Submission to the UKEF Inquiry

Dr. Rebecca Harding
CEO Coriolis Technologies

Overview

1. This submission focusses on the needs of exporting SMEs, both from the experience of interacting with UKEF at a business level and from the perspective of large amounts of academic research that I have done in the area of SME access to finance generally and to export finance in particular. References are not provided here for the sake of simplicity but can be provided on request. My personal experience in this area is based on 6 years at London Business School where I ran the Global Entrepreneurship Monitor, submissions and input into government SME initiatives, including the Women's Enterprise Task Force in 2010, my role as the owner of a FinTech business whose markets are predominantly in emerging markets, and as Chief Economist of the British Bankers Association. I ran the Santander Trade Barometer (a survey of exporting SMEs) and have run multiple SME growth surveys over the past 10 years for clients in my various businesses. Coriolis Technologies has been in receipt of Trade Credit Insurance from UKEF which was invaluable during the early stages of the pandemic.

The current supply-side challenge

2. According to the British Business Bank (with research input from Coriolis Technologies), there are 550,000 exporting SMEs in the UK with a potential contribution of up to £200bn to the UK's economy. The majority of these businesses are in service sectors, with an increasing number of them in Information and Communications Technologies and digital services/e-commerce. On average across the UK, only 30% of "purely domestic" businesses do not have any international exposure at all, according to the Santander Trade Barometer, yet these businesses do not identify as exporters or importers, or even internationally exposed because they have a proportion of their workforce abroad.

3. These businesses are unlikely to qualify for current government schemes to support businesses through the pandemic. Their cashflow, whether in manufacturing or services trade, is often financed through receivables contracts or invoices and the CBILS structures are not appropriate to meet their financing requirements because they do not need debt as such, they need finance that covers the pre-invoice risks that they face. This is the riskiest stage of financing for banks on multiple grounds:

    a. There is a risk of non-delivery by the SME
    b. There is a risk of non-acceptance by the buyer

c. The financial requirements are often short term
d. There is a risk attached to the SME by virtue of the fact that it is small and dependent on prompt payment of the invoice for cashflow rendering a riskier proposition than a larger exporting entity
e. The costs of on-boarding any business for trade finance purposes is estimated to be between £30,000 and £60,000 according to a participant in the Cole Review, interviewed for this submission. The deals that can be done are too small and too short term to justify this cost. Banks interviewed for this submission also argue that SMEs are often under-prepared for onboarding process in terms of their cashflow or working capital forecasting and in terms of the detail of their overseas buyers.
f. During the Covid-19 pandemic the risks of non-delivery and non-acceptance for SMEs have increased because of supply chain disruptions affecting them and their buyers.
g. Against this backdrop, non-government Trade Credit Insurers have moved away from higher risk propositions – particularly smaller deals, deals in riskier markets and deals with riskier clients.
h. Given low yields in trade finance generally because of persistent extraordinary monetary policy, a justifiable focus on CBILS and BBLs in the current environment and the high cost of onboarding SMEs, there is a reluctance on behalf of most banks (with some notable exceptions such as Santander) to fund SME export finance for businesses below turnovers of £6.5m annually with established track records.

4. As a result, it is likely that many SMEs have been excluded from the current support schemes; they are also excluded from accessing trade finance more generally by virtue of their size, nature of their business and documentation, and therefore of their suitability for traditional forms of trade finance.

The current demand side challenge:

5. There are several problems from the demand side of trade finance:

a. If only 30% of domestic businesses are not internationally exposed, then there is a challenge for the export finance supply side: most businesses in the UK are either exporting or importing or have staff or assets abroad, or trade in foreign currencies but do not identify as “international.” This means that they are not likely to seek trade finance in the first instance.
b. It is also unlikely, given the general unawareness about international exposure, that SMEs will know that they can take out insurance against their buyer rather than themselves as a means of financing their exports
c. An SME contacting their bank will not necessarily have the knowledge to get through to the right sources of information in banks since many will be screened by a call centre if they are “business” rather than “commercial” clients. Even if they do get through, banks are unwilling to take on an insurance policy confirmation from UKEF as a sufficient guarantee to undertake a longer-term loan-based export finance

facility. And, as noted above, this is often inappropriate to the shorter term invoice financing needs of the SME.

The market failure

6. All of this means that there is a market failure from the demand and the supply side of trade finance when it comes to SMEs, especially the smaller ones. Yet if the contribution to GDP suggested above is correct, and if one fifth of these businesses fail in the current climate (based on estimates from organisations like the British Chamber of Commerce, the Federation of Small Businesses and the Confederation of British Industry) then there is a likely loss in trade-based revenues to the UK economy equivalent to some £40bn.

The role of UKEF

7. UKEF provides Financing, Guarantees and Insurances as well as tools to access finance as a buyer or as a supplier internationally. These are all appropriate and usable as part of the toolkit for addressing the market failure addressed above. Efforts recently by UKEF to expand guarantees and buyer facilities to keep supply chains moving have been noted by international organisations such as the ITC/Intracen and the International Chambers of Commerce as leading the way in defining best practice.

8. However, to improve the services offered by UKEF, there needs to be a step changes in the following:

    a. **Increased focus on the growing short-term financing needs of SMEs through invoice or receivables finance**: the banks have the liquidity to fund such short term needs but largely do not have the appetite to move into these services because of the costs and returns expected. UKEFs offering at present is largely in the "traditional" trade finance arena – in other words, finance against promissory notes or bills of exchange which do not necessarily meet the requirements of services or digital businesses who are exporters. Rather, UKEF can fund contracts or indeed Schemes of Work and lead the way in providing appropriate forms of export financing for a group of companies that are currently under-served.
    b. **Raising awareness of insurance for riskier projects**: An recent experience-based observation: UKEF was the only organisation that would provide trade credit insurance for a contract with a business in Africa, despite that business having a strong credit track record. There was no direct finance available but invoice finance from a non-bank was received once the insurance from UKEF was put in place. UKEF should raise awareness amongst the banks, non-banks and SME community of this type of service as it is extraordinarily helpful.
    c. **UKEF needs to increase cross-departmental support for riskier trade**: in the example above, the banks were not able to provide support because it was not guarantee based but rather it was insurance based. The UK government did not have (still does not have) an explicit Covid 19 programme for SME exporters in the services and digital space, and yet a combination of a CBILS or British Business Bank support (such as the Future Fund)

and insurance would have de-risked the short-term finance completely and been a swifter solution.

d. **UKEF and the banks need to work more systematically together:** solutions such as those offered by the Kreditanstalt für Wiederaufbau (KfW) in Germany include a mix of co-investment, guarantees and insurances tapered according to the private or public returns of the project. There is no evidence that this disincentivises trade amongst SMEs in Germany's Mittelstand, but the structures are well-known/well-established amongst the trade finance banks in Germany that serve this sector.
e. **UKEF needs to work cross-agency using technology-based solutions to address the demand side gap**: the awareness gap amongst the SME market is a frustration to banks and to UKEF itself. If an SME does not demand trade finance, and indeed doesn't even know what it is, then there isn't a market for it. Supply does not create its own demand in this instance because the market is unaffordable/unadressable at present below the turnover threshold of $6.5m. Even at higher levels of turnover, banks make considerable efforts to work with their clients to ensure the market exists and this in unsustainable. This is more than a call for greater education. There are technologies that will link bank accounts to trade financing potential through the Open Banking Implementation Entity and its data organisation, FDATA. The FCA digital sandbox also offers potential and the Bank of England is also addressing the issue. It has the full enabling support of UK Finance and resources from Innovate UK to develop the technology are available (from experience). Banks will not come into this market unless they have a technological solution that reduces their costs as yields are likely to remain very low for the foreseeable future.

September 2020