The role of development banks and other public entities in promoting SCF

Posted on Mar 1, 2021
Submitted by TRF News
TRF News

Eva Degenhart, Partner at MH Corporate Finance GmbH and Patricia Martínez, Independent consultant, both engaged as senior supply chain finance (SCF) specialists with IFC, explain the role of development banks and other public entities for the development of SCF.

Development Banks, Central Banks and other public institutions around the world are actively exploring SCF as a viable way to facilitate more access to credit to SMEs. Through its recent publication on the topic, the IFC/WBG analyses the role of these entities in promoting SCF, based on practical evidence of nine example cases of SCF initiatives by Development Banks and Central banks.1

Example cases include entities in Asia, Latin America, Africa, Europe and MENA. Some have been around and successfully running for many years; others are still in early stages or still within a concept stage:

- Nacional Financiera (NAFIN) - Mexico: "Cadenas Productivas"
- Banco de Inversion y Comercio Exterior (BICE) - Argentina: "e-Factoring"
- Asian Development Bank (ADB) - all Asia: "Supply Chain Finance Program" (SCFP)
- Credit Reference Center of People´s Bank of China (PBOC-CRC): "Receivables Finances Service Platform" (RFSP)
- Reserve Bank of India (RBI): "Trade Receivables Discounting System" (TReDS)
- Afrexim Bank (AFREXIM) - all Africa: Factoring promotion & plans for a Supply Chain Finance initiative
- European Bank for Reconstruction and Development (EBRD) – CEE, MENA: "Trade Facilitation Program" (TFP)
- Hong Kong Monetary Authority (HKMA): "e-TradeConnect"
- International Finance Corporation (IFC) - worldwide: "SCF related Advisory, Financing and Investment"

Motivation, background and roles of public institutions engaging in SCF

First, let's have a quick look at the motivation of development banks and other public institutions to engage in SCF. Following their policy mandate and strategic goals - to take care of financial inclusion, closing market gaps and enable access to finance for underserved segments in their markets - these institutions start to intervene, particularly where the private sector (mainly commercial banks) either don't find an inducive environment or lack the capabilities and capacities to provide such an offer.

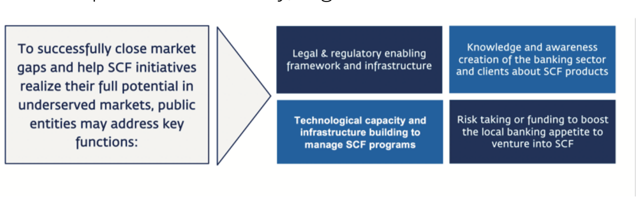
While SCF is now quite popularised via thought leadership, advocacy and industry level efforts, the level of adoption varies among geographies. Frequently mentioned reasons for lower uptake of SCF in a country may be related to the following types of market gaps:

- Shortcomings within the **legal and regulatory framework** to ensure the enforcement of creditor's rights in case of conflicting claims, or the inability of the legal framework to facilitate the use of assets as collateral.
- **Knowledge and capacity** gaps, as SCF solutions are often unknown to both the banking sector and its clients, along with a lack of understanding of SCF´s programmatic approach to serving and connecting various parties of all sizes (small, mid-size and large) and a lack of adequate skills among FIs about how to develop and implement sound SCF programs.
- Low **technological capacity** within the banks to provide and manage SCF platforms themselves, besides the inability to bear high costs of IT platform implementation and to reach the necessary scale.
- **Financial institutions' risk perception and funding gaps**, resulting in too little desire for venturing into a new product category, such as SCF, which may be misperceived as being a risky undertaking, as well as liquidity constraints to fund SCF programs or restrictions in FI's product offerings due to banking regulations.

To successfully close the market gaps and help SCF unfold its full potential in underserved markets, these points need to be addressed. Indeed, multinational and national development banks and other public institutions can play an active role in mobilising public and private sector resources, in order to support the creation of a sound SCF ecosystem.

In principle, public institutions should only intervene when their activity is additional to and supportive of private sector activity. Several development banks and central banks across the globe have already adopted SCF within their scope of activities. Their roles and approaches vary, as does the depth of their interventions.

Public sector institutions can engage in SCF initiatives in different ways: depending on their specific goals and the market gaps identified, they can choose different focus areas and take different approaches empowering SCF development. These can be applied individually or in parallel, based on the circumstances and market assessment of the particular country/region:



Source: "Guidebook on Supply Chain Finance by Development Banks and Public Entities", IFC/WBG, 2021

Intervention and functions of Development Banks become even more imperative in the light of limited access to finance to the SME segment, and particularly in times of crisis when liquidity becomes decisive for survival.

The different approaches

In general, the approaches and models that public institutions can take differ amongst other factors remarkably in terms of financial investment and risk-taking, as well as in regard to the reach of SME. Of course, in practice also, variations and/or hybrid versions of these approaches appear, or - as the institutions in the example cases show us - use various models in parallel.

In the above context, the approaches can in simple terms be categorized as follows:

Service Oriented approaches:

- **Enabling Framework provider approach**

  Development banks and other public entities working under the enabling framework provider approach deal with establishing a suitable and robust legislative and regulatory environment, which will form the basis for the contractual agreements and operational conditions of SCF programs. In order to motivate lenders (bank or non-bank) to offer supply chain finance solutions to the SME segment, the enabling framework addresses various elements, e.g. secured transactions and asset-based lending reforms, the establishment of transparent credit reporting, prudential regulation, the existence of efficient insolvency rules and effective enforcement mechanisms; all of which are critical steps towards responsible and inclusive access to finance.

  Establishing an enabling framework for financial infrastructure has a positive impact on the evolution of SCF. It requires – if not already in place - adequate reforms led by regulators, legislators and central banks, making public institutions a relevant actor to catalyse such reforms. They can also use their influence to establish standards for e-invoicing, e-identity or digital payments infrastructure to support the adoption of SCF effectively.

  The private sector can leverage this infrastructure to build innovative SCF propositions to overcome the challenges they generally face in their traditional lending offers.

  Examples of institutions under this approach are Afreximbank with the Factoring model law; IFC with advisory on establishing Secured Transactions environment and reforms; RBI in India with the fully-fledged guidelines and rules for the operation of TReDs.

- **Advocacy and Advisory approach**

  When development or central banks take an advocacy and advisory approach, their activities are numerous. They range from pure knowledge transfer and training activities to working with government agencies and regulators to establish an appropriate regulatory and legal environment, issuing guidelines and fully hands-on advisory mandates to set-up SCF programs in partnership with other private and public financial institutions.

  Institutions applying this approach are, for example, EBRD by participating in and organising conferences and events dedicated to supply chain finance topics, or Afreximbank by continuously creating awareness of factoring across the continent through workshops, seminars and webinars, and IFC SCF Advisory Services program, launched in 2014, which helps banks build or scale SCF operations.

Financing & Risk sharing approaches

Under these approaches, the institutions provide – depending on whether their underlying business model is a first tier or second tier model - their balance sheet, either via direct or indirect funding participation or a risk-sharing mechanism.

- Direct financing as a sole-funder or co-funder can be adequate in markets or economies where (local) commercial banks have limited interest, or lack the technical capabilities for financing SMEs via SCF solutions.
- Indirect mechanisms in the form of re-financing or risk-sharing are applied in markets where private Financial Institutions are reluctant to do SCF because of funding constraints and perceived risk/cost issues. They are suitable for development banks with a second-tier business model. Based on predefined eligibility criteria for both the participating FI's and the SCF deals, the development institutions leverage existing SCF product offers of the participating FI's. Such funding and/or guarantee schemes are offered by e.g. NAFIN, ADB, EBRD, IFC and Afreximbank allow the private sector FI's to grow their SCF programs to reach out to more SMEs, and to achieve capital relief.

Technological Infrastructure provider approach

Finally, development banks can act as the provider of the digital infrastructure for SCF products. According to the analysed examples, the public institutions applying this approach did so mainly because there were either not enough or no private infrastructure providers in their markets. Furthermore, their intervention was deemed necessary to orchestrate the creation of the SCF ecosystem and encourage the private sector's participation; this is done by giving them the right tools to finance SMEs without having to take on big investments in the build-up of a technical SCF platform.

The basic options under this approach category include developing a proprietary SCF platform as implemented e.g. by NAFIN with their "Cadenas Productivas" program in Mexico, as well as BICE in Argentina or PBOC-CRC in China. Others utilise existing IT solutions from external vendors like Afreximbank, or employ the provision of SCF by third-party platform providers, like RBI with the concept of TReDS. One institution - the HKMA - also teamed up with partners and took a strong lead in orchestrating a DLT consortium initiative, named e-TradeConnect.

The type of the established SCF platforms where the target clients (buyers, suppliers, distributors) and (multiple) funders meet vary in terms of product coverage, legal relationships, functionalities, pricing mechanisms and connectivity to external applications (e.g. collateral registries, client´s ERP systems, government procurement systems and e-invoicing platforms). They are either set-up as multi-funder platforms or marketplaces.

Key takeaways

The examples of various SCF initiatives by development and central banks show the beneficial effects of such initiatives. The different institutions designed their initiative according to their mandate and tailored it to the needs of their country or region.

In most of the example cases, establishing the underlying legal and regulatory environment was a major necessity. Collaboration between parties and the use of various data sources, as well as the creation of the respective technical interfaces, are important components.

Onboarding Government entities as key client segments (sometimes even mandatory) turned out to be another critical success factor while supporting and speeding up adoption, as examples from NAFIN, PBOC-CRC, or TReDs show.

Certainly, there is no one-size-fits-all approach, and there are several ways to tackle similar problems while respecting different environments. In order to find a suitable approach for a SCF initiative, one can look at key determinants like compatibility of different approaches with the strategy and goals of the institution, the specific market needs and focus areas, the existing enabling framework and gaps, other stakeholders' interests and willingness to collaborate, own capabilities and capacities, and last but not least the envisaged level of control and influence.

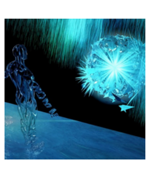
Development banks, central banks, and also commercial banks in emerging markets can leapfrog some steps in a usual product development cycle by building on the experiences of other regions. They also have a big chance to base their SCF initiatives on the best technology or create some advanced proposition and even reach out for financing the deep tier in their economy's supply chains.

1The authors have conducted the respective analysis and elaborated the "Guidebook on Supply Chain Finance by Development Banks and Public Entities" IFC/WBG, 2021, where more details can be found.

LATEST NEWS


INVOICE FINANCE COMPANY IS SOLD TO CUBITT TRADE HOLDINGS
Posted on Mar 1, 2021


AUSTRALIAN GOVERNMENT PRESS FOR MORE TRANSPARANCY TO...
Posted on Mar 1, 2021


MONETAGO: WHY DIGITALISATION IS THE BEST DEFENSE AGAINST...
Posted on Mar 1, 2021


OPTIMUM FINANCE HIRES EX-MICROSOFT DIRECTOR AS NEW CTO
Posted on Mar 1, 2021