

## KEY POINTS

- Market gaps for trade finance persist
- Gaps inhibit economic growth and job creation
- Anti-money laundering regulations are a significant contributor to trade finance gaps
- Companies lack awareness of trade finance options and innovations

**Keywords:** trade finance, Asia, BRICs, due diligence, trade, development financial crimes compliance, bank regulation, anti-money laundering (AML), know your client (KYC)  
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## ADB TRADE FINANCE GAP, GROWTH, AND JOBS SURVEY

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### Introduction

Trade finance gaps are a persistent feature of the global trade landscape. Yet the reasons gaps exist and the populations which are most impacted vary both temporally and geographically. In 2013, ADB, in cooperation with partner organizations, surveyed financial service providers and companies involved in international trade about their use of trade finance.<sup>1</sup> This brief introduces the key points of ADB's second effort to quantify the adequacy of global trade finance and its impact on economic growth and job creation.

An earlier survey in 2012 provided evidence that trade finance gaps—which had widened with the global financial crisis—continued to negatively impact growth and job creation. The 2013 survey sought to go further in understanding recent trends in risk management, financial sector innovation, and contributing factors to trade finance gaps.

The main findings of the 2013 Trade Finance Gap Survey are that significant market gaps for trade finance persist even as the global economy has recovered. Unintended consequences surrounding financial crimes regulation and a lack of awareness among companies of trade finance options are major contributors to trade finance gaps. Compared to 2012, companies and financial institutions perceive that more trade finance is available in the market, particularly to larger firms.

<sup>1</sup> ADB acknowledges the advice, support, and cooperation of our partner organizations. These include UNESCAP, APEC Policy Support Unit, the World Trade Organization (WTO), International Chamber of Commerce (ICC) Banking Commission, International Enterprise (IE) Singapore, Factors Chain International (FCI), the International Trade and Forfaiting Association (ITFA), the Centre for the Promotion of Imports from developing countries (CBI), Fung Global Institute, and the many banks and companies that took time to complete our surveys.

## Trade Finance Gaps in 2013

In 2013, the global trade finance gap was estimated at \$1.9 trillion.<sup>2</sup> Of this gap, \$1.1 trillion is in developing Asia (including India and the PRC).<sup>3</sup> Banks reported a global rejection rate of trade finance applications of 29%.

Case studies of factoring, forfaiting and credit insurance providers reported similar global rejection rates at between 25%–40% of proposed transactions. However, in the company surveys, only a very few proposals for these types of finance were reported and rejection rates for these were very low with factoring at 7%, forfaiting at 3%, and credit insurance at 5%. This suggests that these forms of finance have considerable room to expand globally.

Geographically, much of the gap in trade finance happens within Asia. Asia registered the largest share of proposed transactions at 57% of the global total. However, Asia also received the highest proportion (79%) of global rejected transactions (see Figure 1). Asia’s BRICs countries – India and the People’s Republic of China (PRC) – registered the highest proportion (35%) of rejected transactions.

In this environment, 75% of banks reported that they had increased the level of credit lines offered in 2013. Most of these banks reported an increase in the range of 1%–25%, while 16% of banks reported more substantial increases of 25%–50%.

<sup>2</sup> We note that this value is indicative of the upper limit of the existing trade finance gap since responses do not distinguish the quality of proposals for trade finance and global estimates require extrapolation from partial data. Sampling populations and sizes varied from the 2013 and 2012 surveys, making comparisons difficult. Notwithstanding the veracity of the figure itself, the data conveys a sense of the magnitude of the trade finance gap.

<sup>3</sup> Of the \$1.1 trillion gap for developing Asia, \$699 billion is attributed to India and the PRC

Both firms and financial institutions reported more positive perceptions about the availability of trade finance in 2013. In 2013, 54% of firms reported that available trade finance met their current needs. This is a significant improvement over the period during the financial crisis where only 30% felt that trade finance levels were sufficient. Firms reporting sufficient availability of trade finance were generally large corporates or multinational corporations (MNCs) as opposed to SMEs.

## SME Constraints Pronounced

Gaps in trade finance affect SMEs more negatively than other company respondents. This is a particular problem in Asia where more than 90% of all firms are SMEs, the majority of which do not engage in direct exports. Lack of financial access is a well-known contributor to the export shortfall.

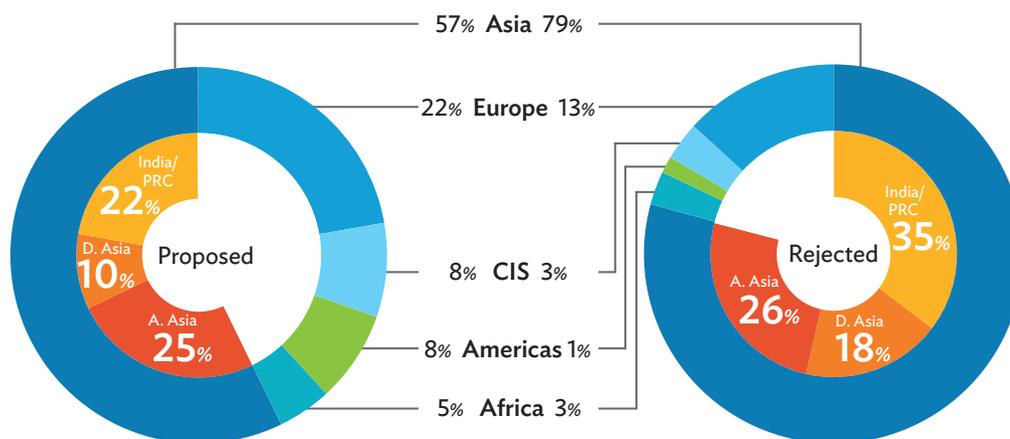
Global rejection rates of trade finance applications are highest for SMEs. Fifty percent of their proposals for trade finance were rejected in 2013, as compared to only 7% for MNCs.

In addition, familiarity of SMEs with many types of trade finance products is limited. In a comparison with MNCs, SMEs registered considerably lower rates of knowledge about both traditional and nontraditional financial products.<sup>4</sup>

This difference in knowledge was particularly pronounced for nontraditional products, such as Bank Payment Obligations

<sup>4</sup> We categorize trade finance products as traditional or nontraditional as a way to seek greater clarity about both innovative forms of trade finance and also those forms which are not yet widespread. Under “traditional” finance we include letters of credit, working capital financing and credit insurance. Under “nontraditional” we include factoring, forfaiting, Bank Payment Obligations (BPO) and supply chain financing. It should be noted, however that there is some overlap between the two categories and that differences are often a matter of terminology. Discounting of letters of credit can be, and in many banks is, described as forfaiting.

Figure 1: Distribution of proposed and rejected trade finance transactions by region



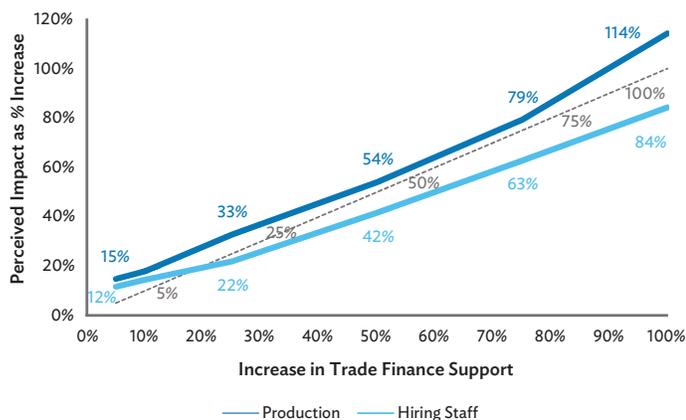
\* PRC = People’s Republic of China  
CIS = Commonwealth of Independent States

(BPO) and forfeiting, SMEs reported recognition rates of only 16%–40% in comparison to MNCs, which were considerably higher at 41%–58%.

## More Trade Finance Can Contribute to Growth and Employment Gains

While it is impossible to disentangle the direct impact that trade finance has on economic growth and job creation, surveyed firms offer some insight into how better trade finance access would manifest in terms of these outcomes (Figure 2). Firms indicated that additional trade finance would enable them to increase production. A 15% increase in access to trade finance would increase production by 22%.

**Figure 2: Expected impact of more trade finance support on production and jobs**



Responses also suggest that greater access to trade finance would have a positive impact on employment levels. Respondents noted that a 15% increase in trade finance support would enable firms to hire 17% more staff.

## De-risking is Creating a Lumpy Trade Finance Landscape

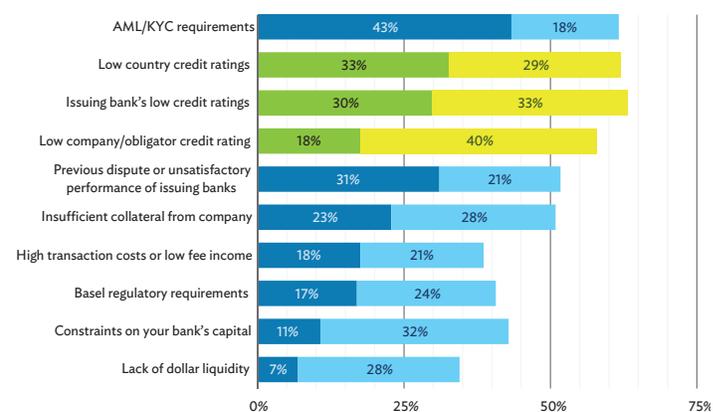
The global trend of “de-risking” in bank transactions and relationships was reflected in the survey data as an important source of systemic credit constraint. Bank-to-bank relationships underpin much global trade, especially in emerging markets. However, it appears that regulatory requirements designed to mitigate the risk of financial crimes have resulted in unintended consequences wherein banks are severing relationships, particularly in emerging markets.

Sixty-one percent of banks reported that Anti-Money Laundering/Know Your Client (AML/KYC) due diligence requirements were significant impediments to their provision of lines of credit. Compliance with these rules is costly and

laborious, which appear to be the driver behind canceled relationships rather than findings of noncompliance in emerging market banks.

A lack of clarity on what constitutes compliance and varying compliance requirements among jurisdictions exacerbate the de-risking effect of AML/KYC. This is particularly important because the other impediments that were ranked highly are more clearly associated with company and credit risk (see Figure 3).

**Figure 3: Impediments to the provision of trade finance** (% reported as very significant and significant)



AML/KYC reporting requirements led to declined transactions by 68% of responding banks. But the constraint goes beyond transactions. More than 32% of banks report that they have terminated correspondent relationships because of AML/KYC.

Globally, Asia and Africa were most negatively impacted. In those regions, more than 50% of banks reported AML/KYC as a significant constraint. Developing Asia (including India and the PRC) also reported a large negative impact with 45% of banks responding that compliance was a significant constraint on their relationships. The negative impact of de-risking has been recognized at the global level and more efforts are required to address this important contributor to trade finance gaps.

Providers of insurance, factoring and forfeiting indicate that AML/KYC requirements are also a factor hindering their provision of trade finance. Though, providers of factoring products were more concerned with unsatisfactory performance of the buyer.

## Nontraditional Financial Products are Underutilized

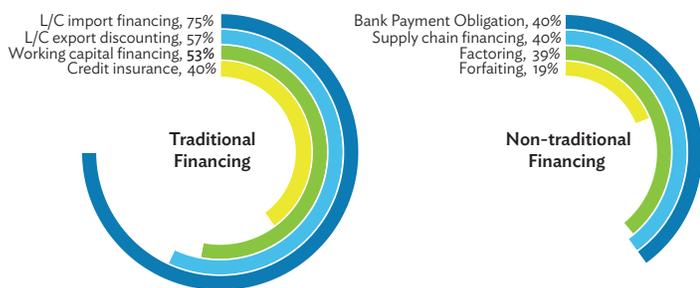
Trade finance involves a wide range of instruments and is undergoing a period of innovation. New products, such as supply chain finance and BPO are intended to reduce financial

frictions. Efforts are being made at the global level to increase the geographic spread of some products and to increase knowledge of others.

However, the 2013 survey suggests that the reach and uptake of these instruments has been slow. One reason appears to be information asymmetries. Seventy-eight percent of companies reported that they would benefit from greater financial education.

This is clearly reflected in a lack of familiarity with financial products (Figure 4). In the case of nontraditional products such as factoring, forfaiting, BPO and supply chain finance, less than 40% of companies report familiarity with these instruments. Even within traditional bank products, companies reported limited familiarity (40%) with relatively established products such as credit insurance.

**Figure 4: Familiarity with traditional and nontraditional financial products (% of responding firms)**



Case studies of forfaiting and factoring revealed that providers of these products also felt there was a supply shortfall. At the same time, they reported an increase in demand for factoring and forfaiting services by more than 50% in 2013. This suggests that expansion in these products is moving forward.

The lack of familiarity of finance options may contribute to the high proportion of companies (68%) that reported they did not seek alternatives for rejected transactions. Of the 32% which did seek alternative financing, 20% did not find any alternative, and the remaining 12% successfully found alternative financing, but it was too expensive.

Interestingly, the rejection rates companies report for bank financing instruments other than letters of credit and working capital are relatively low (5%–16%). This suggests that greater use of new instruments may reduce the trade finance gap. Better information sharing about trade finance options and innovations can also help to address low utilization rates.

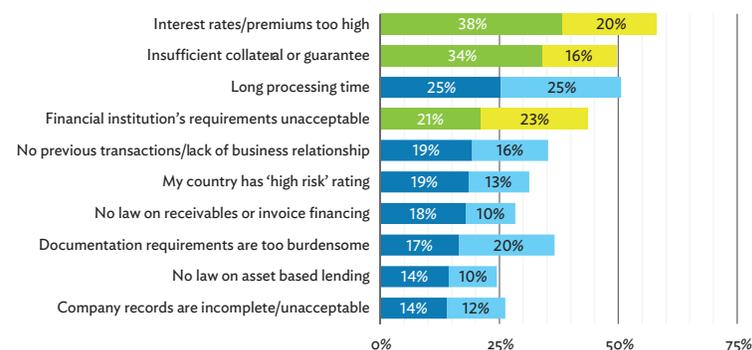
### Costs Constrain Access

While 74% of firms reported that the availability of trade finance either increased or did not change in 2013 compared with 2012,

they cited factors related to the price of trade finance as a key bottleneck to access.<sup>5</sup>

Perhaps reflecting the increased availability of lines of credit, most firms report that the cost of financing is where much of the problem of access lies. There were three issues directly related to the high cost of finance which were reported by more than 40% of respondents as significant. These include the level of interest rates/premiums, insufficient collateral and unacceptable terms of financial institutions (Figure 5).<sup>6</sup>

**Figure 5: Factors limiting companies' ability to obtain trade finance (% very significant/significant)**



The problem of price appears to be embedded in the system rather than the result of any shock. Firms report that the prices of products have been stable over 2013, with 67% of firms reporting either no change or very small changes (+/- 10% or less) in pricing over the last year.

An additional cost-related issue comes from countries which have either no sovereign credit rating or poor sovereign ratings. These (lack of) ratings have a direct impact on the cost of trade finance and increase costs to companies working in or with developing countries. While this survey's data does not separate out individual countries, this is in evidence in regions where costs are particularly high. Multilateral Development Banks have rolled out guarantee programs to address these systemic gaps.

### Conclusions

Significant trade finance gaps remain. SMEs continue to be credit constrained in every region. Narrowing of trade finance gaps will lead to more economic growth and job creation. Unintended consequences of (overlapping) regulatory requirements, particularly with respect to financial crimes

<sup>5</sup> The price constraints reported by companies are very likely primarily referring to traditional finance instruments, since usage of and familiarity with nontraditional instruments was very low for survey respondents.

<sup>6</sup> While "long processing time" does not represent a direct monetary cost, it could also be interpreted as a cost factor due to its role as an opportunity cost.

compliance, are contributing to the gap and have the most negative impact on developing countries with weak financial systems.

That said, companies and financial service providers confirmed that the disruptive effects of the 2008/2009 global financial crisis have become muted. New instruments such as BPO are becoming available and nontraditional forms of finance are spreading (albeit slowly). More outreach to companies about “nontraditional” forms of trade finance can contribute to closing trade finance gaps.

The 2013 survey is an improvement from the previous year with expanded set of questions, greater engagement with industry associations, and inclusion of nontraditional finance. Challenges with respect to data availability, however, remain in this round. Going forward, there is a need to standardize methodology and increase sampling sizes in order to make meaningful comparisons with previous years’ studies to trend trade finance gaps and their impact on growth and jobs.

### About the Asian Development Bank

ADB’s vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region’s many successes, it remains home to approximately two-thirds of the world’s poor: 1.6 billion people who live on less than \$2 a day, with 733 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

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