of risk costs.

But if the foreign party is an SME, such elements become very uncertain, and the ratio: "operational cost to potential profit" becomes dissuasive.

- The complexity of the international operations, a true chain process, involves many actors which all can interfere with risk elements, as the final positive result depends on the true reliability and efficiency of each link:

The chain goes from the exporting firm to its bank, then involves all or several of the following export intermediaries or associated parties: brokers, credit insurers, shipping companies, insurance companies, tax authorities, technical regulation authorities and control bodies, clients and clients' bank.

Each stage, each participant can have an influence on the success or the risk of the operation, and require perfect knowledge on its action, its principles, its experience, before risk stakeholders can rely on it.

- Specific rare technical skills are needed in the staff of the Loan Guarantee Scheme (LGS) to enter safely into operation with the aptitude to dialogue and confirm the proposal of the other elements of the chain; but the usually small staff size of most LGS make export staff specialists in their ranks a rare commodity.

Specialized financial actors exist, working with limited populations of well experienced SME actors ; thus not addressing the vast majority of would be exporters.

All these factors limit the spontaneous expansion of possible cooperation between LGS and these specialized entities to the benefit of a large population of SMEs.

- Risk level is high if not sufficient technical experience and experience in the destination legislation is available: the possibility of default of foreign party (either payment or faulty/improper supply) has to be generally suspected, and the matter has to be cleared before operating.

Recovery on default can be low, or nil for the financial actors involved.

Public authorities generally hesitate to develop in a large-scale guarantee instruments before the operator's technicality and risk management ensure a reasonable probability on the business model of such guarantees.

- Data bases needed for risk analysis exist in most Western countries.

But beyond data on corporate and large enterprises, reliable data on SMEs are scarcer and less complete, and barely accessible due to confidentiality matter aspects, from the SME and from its banker.

Data bases are often limited to financial aspects (financial performance, credit history...), but there is a lack of information on the other indispensable dimensions of the risk: professional reliability, technical ability, legal aspects of operations...)

- Data needed for project analysis, which can be available in the foreign client's country, can often be structured in unmanageable form for interlocutors in the bank or the LGS, especially if they lack sufficient practice on such operations.

Access to it is made more complex to request from abroad (language, restrictions/protection from each national legal framework ...).

Resulting from all these impediments, the development of support from LGS to international activities has in most cases (apart from notable exceptions) a limited outreach for what concerns SMEs, due to lack of resources and technical/legal experience in most institutions.

The digital (r)evolution opens some interesting trails for a positive evolution

- Digitalization is creating a progressive improvement of accessible structured data on SMEs from reliable sources, based on standard regional (and sometimes world-level) regulation. The impact of big data opens other possibilities; the development of artificial intelligence accelerates the process.
- Networks, associations, work groups and communication tools of international institutions allow today a real, global, and immediate diffusion of good practices in each profession, and notably in the guarantee profession. A striking example of this appears in the panoramas of covid 19 crisis correcting measures collected by AECM and OECD.

This is playing a great role in partially alleviating difficulties.

But knowing on paper the technical rules of a trade does not suppress the need for accurate own experience on the practice.

- Thanks to digitalization, intermediate service providers in data collection emerge.

They can provide indispensable go-between services linking the actors in the value chain of international finance:

from the exporting firm to its bank, then to all (or several of) the export intermediaries or associated parties: broker, credit insurer covering “country risk”, shipping company, insurance company for travel hazards, tax authorities in both countries, technical regulation authorities and control bodies on the client side, foreign client and its bank.

The technicality of these new actors gives them access to various types of data bases, from which extracted information is processed in order to allow project study and analysis, determine the appropriate price of risk coverage, and speed up the decision’s management. They contribute to the solution for the “KYC” challenge facing banks and guarantors.

The example of COMPEON (<https://www.compeon.de/>), a German company (even if it is not dedicated to international operations and not aiming especially at SMEs) shows how a comprehensive approach can mix useful information from the whole elements of the economic framework : on this platform you can find connected data from SMEs, large companies, banks, equity investors, guarantors, consultants and advisers, insurance companies, public authorities instruments such as grants , innovation support agencies, and public and private data bases.

The development of the elaborate programs set by the platform allows a SME presenting a project to get the result of an analysis of its venture and its risk, the design of the adapted financing solutions, and a set of recommended external services.

These new service providers can progressively integrate in algorithms the logic of the decision-making process of the financial intermediaries which are their clients, and gradually involve artificial intelligence for some or all operations (automated processes being more suitable for smaller operations).

Once validated by beneficiaries, the process can also create great positive consequences in the limitation or even reduction of transaction cost for all stakeholders in the project, and principally for the SMEs.

- The parallel digitalization efforts of loan guarantee schemes observed by AECM within its member base should bring progressively more of such service providers into possible cooperation.

LGS are presently structuring their IT systems, for their traditional activity limited to local SME projects and operations in their country, in order to get use of all needed information available from external sources, starting from financial accounts data bases, credit bureaux, professional associations, ...

Data needed for decisions on international financing requires additional sources, and a more complex understanding of the factors entering into a good risk analysis. But this additional layer of complexity can be greatly mastered with the support of service providers.

Once this is done, LGS will move on to allow the development of available risk coverage offered to banks or other financial intermediaries on their specific financing instruments.

- It is a matter of detaining skills able to access external data bases, to aptly negotiate with the service suppliers, and adapting data mining and transferring necessary data in the appropriate form and detail in their decision-making processes.

The financial cost of such an objective (staff and external services cost, plus necessary IT investment) is naturally a difficult matter, especially in the present context.

Great differences exist from one loan guarantee scheme to another in the existence and depth of implication in the provision of its guarantees to trade financing.

Once again, size of institution, outreach of activities, financial capacities (facing the cost of such change in IT instruments) , staff dimension and skill quality, history, experience and operational aspects of the technical relationship with banks have a great effect on the speed and impact of digital change.

Consequently, such contextual elements will bear large consequences on the extent and speed of development of the schemes' implication on SME support for this topic of financing.

How could policy approaches support SMEs in reaping the benefits of digitalisation in this respect?

- Policies should support LGS on their investment policy related to the topic of digitalization (cost on IT equipment, programming, recruitment of needed skills and training): it should be considered by public authorities as essential. Some grants could cover partially these costs, just as they exist for SMEs.
- The approach to operate with data providers and “solution providers” is, applies to both, the bank and the guarantor, which are both in need of structured additional information and objective driven analysis (“should we finance and guarantee?”), at reasonable cost and in a swift manner.

Large banks with export departments often fall short of sufficient capacities to address SMEs needs in trade finance, because at the initial level of a request for a potential export project, at the branch level, SMEs come often with insufficient information and leave too many unanswered questions to the local bank manager.

A solution to this problem could be a common instrument that allows to avoid unnecessary repetitions of due diligences, if those (collection of information and their analysis) are delivered by a service provider that offers absolute confidence for both bank and LGS.

Public incentives for such collaborative promotion of the technical solutions should be explored just like support to collective innovation programs is today offered in some countries to a group of enterprises.

Group cooperation (with bank associations) should be preferred to bilateral cooperation with single banks, in order to avoid complexity of different solutions, observed in the OECD study.

- The recent limited but encouraging development of supply chain finance instruments is a sign of the emergence of alternative solutions to traditional banking.

Based on recorded transactions between enterprises, its main forms are receivables purchase and advance based mechanism.

This type of operation also demands a fully digitalized process, for data management and for risk assessment purposes.

An increased confidence factor for the bank in the viability of the applicant is given by the consideration of the delivery of the goods or services by the credit borrower to its clients (thus the available receivables), or the acceptance by one of the borrower's client to grant an advance payment on the production to be delivered.

This reveals the existence of trust between the exporting SME through practical events, as a partial but valid proof of reliability, regularity and competence.

Naturally, confidence can reach its limits with considerations of risk volume, possible changes in either provider or client's context (sectoral crisis, change of manager, accelerated technical upheavals...), or simply because the relationship has been short and remain still under consideration by one of the parties.

The existence of a risk sharing process on such type of financing would facilitate its use, and allow either better mobilization of receivables, or the allowance of a larger advance payment.

The question to incite LGS considering such forms of trade finance as possible targets of their guarantees raises a new interesting field of investigation.

This additional answer to the everlasting problem of SME working capital needs (and specially on trade finance) might play a positive role in the future.

Some reflections on EU Policies

Digitisation is along with Sustainability and currently the fight against the corona virus, a top priority of European Union policies. In February, the European Commission published its strategies for data and Artificial Intelligence. The key objectives of the Union in digital are :

- Technology that works for people;
- A fair and competitive economy; and
- An open, democratic and sustainable society.

According to the strategy, new EU policies and frameworks will enable Europe to deploy innovative digital technologies and strengthen its capacities in the area of cybersecurity. Europe aims to become a globally competitive, value-based and inclusive digital economy and society.

The basis for this is a performant infrastructure concerning AI consisting excellent research centres, secure digital systems and a robust position in robotics as well as competitive manufacturing and services sectors, spanning from automotive to energy, from healthcare to agriculture.

Please find more information on this site:
https://ec.europa.eu/commission/presscorner/detail/en/ip_20_273

Export and trade activities are not at the centre of this strategy. However, in light of the huge potential that digitisation can bring to export and trade activities, we should act upon focalising concrete policy action under the new strategy on export and trade.

One concrete example of European policy to foster digital transformation is a pilot programme under the SME guarantee programme COSME targeting digitisation projects. This programme was launched by the European Commission and the European Investment Fund (EIF) in October 2019 and offers more favourable conditions with regard to the standard COSME programme. AECM's members are also among the financial intermediaries using this counter-guarantee for projects of SMEs in the area of digitalisation.

More information can be found here:

https://www.eif.org/what_we_do/guarantees/news/2019/cosme-digitalisation.htm

What are AECM and its members doing in this area ?

While most AECM members concentrate on domestic SME guarantees, there is a group of AECM members that are also active in export guarantees. These are notably: SOWALFIN/Belgium, KredEx/Estonia, Finnvera/Finland, Bpifrance/France, Altum/Latvia, Invega/Lithuania, members of SPGM/Portugal and members of CESGAR/Spain. There might be more members offering solutions to SMEs engaged in trade projects. In order to organise an exchange of best practices among those members active in export guarantees and also in order to share knowledge with AECM members that would like to start engaging in this area, AECM in 2019 set up a task force on export guarantees. A first meeting of this task force took place in October 2019.

Also in the area of digitisation, AECM get more and more active. A working group on digitisation has been introduced in 2018. While physical working group meetings take place on an irregular basis, we are organising (nearly) monthly webinars with external speakers.

Among AECM members there are numerous interesting examples of digitising the guarantee business. The experiences of digitisation in the standard business could serve as a reference when it is about developing solutions for export credit guarantees. The following list gives examples for the digitisation projects in the guarantee business:

- VDB/Germany engages in IT infrastructure as well as IT projects and explores ways of digitising the guarantee application process: <https://vdb-verbandsbericht.de/die-zukunft-der-buergschaftsbanken-ist-digital/>
- MPME/Luxembourg: online application for guarantees in the construction and crafts sector; implementation of an integrative managing system combining the whole process from application, through analysis (scoring system) and decision taking to implementation of guarantees and follow-up procedures
- aws/Austria: Digital application and processing platform for guarantees, guarantee pre-check (self-check for applicants before they file an application), fully digitized signature
- FNGCIMM/Romania: Internal scoring; online data information from and to partners (online apps, communication with banks and applicants);

- AVHGA/Hungary has one integrated IT system for the whole business procedure, from the application (the bank files it in) to the issuance of the e-guarantee, including decision-making and paperless assessment.
- Garantiqa/Hungary: Between the partner banks and Garantiqa, there are an online web surface or a web service connection to apply a new and/or modify an existing guarantee per transactions in frame of “Customer portal” contract. In case of COSME portfolio guarantee, Garantiqa has an automatic decision and guarantee issue procedure with digital signature from both sides.
- Altum/Latvia: Issue of guarantee / Digital signature; Calculation and processing of guarantee payments; Information, communication, marketing, cross selling, multiple service impact Customer data capturing - automated reply and sending application forms - retargeting pixels - Social media communication / targeting / content marketing and lead generation

Feedback from Bpifrance/FR

As a feedback, we would like to share with you some actions taken by Bpifrance through the ECA subsidiary (Bpifrance Assurance Export) regarding the financial gap to fill for SMEs and digitalization:

Bpifrance Assurance Export has developed a special focus on SMEs in line with the company policy in order to fill the financing gap left by the private market. Since a long time ago, Bpifrance Assurance Export offers a working capital guarantee and “traditional” Assurance Export with preferential terms for SMEs (down payment, percentage of cover, etc.). Added to this, the main objective of Bpifrance is to offer a one-stop-shop for all official financial support and develop a network all over the country and abroad to better reach out SMEs. This evolution goes together with a digitalized customer approach:

- Customer Relationship Management (CRM) for the whole Bpifrance group, but with specific thresholds for the ECA subsidiary of Bpifrance
- Customer portal available in Bpifrance website
- Online application for all Bpifrance Assurance Export products (already implemented for the change guarantee and the bond guarantee, for the other products the implementation is expected for 1H 2020)
- “Go no go”: possibility to assess online the eligibility of the project for credit insurance
- Letter of interest request online
- Digitalisation of the KYC process (in progress)

The enhancement of our processes and products through digitalisation is one of Bpifrance Assurance Export priorities for the current year.

We also have a comment on the paper: concerning the solutions proposed by the States mentioned in the document, it would be useful to know the national agencies in charge of their implantation, if this information is available.