How governments can help SMEs without adding to debt levels

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The challenges facing countless small businesses following the COVID-19 pandemic do not need to be reiterated. Everyone is aware of the challenges posed by the lockdown measures, especially as governments brace for the second wave, and the toll this has had.

The recovery efforts put in place following the impact of COVID-19 have also been considerable. While these schemes have softened the economic blow, they are somewhat short-term and do not address the underlying symptoms – the lack of national and cross-border trading opportunities caused by the global economic slowdown.

There are still considerable challenges that businesses – especially SMEs – face in the coming months as furlough schemes draw to a close. While government efforts have focused on reducing the financial impact felt by smaller businesses, there is still a need for a more surgical approach that helps entire supply chains rather than individual organisations.

Addressing the bigger picture

Even with governmental support, supply chains for small businesses continue to suffer. In part, this is due to the longstanding barriers that have limited SMEs from receiving the finance needed to support their international trade. Many of these issues are deeply rooted, and they have been exacerbated by the pandemic, making any pain points even sharper and longer-lasting.

Take, for example, access to trade finance. This is the lifeblood of international trade – without it, cross-border trading activity would seize up. Prior to the pandemic, there was a USD1.5 trillion shortfall in the amount that businesses needed to fund their trading activity. This has only gotten worse in 2020.

Traditional methods of trade finance are harder to access for small businesses, as they often lack a long financial history and cannot showcase their risk profile accurately. Even when this can be established, Basel III and IV restrictions have made the cost of capital more expensive for trade finance, reducing the potential return on equity and making trade finance less attractive.

As such, SMEs often fail to receive funding through these traditional avenues. Under normal circumstances, they would simply be limited in their options, but with the fallout of lockdown still being felt, entire companies can be at risk.

Direct government support to boost global trade

While the continual easing of lockdown is helping these businesses return to some sense of normality, the inaccessibility of trade finance remains a considerable long-term barrier to recovery.

It's here that governments need to take more action. In the same way that they provided funding through short-term loans and by covering employee wages, there needs to be a direct injection of capital specifically to support cross-border trade and long-term economic growth.

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This would build on the government's existing efforts to encourage and increase investment and stimulate business opportunities – only at a more macro level.

This will not only allow SMEs to survive but to thrive. More business means more income. This will help to support jobs without needing additional government support, boost supply chains and re-instil much-need business confidence.

Technology can maintain a balance between stimulus and debt

Naturally, technology will be crucial to achieving this. Artificial Intelligence (AI) and machine learning are already being applied in innovative ways to improve access to trade finance for SMEs.

Of course, any serious government needs to ensure debt levels, which have already jumped to record levels in some countries, do not get out of hand. This is where the efficient distribution of trade finance assets to investors can help.

The low-risk profile of trade finance as an asset class is widely acknowledged. It is based on tangible flows of goods and services, making it less susceptible to bouts of volatility observed in other financial markets. Furthermore, default rates for trade finance products are lower, and time to recover in case of default is much shorter than for other products and asset classes.

This presents a compelling multi-trillion-dollar investment opportunity. By distributing trade finance, institutional investors will gain a return on their investment, debt levels remain sustainable while SMEs get the vital funding they need.

The technology and market infrastructure exist to parcel all trade finance instruments into investable assets. This will not only close the USD1.5 trillion gap but allow smaller organisations in the supply chain to get access to funds they would not have previously had.

With COVID-19 and its effects set to affect the global economy for the foreseeable future, SMEs cannot be left to weather this storm alone. These companies represent 90% of the world's businesses and more than 50% of employment worldwide. Their stagnation would be felt in every region and across every industry.

Direct injection of capital to support the trade finance market could act both as a lifeline to help SMEs survive the pandemic and maintain sustainable debt levels. More importantly, it will provide lasting positive economic effects would be felt in the years to come.