Supply Chain finance mechanism for SMEs integration into global value chain

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Supply Chain and Value Chain

SUPPLY CHAIN:

- Supply Chain is a system of Organizations, people, technology, activities, information and resources involved in moving a product or service from supplier to customer.
- Supply chain activities transform natural resources, raw materials, components into a finished product that is delivered to the end customer in sophisticated supply chain systems. Supply chain links value chains.

VALUE CHAIN:

- A value chain includes every step a business takes to produce a product or service and deliver it to the customer from its conception to its end use and beyond.
- This includes activities such as research, design, production, marketing, distribution, and support to the final consumer.
- Productivity, innovation, flexibility and responsiveness to the consumer become critical attributes of the value chain and one must choose the most effective solution for each link in the chain.

Global Value Chain

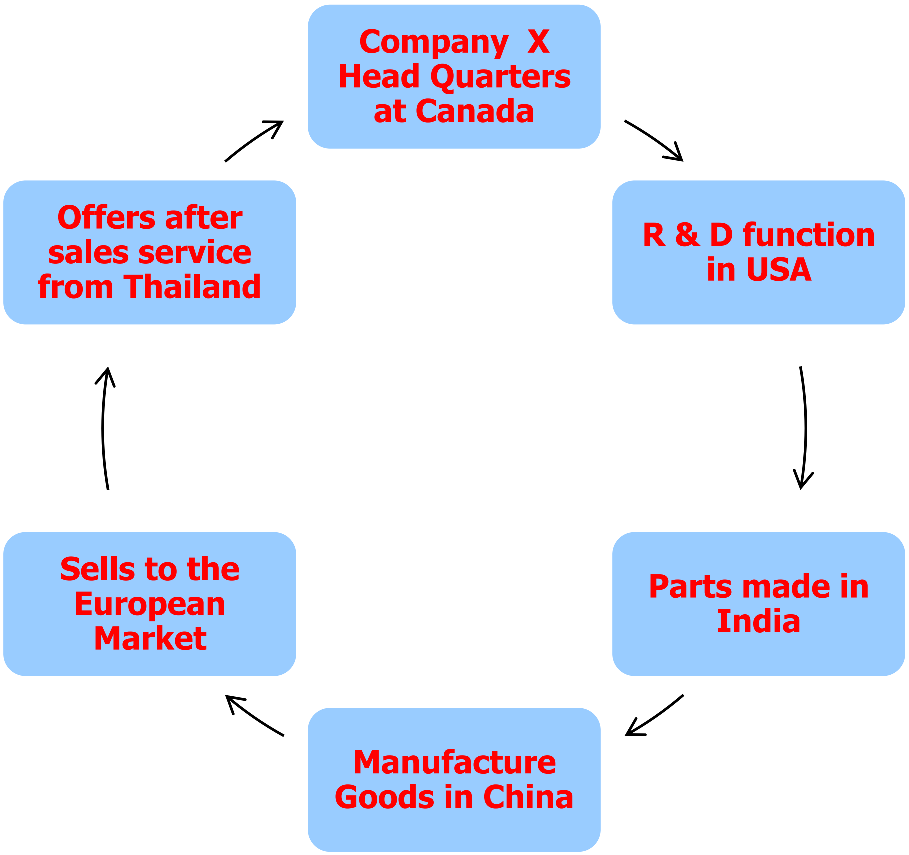
GLOBAL VALUE CHAIN:

- The term "global value chain" (GVC) refers to the **full range of cross-border**, value-added business activities that are required to bring a product or service from the conception, design, sourcing raw material, and intermediate inputs stages, to production, marketing, distribution and supplying the final consumer

IMPORTANCE OF GLOBAL VALUE CHAIN:

- GVCs bring benefits beyond those traditionally associated with international trade in final goods, reflecting the more granular division of production and task specialization, which enables each participating country to exploit finer comparative advantage niches and raises the benefits from economies of scale and scope
- Helps to guarantee security to supply
- Makes it easier to advance technology through collaborative innovation
- Enables faster response to changing market conditions and customers
- Help countries improve a country's balance of trade and strengthen productivity by making sure they gain maximum value from the presence and success of the larger or high-profile companies that form 'anchor points' of manufacturing activity.

A Typical Global Value Chain



Need for SMEs integration into Global Value Chains

- The rise of niche markets and the importance of customization
- Technological advances
- Reduced product life cycles that have made flexible production more important than volume of production
- Subcontracting opportunities arising from the growth of the global production system and global retail sourcing; increased importance of the services sector (dominated by SMEs)
- Knowledge, skills, innovation, ability to commercialize these, as core sources of competitiveness, value creation, and value adding in the economy
- Ability to respond to rapidly changing customer demands and technology
- Participation in clustering (horizontal and vertical) and networking that can facilitate access to knowledge-sharing spillovers and skilled labor as well as achieve economies of scale and scope, which would be impossible in isolation
- Flexibility in technology development, adaptation, and application
- Recognition by policymakers both at the national level and international regional levels of the important role that SMEs can play in economic development, particularly employment generation, empowerment, and poverty alleviation.
- SMEs participation in value chain exposes them to a large customer/buyer base.
- It gives an opportunity to learn from large firms and from engaging and surviving in the hotly contested sectors of the global marketplace.
- It enhances SME competitiveness, create more jobs, and promote inclusive growth in developing economy.

Issues involved in SMEs integration into Global Value Chains

- Obtaining reliable foreign representation and identifying foreign business opportunities
- Limited information to locate/analyse markets
- Maintaining control over foreign middlemen
- Inability to contact potential overseas customers
- Keen competition in overseas markets
- Offering satisfactory prices to customers
- Accessing export distribution channels
- Difficulties in enforcing contracts and resolving disputes
- Unreliable data about the international market
- Granting credit facilities to foreign customers
- Lack of managerial time to deal with internationalization
- Shortage of working capital to finance exports
- Inadequate quantity of and/or untrained personnel for internationalisations
- Unfavourable foreign rules and regulations
- Difficulty in matching competitors' prices
- Complexity of foreign distribution channels
- Slow collection of payments from abroad
- Adjusting export promotional activities to the target market

Supply Chain Finance

- Supply chain finance is a new financing mode tailored specially for SMEs by financial institutions.
- The financial institution develops synthesis credit for SME from the supply chain angle and transforms risk management aimed at single enterprise to risk management of the whole supply chain.
- Supply chain finance breaks the bank's old thought model of inspecting single enterprise's static state credit, but takes the upstream to downstream enterprise as a whole to design effective financing plan according to the chain relationship formed in the transaction and industrial characters.
- The supply chain finance can not only solve SME's capital problem, but also promote the competitive power of the entire supply chain.

Supply Chain Finance Mechanism

Large corporates purchase goods from SMEs

SMEs supply goods and submit invoice to corporates for payment on the industry standard credit term of 30 to 90 days

If SMEs want payment before credit period, requests Large corporate's Banks/ FIs for immediate discounted payment

Banks/ FIs make payment to SMEs at discount

Supply Chain Financing Solutions

- Bill discounting
- Invoice discounting
- Electronic platform for these solutions such as N-Trees and TReDs
- LC discounting
- Discounting bills backed by Bank Guarantee
- Factoring

Benefits of Supply Chain Finance

- Offers short-term credit that optimizes working capital for both the buyer and the seller.
- Connects the different links in the chain of a transaction, such as the financial institution, the seller, the buyer, brings them together, which helps in lowering financing costs and thus enhancing the business efficiency.
- Ensures business continuity seamlessly by avoiding bottleneck in working capital needs at both ends.
- It mitigates risk for all players that are part of the supply chain.
- Optimize the cash flow by letting businesses to stretch the payment owed to their suppliers, while ensuring that suppliers get paid early.
- Purchaser's working capital is made better use off; the extra cash the supplier generates, can be used for further investment
- Uses a technology platform that automates transactions and tracks the entire process, right from invoice approval to the settlement process.

Policy Principles and Best Practices

- Availability of timely and adequate finance
- Reasonable cost with Simple delivery process
- No collaterals
- Single window for financing requirements
- Awareness of schemes of Banks/FIs
- Support and Handholding services
- Government should provide attractive tax rates
- Easy accessibility of information on government programmes
- Banks should work to develop their ability to offer more diversified financial services to SMEs
- Supporting bank credit with market-compatible public interventions such as government guarantees, securitization, etc
- Develop complimentary sources of debt financing such as private equity, venture capital, risk capital etc.
- Creating common market standards and best practices
- Create incentives for institutional investors
- Promoting cross-border venture capital investments

Challenges & Way ahead

- With global value chains (GVCs) playing a prominent role in the international trading system, integrating SMEs into GVCs brings benefits, but also faces challenges.
- The analysis of GVCs in the agriculture, food processing, automobile, electronics, and handicraft sectors show heterogeneity exists among them, in terms of value chain configuration and characteristics.
- Currently, around 80 percent of global trade is conducted through global value chain networks.
- Since the global financial crisis, GVCs are experiencing consolidation, with multinational corporations (MNCs) sourcing from a few large and competent suppliers rather than a large number of smaller suppliers.
- As production costs are starting to rise in developing Asia, some MNCs based in developed economies are re-shoring some operations .
- Globally, major consumer markets are shifting to developing economies, pushing geographical expansion of the value chains.
- Trade in services is taking a more prominent role, linking different players along the chains.
- The rise of e-commerce is enabling a further expansion of global value chains.

Practices on improving access to finance for SMEs

Key challenges faced by SME sector

The major issues confronting SMEs are:

- Technology obsolescence
- Managerial inadequacies
- Delayed Payments
- Poor Quality
- Incidence of Sickness
- Lack of Appropriate Infrastructure
- Lack of Marketing Network
- Lack of Capital
- Pricing Pressure
- High competition
- Lack of entrepreneurial knowledge
- No R&D initiatives from sector
- Majority are non corporate entities, Issues of corporate governance, Lack of financial discipline, Lack of professional skills, No growth strategies, Inadequate Working Capital

There can be many more similar issues hindering the orderly growth of SMEs.

Good Practices for Access to Finance SMEs

- Banks are now developing new business models, technologies, and risk management systems to serve volatile SME sector.
- Lending is only a fraction of what banks offer to SME, as banks try to serve SMEs in a holistic way through a wide range of products and services, with fee-based products rising in importance.
- Foreign banks entry and banking sector consolidation is important. Large banks can sort out well-functioning and promising SMEs via their corporate clients with which SMEs maintain supply and outsourcing relations.
- Adaptation of technology promises to reduce costs and improve transparency in delivering financial services
- Technology forecasting & assessment studies
- Technology & market linked business opportunity reports in emerging technology areas of national importance in close association with academia, R&D and industry.
- 4E (End-to-End Energy Efficiency) Solutions to help the SME unit to adopt energy efficient practices by providing them handholding support
- TReDS, Fintech Companies, etc.

Good Practices for Access to Finance SMEs

- **Information Systems:** Custom-built or commercially available software that allows financial institutions to track transactions and create reliable financial reports. Getting this right is a critical building block for all other technology applications.
- **Connectivity:** Network connections (for example, dial-up, broadband, or satellite) that link staff and branches for real-time information exchange, transaction processing, and distance learning.
- **Personal Digital Assistants (PDAs):** Small handheld computers that help field staff more efficiently collect data, manage SME client records, and process loans.
- **Credit Scoring:** Automating or enhancing the loan approval process by computerized analysis of client characteristics and behavior to predict willingness and ability to repay.
- **Automatic Teller Machines (ATMs):** Working Capital facilities, OD facilities, etc., can be offered through ATMs.
- **Internet Banking:** The ability to conduct banking transactions from any location, such as Internet kiosks. This service is probably more relevant for urban area clients.
- **Mobile Phones:** Millions of people in both urban and remote areas now have access to cell phones, and increasingly use text messaging. This technology offers an opportunity to operate virtual bank accounts with minimal infrastructure

Financing Options

- Financing through Banks, Rating SMEs, Working Capital
- Risk Capital, Venture Capital / Private Equity
- SME Exchange, Export Lines of Credit, Hedging Instruments
- Credit Guarantee scheme
- Cluster financing
- Micro finance
- Securitization

- **CAPACITY BUILDING:**

- Enterprise promotion/ skill development
- Management Development
- Cluster Development
- Marketing Support
- Policy advocacy
- Credit Advisory

Government Initiatives Required

- Set a sound policy framework for the financial sector
- Strengthen the institutional infrastructure
- Build the information infrastructure
- Liberalize interest rates
- Promote competition
- Have supportive regulations regarding SME banking, leasing, factoring, and equity
- Reduce and rationalize direct public sector intervention
- Improve the legal and judicial frameworks
- Support relevant training for interested financial institutions
- Provide or facilitate initial financial support (equity infusion, product development, risk mitigation methodologies)
- Promote accounting standards
- Invest in and promote credit bureaus and registries
- Invest in technology

The Way Forward

- Origination and monitoring in Receivables-based financing to Seller
- Overdrafts/loans to Distributors/sub-Distributors
- Floor-planning & equipment financing including end-user financing
- Funding risk sharing facilities/partial guarantee.
- Advisory Services solutions for distributors and / sub distributors, for capacity building and risk mitigation, to be customized as per needs
- Support clients with their growth strategies, increase profitability ratios, and **augment the bank's capabilities across key areas of customer management** to better acquire and retain SME clients
- Identify best customers within an SME Banking portfolio
- Optimize risk and performance based pricing
- Optimize SME touch-points for marketing profitably
- Manage retention and churn practices
- Optimize collections and recovery actions
- Manage loyalty for SME clients
- Manage customer campaigns
- More thrust on Risk Capital and Energy Efficiency Funding.

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