Supply Chain Finance for SMEs
There exists $2.1-2.6$ Trillion global SME credit gap, formal & informal

Source: IFC Enterprise Finance Gap Database (2011)
For “formal” enterprises, $1 trillion SME finance gap in emerging markets

- **East Asia**: Gap Estimate: 167,523 USD MM
  - 32% SMEs that do not need credit
  - 6% SMEs with Access to Finance
  - 61% SMEs that are credit constrained

- **Middle East & North Africa**: Gap Estimate: 294,148 USD MM
  - 58% SMEs that do not need credit
  - 16% SMEs with Access to Finance
  - 27% SMEs that are credit constrained

- **South Asia**: Gap Estimate: 14,884 USD MM
  - 41% SMEs that do not need credit
  - 51% SMEs with Access to Finance
  - 7% SMEs that are credit constrained

- **Sub-Saharan Africa**: Gap Estimate: 80,085 USD MM
  - 72% SMEs that do not need credit
  - 7% SMEs with Access to Finance
  - 9% SMEs that are credit constrained

- **Latin America**: Gap Estimate: 235,292 USD MM
  - 65% SMEs that do not need credit
  - 14% SMEs with Access to Finance
  - 21% SMEs that are credit constrained

- **Central Asia & Eastern Europe**: Gap Estimate: 170,061 USD MM
  - 31% SMEs that do not need credit
  - 9% SMEs with Access to Finance
  - 61% SMEs that are credit constrained

Size of the pie roughly relates to the size of the Gap in terms of Number of SMEs.
Financing Constraint seen as the top growth impediment amongst SMEs

Percent of Enterprises citing biggest obstacle
(SMEs between 5 - 100 employees)

<table>
<thead>
<tr>
<th>Region</th>
<th>Access to Finance</th>
<th>Electricity</th>
<th>Tax Rates</th>
<th>Political Instability</th>
<th>Practices of Competitors in the Informal Sector</th>
<th>Corruption</th>
<th>Inadequately Educated Workforce</th>
<th>Access to Land</th>
<th>Crime, Theft, and Disorder</th>
<th>Transport</th>
<th>Customs and Trade Regulations</th>
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In 71% of countries SMEs cite Access to Finance as the biggest obstacle....
IFC completed a review of leading SME finance practices and models as part of our work with the G20

- G20 SME finance Sub Group identified successful practices & policy measures for SMEs in 2011
- Work involved review of 164 different models globally and subsequent policy requirements

**Key Recommendations from the G20 Sub-Group**

- *Developing supporting legal & Regulatory framework* for facilitating alternate finance (e.g. supply chain)
- *Building reliable data sources* for SME finance
- *Strengthening the financial infrastructure*
- *Effective government support* mechanisms
- *Address specific market failures* e.g. women and non financial services
- *Building the capacity* of financial institutions

SME Finance Policy Guide - issued October 2011 by IFC
Supportive legal & regulatory environment and alternate finance through e.g. supply chain finance can be highly effective

- Support and legislate non-FI alternatives to bank lending e.g. supply chain finance

- The public sector is a major buyer of goods & services from SMEs, and can more effectively link SMEs to supply chain finance through contractual and payment relationship

- Electronic security and signature laws, and market facilitation platforms, can facilitate supply chain finance

- Strengthen credit reporting to even the playing field between small and big banks

- Capacity building for FIs and SMEs to significantly enhance scalability

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**Case Study: NAFIN, Mexico**

- “Productive chains” program allows SMEs to use big buyer receivables for working capital finance
- By 2009, nearly 500 Corporates involved, and $60 Billion in finance extended to more than 80,000 SMEs through 21 banks and non-banks

**Case Study: Chile Compra, Chile**

- Chile Compra is a public, electronic system for purchasing and hiring, with more than 850 purchasing organizations
- MSMEs provide 55% percent of total purchases, and their participation in government purchases is double their overall share in the Chilean economy
Why we should focus on supply chain finance for SMEs

- More than 27 million formal Small, Very Small and Medium Enterprises in Developing countries, of which 39% and 22% are unserved and underserved respectively
- Addressing the SME needs through appropriate partners, products and processes is key to accelerate job creation. The World Bank estimates that 600 million jobs are needed by 2020

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1 Source: IFC Enterprise Finance Gap Database

IFC Enterprise Finance Gap definition of MSMEs: Micro - 1-4 employees, Very Small - 5-9 employees, Small - 10-49 employees, Medium - 50-250 employees
SCF proposition typically falls under “Supplier finance” and “Buyer Finance” categories but both linked to large reputable corporate entities (Anchor).

**Suppliers to the Anchor are financed**

**Key Benefits for small supplier:**

- Reduce their cost of working capital
- Give them flexibility of accelerating their cash flows thereby improving their liquidity
- Reduce hassles of following up for payments
- Receivable financing, allowing open account trade, reduces the cost of transaction processing, comparing to the cost of LSs / Inland LCs.
- Avoid delays in receipt of payment
- Match funding based on the quantum of purchase orders
- Minimize cost of collections

**Buyer/Distributors to the Anchor are financed**

**Key Benefits for small buyer:**

- Ability to access finance which would be more challenging, collateral heavy and many times not possible on a standalone basis. This will potentially generate growth in the retailer business, which results in higher purchases from anchor.
- Strengthening of relationship with suppliers by ensuring certainty of supply
- Avail finance at more competitive rates given corporate linkage
- Assured funding linked to actual business needs
- Easy to access the bank for further incremental limits as these are linked to Anchor sales and unlikely to be easily declined.
Multiple opportunities exist for Banks to become involved in the supply chain financing, however traditional receivable finance most commonly preferred

**Supplier Finance**

- **Pre Shipment**
  - Financing the procurement side of the corporate business

- **Post Shipment**
  - Financing the sales and distribution side of the corporate business

**Purchase Order Finance**

- Made available to a Supplier based on a Purchase Order received from a Buyer
- Financing typically covers the working-capital needs of the Supplier, including raw materials, wages, packing costs, and other pre-shipment expenses in order to allow it to fulfil delivery against the relevant Purchase Order
- The Supplier’s bank provides finance to the Supplier treating the Purchase Order as evidence of a good source of repayment

**Reverse Factoring**

- The anchor initiates the program, usually the bank deals with 1 buyer and multiple suppliers
- Financing bank takes an assignment of the receivables which have been approved by the buyer

**Receivable Finance /Factoring**

- Bank approaches each single supplier to finance their receivables
- The most common form involves factoring of ‘Whole Turnover’ or significant element (75-90%) of a seller’s portfolio of open account trading receivables

**Buyer / Distributor Finance**

- Bank finances distributor after presentation of authenticated delivery note/invoice
- Key risk mitigation: the anchor agrees on a first loss repayment in the case of default and can also agree to establish a stop-supply clause (but only when the distributor is very dependent on the seller)
Only a few banks and FIs have set-up successful and scalable supply chain finance solutions, but this is an opportunity mostly untapped.

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<tr>
<th>Purchase Order Finance</th>
<th>Receivables / Invoice Discounting</th>
<th>Factoring</th>
<th>Buyer / Distribution Finance</th>
<th>Agriculture Supply Chain</th>
<th>Capacity Building/ Business Training</th>
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SCF product category offered by FI
While SCF offers an attractive opportunity, banks are confronted with challenges across 4 main areas:

**Revenue**
- Market sizing complexities
- Sales methodologies
- Building for scaling
- Product structure

**Cost**
- Skill gap bridging
- Sales outfit
- Operational burden
- Channels usage

**Risk**
- Policy & program
- Assessment tools
- Portfolio management
- Collections framework

**Anchor**
- Sensitivities
- Selection mechanism
- Technology usage
- Engagement plan

Supply Chain Finance (FI Dilemma)
There is a need for FIs to better leverage SCF Ecosystem & synergize activities

Industry Associations
- TWIST, ISO, ICC

Technology Platforms
- Financing Platforms, Trade Logistic Network platforms, Invoicing / Payment Platforms

Market Analytics
- ChainLink

Solution Providers
- Software / IT vendors: IBM, Oracle, SAP, Taulia

Regulators
- Central Banks, Ministry of Finance

Industry Networks
- SWIFT, ACH, other clearing house associations

Logistics Providers
- Vendors, Logistical firms, 3PL Carriers

Corporations
- e.g. Coca Cola, Nestle etc.

Specialized Investors
- PE, VC, HFs

SMEs

MFIs

NBFI
- Insurance Providers, GE Capital, Factoring (FCI), Leasing and Financing Companies

Multilaterals
- EBRD, WBG, EIB - providing SCF investment and advisory solutions for the banks

Advisors
- IFC, PwC, KPMG, ChainFinance, Bain, McKinsey

Example: Coca Cola, Nestle etc.
IFC through its Global Trade Supplier Finance (GTSF), is helping FIs tap this market opportunity

Funding and risk mitigation for banks’ supply chain finance clientele

- Provides banks with additional credit capacity to support clients’ suppliers from higher-risk countries
- Provides funded and unfunded risk-sharing of up to 100% of a client’s accounts receivable
- IFC may also provide liquidity and discount A/R itself
- A/R is discounted using market-based pricing
- IFC accepts bank proposed discount rate on risk-shared receivables

$1.6 Billion commitments
700+ suppliers financed
7 Countries supported

1. Buyer uploads invoices (automated process)
2. Supplier views invoices and requests early payment of approved invoices
3. Financier accepts early payment requests
4. IFC provides funding or guarantee coverage
5. Financier pays discounted invoice amount
6. Buyer pays full invoice amount on due date (automated transfers established)

Emerging market suppliers
Bank
SCF platform
Buyer
Program partners
Mobilization

13
IFC through its Distributor Finance Program is also facilitating access to finance for SME buyers/distributors

**Benefits to Bank:**
- **Risk-mitigation:** portfolio management tool
- **Strengthening business line with global corporate clients**
- **Capacity expansion** in distributor finance business

Focus: food, agribusiness, health, energy efficiency, infrastructure, and pharmaceuticals

**IFC ROLE**
- Funded or unfunded risk-sharing facilities and partial guarantees
- Capacity building: IFC’s Advisory Services, including SME Management Services, can engage to improve financial sustainability of distributors

**BANK ROLE**
Origination and monitoring in:
- Receivables-based financing to seller
- Overdrafts or loans to distributors/sub-distributors
- Floor-planning and equipment financing, including end-user financing

**SELLER** provides some contractual support: first loss or counter-guarantee, stop shipment clause, etc.
IFC also provides supply chain finance program building advisory services to FIs by building capacity across 5 key areas

1. Market Sizing
   - Market Opportunity sizing in SCF
   - Identify industries with cluster local buying and sales and respective opportunity size
   - Review client’s SME portfolio to assess payment linkages magnitude
   - Review corporate portfolio and establish Anchor linked opportunities

2. Anchor Engagement & Product Plan
   - Assessment of Corporate clients with large supplier/distributor opportunities
   - Design anchor selection/engagement strategy
   - SCF product selection with phased approach for the bank
   - Design products and launch plans including IT platform advice
   - Anchor/suppliers due diligence

3. Sales Approach
   - Assessment of sales origination and closure
   - Corporate anchor sales approach design
   - After sales approach advise- (i.e. Corporate, supplier/distributor onboarding)
   - Product and implementation team structure
   - Joint meetings for launching the pilot program
   - Onboarding program

3. Credit Process
   - Assessment of Credit Process
   - Product Program design with financial projections
   - Review legal environment for enforceability of claims
   - Anchor and SME documentation
   - Recourse/non recourse mechanism
   - Technology and systems usage

3. Monitoring & Portfolio Management
   - Portfolio Monitoring and Collections Review
   - Development of portfolio risk monitoring criteria for the Supply Chain product program and an early warning system framework
   - Development of standardized collections and operation processes
SCF Advisory is part of IFC’s SME Banking advisory services where we have implemented 84 advisory projects globally worth $50 million from 2007-13.
IFC’s SME Banking advisory services are supported by innovative tools

SME Banking Knowledge Guide: Outlines leading practices and success factors for profitable SME banking operations. Guide has been translated into Arabic, Chinese, French, Russian and Spanish.

SME Banking Training Program: IFC offers two courses: An introduction or Scaling up course. The three day course consists of modules, case studies and exercises covering the following areas: business models for SME Banking, identifying Market Opportunities, Customer Management, Products & Services, Sales, Credit Risk Management, IT & MIS,

Customer Management Best Practice Guide: The guide outlines key success factors in better serving the SME clients and allowing banks to maximize the revenue opportunity. It is primarily a technical publication, intended for bank directors and managers interested in acquiring the key capabilities to enhance growth and revenue, as well as building and retaining profitable customer relationships amidst ever-increasing competition for the SME segment.

Customer Management Tools: provision of wallet sizing, du pont model and revenue projection models for the SME segment

SME Banking CHECK Diagnostic Tool: A guide to assess SME banking operations and design relevant advisory services projects.

SME Banking Benchmarking: An online SME Benchmarking Survey, automatically benchmarks SME banking practices.

Market Segmentation Tool: Generates information that can be used by the Bank to make a decision whether to invest in developing its SME operations, identify target SME segments, and decide how to target them, design & sell products

Assessing & Mapping the Global Gap in SME Finance: A joint IFC & McKinsey report that assesses and maps the global gap in SME finance, including the number of enterprises by region, size and formality, as well as SME’s access to credit and value of the credit gap.
IFC’s blend of Investment and Advisory solutions are targeted towards enhancing access to finance for SMEs

**Capacity Building for FIs**
- Build capacity of FIs in strategy, market segmentation, credit risk management, product development through new approaches and systems to scale up their financing for SMEs on a sustainable basis
- **Promote sub-sector focus**: women-owned SMEs, sustainable energy SME projects, agri SMEs, leasing, etc
- Raise awareness on best practices in the SME Finance space

**Financial Infrastructure**
- Develop credit reporting infrastructure based on country needs
- Support development of secured transactions, collateral registries, legal and regulatory framework
- Build capacity of public/private stakeholders through advice and training

**SME Financing & Investments**
- Equity Investments in Financial Institutions / Equity Funds for SMEs
- Funded lines to expand investment and working capital lines especially in illiquid markets
- Blended finance options to support the expansion of IFC’s risk appetite (e.g. grace periods, performance based pricing, subordination, higher risk/lower security or in limited cases, local currency positions) [for selected projects]
- Focus underserved segments, e.g., gender, fragile/conflict, agri, climate

**Risk Mitigation & Enhancements**
- Risk Sharing Facilities / Partial Credit Guarantees to:
  - Enhance risk taking capacity and provide capital relief via low risk weightings
  - Avoid FX mismatches and encourage domestic resources for SME financing
Thank You