Non-Bank Trade Finance as a Viable Alternative to Traditional Bank Funding for Internationally Trading Small and Medium Enterprises in South Africa

A research proposal submitted by
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31 October 2014

ABSTRACT

This study was conducted to evaluate whether trade finance offered by non-bank financial institutions was a better funding mechanism for internationally trading small and medium enterprises (SME's) than traditional, and more commonly utilised commercial bank finance. While the two products are similar, non-bank trade finance specifically funds the trade of goods and bank finance incorporates a host of other financial products as well. The topic was deemed relevant at this time for both demand and supply side reasons. From a demand perspective, internationally trading SME's operating in South Africa list access to enough of the correct type of finance as one of their biggest obstacles to doing business. On the other hand, certain market and structural aspects – affecting both non-bank and bank providers – seem to limit the supply of working capital credit to internationally trading SME's.

A qualitative research methodology was chosen to allow as yet unknown information to possibly come to light. Semi-structured, open-ended interviews were employed to gather data from two sample sets – namely internationally trading SME's and the providers of trade finance or working capital debt in South Africa. Thereafter, a technique of inductive content analysis was engaged to identify and rank pertinent factors. These factors were then analysed to directly address the topic of the research.

What materialised, is that non-bank trade finance is not necessarily a better form of working capital funding for internationally trading SME's. Traditional bank finance does have its uses and advantages in many respects. However, it was found that non-bank trade finance may be more effectively utilised to raise much needed credit when either bank lending is tight or a business requires additional capital in times of growth. Non-bank trade finance is also often better suited to fund the extended cash flow cycle of an international trade transaction. Therefore, non-bank trade finance should not replace bank finance, but rather be used as a complimentary product in conjunction with bank lending.

DECLARATION

I, Menso Kwint, declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Wits Business School, University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

Menso Kwint

31 October 2014

ACKNOWLEDGEMENTS

I would like to specifically thank the parties that assisted either directly in the writing of this research assignment, or indirectly in support of the writer.

Firstly, thanks to my wife Lorna, who supported me throughout and is always, always there when she needs to be. Our cat, Solomon, should get a mention for his stoic and unsolicited warming of my notes and keyboard at all times.

My family and friends, you have helped often, and often without knowing it.

A very important thanks go to Lombard Trade Finance and the Lombard Insurance Group, who unquestioningly paid for my studies and allowed whatever freedom I required. A special thanks go to Dean Burscough in particular, who has guided much of my thought around the topic of trade finance.

To my supervisor, Professor Eric Schaling, thank you very much for your input and direction through the entire process. Your ideas and experience helped me to change certain fundamentals in the assignment and hopefully bring about a better result.

Thanks to the Wits Business School for providing the medium for the entire MBA course.

Lastly, and of course, thanks to every person and institution that contributed to the data gathered and research of this assignment.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

1 INTRODUCTION

1.1 Purpose of the study

The purpose of this study is to evaluate the viability and attractiveness of non-bank trade finance as an alternative to traditional bank funding for internationally trading Small and Medium Enterprises (SME's) in South Africa. The central concept of trade finance will be defined as the financial mechanism that supports and enables a trade transaction to take place (Beard & Thomas, 2006). South African commercial banks do provide trade finance, but more often within a general short term working capital facility, and not as a specific trade finance product. Non-bank trade financiers lend to exclusively fund trade. This fundamental difference has implications on how these institutions operate and what financial products are offered to businesses requiring finance. Particular significance is leant to the research by the current credit lending environment post the recent financial crisis. Traditional bank lending criteria have become more stringent and focused towards bigger businesses (Fisman & Love, 2003). This has made it harder for smaller businesses to access the finance they require. Therefore, an opportunity may be seen to exist for internationally trading SME's to look more to non-bank trade financiers in order to raise the working capital debt they need to fund their operations.

1.2 Context of the study

Working capital management is crucial to most businesses as they balance the need for cash between inventory, debtors and creditors. Without suitable cash resources a company may have insufficient funds to meet day to day cash flow demands, thereby threatening their longevity (Firer, 2008). Businesses that trade goods for profit require financial resources to bridge the cash flow gap from outlay of monies for the purchase of stock to the inflow of funds on receipt of payment from their customers. An internationally trading business has an especially long cash flow cycle as goods take time to be exchanged across borders. Also, information asymmetries and the chance of payment default often require goods to be paid for upfront, or for a financial instrument to guarantee payment before goods are sent across borders (Beard & Thomas, 2006). Due to this extended cash flow cycle, financial resources in the form of equity or short term debt are essential to fund internationally trading business.

In South Africa, the largest providers of working capital debt are the traditional commercial banks. The most common form of this type of funding is a bank overdraft coupled to a business transactional account and securitised through the personal sureties of the owners of the business and a cession of the debtors' book (Kim, 2010). Trade finance is a form of short term working capital debt that is specifically used to fund the trade of goods between buyers and sellers in one way or another (Beard & Thomas, 2006). The banks in this country do provide businesses with trade finance but generally as a component of a working capital facility, and together with other short, medium and / or long term lending and also transactional banking products. A non-bank trade financier typically only funds trade and provides a limited number of financial products that support this core offering (Burscough, 2012).

An important limitation of traditional commercial bank finance is that the banks generally do not take security over stock or inventory held (Kim, 2010). This often results in insufficient funding being made available to a company that buys and sells goods. Normally a trading company's biggest asset is the inventory they purchase and then hold to be sold at a later stage for profit (Hartley, Firer, & Ford, 2006). Therefore, if stock is not considered as collateral, a large portion of the borrowing businesses' assets are excluded as leverage for credit, making it difficult to raise sufficient finance. A specialist trade financier (whether it is a bank or non-bank institution) would normally securitize a lending facility through a lien over the stock financed, or an ability to claim that stock at a later stage (Beard & Thomas, 2006). In this way specialist trade finance providers can often provide larger credit facilities to trading businesses.

The third quarter of 2008 saw the beginning of a global economic downturn which began in the financial sectors of predominantly developed countries, but had repercussions around the world. The crisis adversely affected access to credit in a significant way (Ahn, et al., 2011). Banks reduced lending through more conservative scoring criteria, and SME's – in particular – were prejudiced as larger companies with lower perceived default rates were favoured (Dorsey, 2009). Together with all credit, this severely affected the availability of trade finance which is necessary to support international trade. Levels of inter-country trade decreased at a significantly higher rate than the trading countries' Gross Domestic Products (GDP's) as the financial enabler behind trade diminished (Ahn, Amiti, & Weinstein, 2011). "According to recent research, the volume of loans around the world declined from 74% of GDP to 65%, while the volume (of loans) at national level declined as a share of GDP in more than 80% of countries" (Unknown, 2010 : 39).

To some degree South Africa avoided the initial financial downturn due to the country's comprehensive legislation and bank regulation. This prevented large exposure in the sub-prime lending markets which affected North America and Europe so drastically. However, the ensuing recessions in these countries was passed on to the world and South Africa after a short time lag (Naudé, 2009). The country is considered to be in a relatively good position, with the 18^{th} largest stock exchange in the world (by market capitalization) and a perception that it could be the gateway into Africa for Multinational Corporations (MNC's). After hosting a successful Soccer World Cup in 2010 the world's view is falling more and more favourably on South Africa, opening up the potential for increased foreign investment, tourism and trade (Tshabalala & Dlamini, 2010). All of this presents an opportunity for economic growth and much needed development. International trade has proved to be a tremendous driver of progression, creating broad based wealth and employment in countries like China and India for the last few decades (Bernstein, 2012). Finance in the form of short term working capital debt is often required as the necessary enabler of this all-important trade, and limiting access to it can constrict the potential for businesses to succeed and grow in South Africa (Mutezo, 2005).

Current literature will be investigated to evaluate what has already been written with regards to the topic of this research. Thereafter, one-on-one interviews with both internationally trading SME's and the providers of trade finance in South Africa will be conducted to gather data. A qualitative research methodology will be utilized to unpack and understand this data and attempt to answer the research questions posed. In this way both the demand and supply-side perspective on trade finance in the country will be explored. Considering the current global and South African economic situation, the aim of the research will be to establish whether non-bank trade finance is a viable alternative to traditional commercial bank finance for internationally trading SME's.

1.3 Problem statement

1.3.1 *Main problem*

To determine whether non-bank trade finance is a viable alternative to traditional commercial bank finance for internationally trading SME's in South Africa.

1.4 Significance of the study

Financial resources are required to bridge the extended cash flow cycle of an internationally traded good (Beard & Thomas, 2006). This finance may be provided in the form of equity or short term working capital debt, and as equity is finite debt becomes an necessary tool for internationally trading businesses (Hartley, Firer, & Ford, 2006). The debt can be raised in a number of different ways, but for the purpose of this research trade finance provided by a specialist non-bank trade financier and that provided by a traditional working bank will be compared.

This study is significant for two main reasons. Firstly, although traditional bank facilities are the most prevalent form of funding, they are not always adequately structured to fund an internationally trading business because they do not securitise through the inventory traded (Kim, 2010). Secondly, post the recent financial crisis of 2008 and 2009, lending institutions have become more conservative and credit has become more difficult to access for all businesses, and SME's in particular (Ahn, et al., 2011). These two factors have resulted in an inability for internationally trading SME's to access the finance they require to run their businesses. Specialist non-bank trade finance companies are more suited to fund trade as they do securitise through the inventory traded. However, they are generally more expensive than bank providers and seem to not be well enough known in the South African market to be effectively utilized (Burscough, 2012).

By determining the limitations and benefits of both traditional bank finance and non-bank trade finance this research will attempt to conclude whether non-bank trade finance is a more viable alternative to fund internationally trading SME's. The study will directly benefit internationally trading SME's in helping to provide an understanding of the financial options available to them. It will also hopefully assist the suppliers of trade finance in South Africa by illustrating whether there is an opportunity to improve their offering and gain market share.

A further investigation will be done to determine whether a public private partnership (PPP) between a non-bank trade finance company and a government owned entity could overcome the limitations of non-bank trade finance to effectively support and enable a greater number of internationally trading SME's in the country.

1.5 Delimitations of the study

The following delimitations will narrow the scope of the study:

- The study will not account for all of the reasons behind the increase and decrease of international trade flows – only the impact of the financial enabler behind trade.
- The study will be demand-side and supply-side focused. Both SME's requiring trade finance; and banks and non-bank trade financiers who provide trade finance will be interviewed.
- The study will focus on internationally trading SME's, who are based in South Africa and are involved primarily in the importing of goods and their resale in South Africa and / or neighbouring countries.
- SME's will be defined as organisations of between 5 and 200 staff members as this is the generally accepted classification of an SME (Mutezo, 2005).
- Well established SME's with experience in importing will be targeted. Either owners; financial managers or purchasing managers will be interviewed.

- Responsible individuals at certain banks and one non-bank trade financier will also be interviewed.
- The study will not address larger companies.
- The study will not address companies based outside of South Africa.

1.6 Definition of terms

BRIC – Brazil; Russia; India and China

Forex – Foreign Exchange

FSB – Financial Services Board

GDP – Gross Domestic Product

GNB – General Notorial Bond

IDC – Industrial Development Corporation

IMF – International Monetary Fund

L/C – Letter of Credit

LIBOR – London Interbank Offered Rate

MNC – Multi National Corporations

PPP – Public Private Partnership

SME – Small and Medium Enterprise

USD – United States Dollars

ZAR – South Africa Rands

1.7 Assumptions

The following assumptions have been made regarding the study:

- The sample size will be large enough and diverse enough to sufficiently represent the greater population of the South African internationally trading SME market, as well as providers of trade finance in the same market.

- Should respondents not have sufficient knowledge or experience their responses will be discounted so as not to skew the data.

2 LITERATURE REVIEW

2.1 Introduction

International trade can be a major force in the growth and development of all nations, and especially for less developed countries. China and India have led the phenomenon in recent times. China, for example, grew their economy 440% and increased per capita income from 3% to 12% relative to North American per capita income in the twenty years from 1980 to 2000. A large part of this growth and improvement in per capita income came from a proliferation of the local manufacture and export of their goods (Bernstein, 2012). Globalisation and improvements in communication and transportation technologies are making international trader easier and therefore an even more important tool for the development and success of economies around the world (Hill, 2010). In order for trade to take place, a financial mechanism is often necessary to bridge the cash flow gap between the buying and selling of goods. Trade finance is the financial means that supports and enables a trade transaction to take place (Beard & Thomas, 2006).

Trade finance may be provided in a number of different ways and by many varying kinds of organisations. Firms selling their stock can allow open account on various terms; bank and non-bank financial institutions lend out monies; insurance companies may insure debt to guarantee payment in the event of a default and even governments can provide a form of trade finance through subsidies and grants; etc. (Chauffour & Farole, 2009 : 133). For the purpose of this study trade finance provided by commercial banks and that provided by non-bank trade financiers will be analysed and compared.

The financial crisis beginning in late 2008 and initially driven by the sub-prime lending markets had a detrimental effect on financial services lending around the world (Naudé, 2009). The crisis and ensuing economic recessions drove up the rate of default of borrowers, and therefore the risk associated with extending credit. This in turn, increased the rates at which lenders were willing to lend (interest rates) and also decreased credit providers' willingness to lend funds out (Ahn, et al., 2011). International trade was particularly affected as it is dependent on an underlying financial mechanism – which is often short term working capital debt. A trade finance 'gap' developed as the supply of credit failed to meet demand in many markets (Chauffour & Farole, 2009). In poor economic conditions, it seems banks become more conservative and focus more on lending monies to larger businesses (Boyes, et al., 1989). In South Africa, Mutezo (2005) claims that SME's in particular do struggle more than larger companies to obtain bank finance.

To compound this, there are certain limitations inherent to both commercial banks and non-bank trade financiers that restrict the access of trade finance for SME's. The most important factor limiting bank funding is that banks prefer not to securitise their working capital lending facilities through stock or inventory held. As stock is an important asset for any trading business, this often limits the security available and therefore the size of credit facility that can be approved (Burscough, 2012). Operational limitations also mean that bank funding can be more general and not specialised in any definite area – for example trade finance (Kim, 2010). This may limit a bank's ability to provide required credit. Non-bank trade financiers tend to be more expensive than commercial banks and not well enough known in the market (Burscough, 2012).

2.2 Definition of topic

In order to trade goods (or services to a lesser degree) financial resources are necessary to bridge the time between purchase of the good / the process of value add (if applicable) / the sale of the good / and receipt of monies due from the end customer (Almeida, Campello, & Weisbach, 2004). This financial resource can be provided through equity held in the business or some form of debt raised (Parson & Titman, 2009). As equity is hardly ever unlimited, debt becomes an important instrument for a trading business to fund its' operations. Trade finance is the extension of credit in some form or another between two or more parties that enables the trade of goods to take place (Beard & Thomas, 2006). The funding may facilitate local or international trade. However, it is more commonly used in an international context due to the extended timeframes and the higher perceived risks inherent in an international transaction (Ahn, et al., 2011). Due to asymmetrical information and the risk of payment default often either payment or a financial guarantee – for the full outstanding value – must be provided before goods are transported from seller to buyer. A trade financier provides the financial backing necessary to attain a smooth and efficient trade of merchandise (Degryse, Ongena, & Tümer-Alkan, 2008).

Banks are often one of the largest (if not the largest) suppliers of working capital funding to businesses around the world. They offer trade finance, either as one isolated product, or more commonly within a bundle of other financial products in one comprehensive solution. For example, a bank may provide one company with a general bank overdraft; a trade finance facility; vehicle and other asset finance as well as transactional banking. Banks tend to secure working capital facilities through sureties from related persons and / or entities and a cession of book debt (Kim, 2010). Non-bank trade finance providers also exist which exclusively provide trade finance in order to fund the trade of goods locally and / or across borders for their clients (Beard & Thomas, 2006). A non-bank trade financier specialises in funding trade, and also takes security over the tradable stock financed through an instrument called a general notarial bond (GNB) – in addition to personal sureties and cessions of book debt. A GNB allows the trade financier to take ownership of stock through the perfection of the bond, and so offset debt owed. With this additional security, often a larger credit facility can be provided to a trading business (Burscough, 2012).

In the current South African environment, lending in general is conservative due to recent economic downturns (Ahn, et al., 2011). In addition to this SME's find it harder to access the short term debt they require to run their businesses (Mutezo, 2005). With this in mind, the topic of this research is to determine whether non-bank trade finance is a viable and in fact better alternative to traditional bank finance for internationally trading SME's in the country.

2.3 Trade finance

From the mid-19th century – and increasingly more in recent times – international trade has become crucial for the wealth and development of countries around the world (Hill, 2010). The more affluent nations of Europe and the United States reflect the highest levels of per capita income in the world, and it is no coincidence that they also boast the highest import / export flows. In the last two decades China and India (to a lesser degree) have used international trade to robustly grow their GDP's (Unknown, 2012).

Due to time lags and increased risk from asymmetrical information flows across borders, international trade is very often supported by an underlying financial mechanism – which is trade finance (Ahn, 2011). An internationally trading business often requires large cash reserves to bridge the long cash flow cycles of international trade. These reserves need to be established through the correct mix of equity and debt (Firer, 2008). As trade has expanded over time, trade finance mechanisms and their providers have evolved in order to support it (Beard & Thomas, 2006). However, in the recent financial crisis international trade has diminished at a much greater pace than the growth rates or GDP's of the main trading countries around the world. Ahn, Amiti et al. (2011) propose that the larger reduction in trade is as a result of the underlying financial enabler not supporting trade sufficiently. Banks are still the largest single provider of trade finance, and their conservative credit lending decisions post the economic recession have led to a substantial trade finance shortage (Chauffour & Farole, 2009). While trade finance provided by a specialist trade financier instead of a bank may be a solution, it does come at a cost. As non-bank trade financiers generally borrow from a bank to lend to their clients, the cost of their funding is more expensive than direct bank lending.

2.3.1 *Capital structure and the need for debt*

The intention of a for-profit business is to generate a return through its operations and the utilisation of assets. An organisation funds their assets and any necessary expenses through capital which is drawn from two principal sources, namely equity or debt (Hartley, Firer, & Ford, 2006). The mix between the two is termed a company's capital structure (Parson & Titman, 2009). Equity is generally made up of shareholder funds invested into the business and / or retained profits built up over time. Once equity has been used up, debt must be raised to fund existing operations and / or growth in a business. It can also be used to reduce costs as the cost of debt is often cheaper than that of equity (Hartley, Firer, & Ford, 2006). Modigliani and Miller outlined a theory on capital structure that says that a firm can borrow up to their debt carrying capacity – that is: their ability to repay debt and the interest costs on the debt. The more a firm borrows, the more their ability to repay this debt is stretched. Interest costs and also the risk of default rise as a business borrows more. An equilibrium between debt and equity is reached depending on a firm's operational structure and debt carrying capacity (Firer, 2008).

A trading company's largest asset is often the stock that it buys and sells. Therefore, the need for finance is often aligned to how much stock is required and how long it takes to sell that stock and recover funds from customers. The cash flow cycle of a trading company begins with paying for goods by either cash or credit and ends with the seller receiving payment from their customers and either banking the proceeds or repaying the credit provider (Almeida, Campello, & Weisbach, 2004). Generally stock is sold over the short term and thus short term working capital solutions are sought to finance it (Hartley, et al., 2006). An internationally trading company has an even longer cash flow cycle due to the time delays of moving goods across borders and the need for upfront payment. Therefore, these kind of businesses often have a greater need for working capital finance (trade finance) than locally trading entities. Credit facilities are also crucial to a business in economic downturns to smooth cash flow and in upturns to enable growth (Parson & Titman, 2009).

2.3.2 *International trade and finance*

Globalization has changed the state of world trade today. Specifically in the last three decades, national self-contained economies have given way to one largely integrated and interdependent economic system – bar a few isolated exceptions. Improvements in capital flows, transportation, communication and other technologies have considerably reduced the barriers to international trade (Hill, 2010). Adam Smith (1989: 364) sites the primary reason for international trade in the precedent setting *The Wealth of Nations*, written originally in 1776: "It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy… if a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it off them with some part of the produce of our own industry, employed in a way in which we have some advantage.” The theory of trade was further refined by David Ricardo’s term of comparative advantage. In 1817 he stated that each country has – more or less – their own unique selection of different factors of production or resource endowments. These attributes enable a country to produce certain goods more efficiently or more cheaply than another country. Furthermore, every country should specialize in the production of these cheaper goods and trade them for goods that they require yet are made more cheaply in another country (Fourie & Mohr, 2009: 372, 373).

International trade is becoming more and more important. Without ascribing causality, the World Trade Organization does show that countries with bigger economies and higher per capita incomes do undoubtedly trade more than poorer nations (Unknown, 2012).

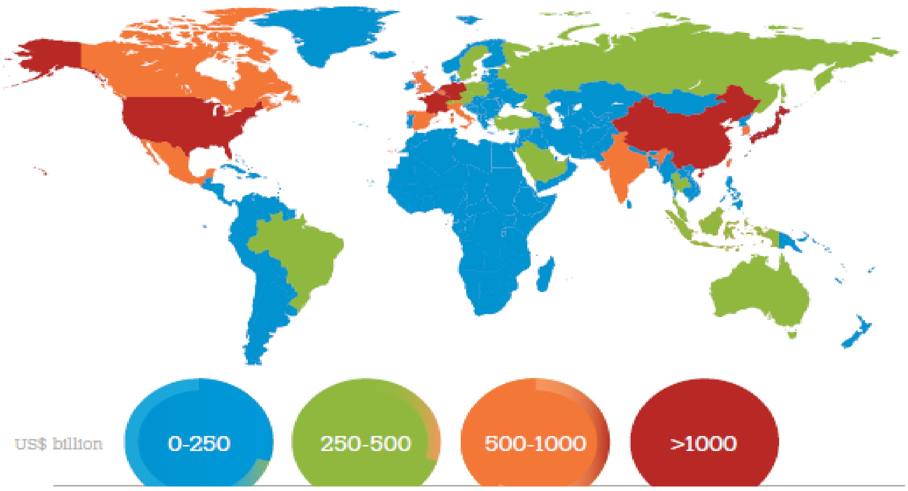

Figure 1: Economies by level of trade in 2010 (Unknown, 2012)

Beginning with the industrial revolution and leading up to the First World War trade between countries grew markedly. Between the First and Second World

Wars it stagnated, but then grew again in the subsequent decades (Jacks, Meissner, & Novy, 2011). However, in recent times international trade has suffered as a result of the global economic recession. In 2009, and for the first time since 1982, world trade declined as measured in a calendar year (Chauffour & Farole, 2009). Ahn (2011) states that the recession that began in 2008 / 2009 was the worst macroeconomic shock since the Great Depression and caused international trade to decrease by as much as 30%. The ebbs and flows of these trade cycles can be ascribed to a number of causes – from Ricardian resource endowments to trade costs and artificial barriers to trade (Jacks, et al., 2011). The scope of this paper is to examine the underlying financial enabler behind these international trade flows.

The financial means is a critical component of any trade transaction. However, in international trade it is made all the more important by the associated complications of time delays; information asymmetries and higher perceived or real risk of payment. When buying or selling goods across borders the following factors increase the risk of a successful interaction:

- Physical distance between buyer and seller
- Ability of the buyer to make payment, whether upfront or on terms
- Ability and integrity of the seller to provide (and possibly ship) the goods as per contract
- Exchange control regulations that may prevent or delay the flow of funds
- Trade barriers between nations
- Time lags in international transportation
- Exchange rate fluctuations
- Time value of capital laid out by either the buyer or seller (Madura & Fox, 2011: 570)

Due to these time delays and risk factors the International Monetary Fund (IMF) has estimated that 90% of all international trade transactions involve a financial product – in some form of credit, insurance or guarantee mechanism – which enables the transaction to take place (Ahn, 2011). Therefore it may be proposed that the financial enabler is crucial to, if not the heart of, the global trading system. Whether it's a Japanese MNC attacking a new market with a Greenfield venture; or a South African SME importing stock at competitive prices from China, companies must take cognizance of the financial environment in which their transactions take place. This also provides an opportunity for financial services institutions to profit from offering a beneficial trade finance solution.

2.3.3 *History and mechanisms of trade finance*

Trade finance has evolved in order to cater to two fundamental factors of trade: risk mitigation and liquidity (Chauffour & Farole, 2009). In most – if not all – economic transactions some measure of risk must be calculated and weighed against the possibility of a successful conclusion. Beard and Thomas (2006) group the risks faced by international trade as either physical; commercial or political. Physical risks are ones that relate to material objects being sold. These risks apply to any good in any trade, but are compounded by the time, distance and transport factors of an international transaction. Commercial risks would be those that prevent the buyer from paying for goods received, or the seller delivering goods bought. On the buyer's side, cash flow could be one example of these risks and on the seller's an inability to manufacture and deliver goods to the agreed upon specifications could be another. Political risks encompass foreign country regulations, exchange controls and political situations facing parties trading across borders (Beard & Thomas, 2006). For example import quotas in the South African textile industry have in the past limited the amount of goods imported from Eastern markets.

The liquidity of an asset relates to how quickly and easily that asset may be converted into cash (Firer, 2008). In trade a product is being sold for cash ultimately. Within an international transaction the time delays brought about by transportation and custom's regulations mean that the liquidity of that stock asset is a lot lower than a fast moving consumer good traded locally. The credit provided by a trade financier bridges this time gap by either providing the monies or the security necessary to achieve a smooth flow between seller and buyer. Trade finance therefore, provides a solution to these risks and liquidity issues, and is particularly important in international trade.

The history of trade needs no introduction and probably started with the dawn of human civilization. International finance, on the other hand, arguably began by facilitating the trade between the cities around the Mediterranean coast and the empires in the East around 5000 years BC (Before Christ). In this time, Babylon (which is current day Iraq) rose to world prominence as a financier of trade. In 3000 BC gold was used to pay for goods and as a store of value by the Egyptians. International finance was prominent in Athens, Greece by 500 BC and Rome, Italy in 100 BC as the fortunes of these nations waxed and waned (Melicher & Norton, 2011). The Renaissance lifted the relatively subdued period of international trade from the dark ages around 1500 AD. As this happened, European cities became centres for international trade finance. They first colonised and then traded with various parts of the world for their own benefit. Spain, Portugal, the Netherlands and England all had trade and financial control over large geographic areas at various times from the 1600's to the 1900's (Taylor & Wilson, 2011). To give some idea of the values involved, Gordon (2010: 1) writes that at one stage the "… colonial surplus (difference between imports or cash outflow and exports or cash inflow) for the Netherlands East Indies (was) estimated at almost 24 billion guilders (positive balance), approximately USD10 billion or some USD156 billion in today's terms." This illustrates far greater wealth flowing into the Netherlands than out as a result of beneficial trade and international colonial expansion. London, New York, Tokyo and now Beijing have become the trade finance centres in recent times. It seems that wherever international trade proliferated financial institutions and international bankers were sure to follow (Melicher & Norton, 2011).

A number of trade finance mechanisms are available to importers and exporters. Beard and Thomas (2006) lay the principal ones out as follows:

i. Letters of Credit (L/C) - a document issued by an importer's bank to the supplier's (or exporter's) bank giving specific instructions relating to a trade transaction. These instructions may be very precise, outlining details on the description of goods bought; dates and means of transportation and all documentation that may be required to safeguard the transaction from both the importer's and exporter's point of view (Richards, 2010). These details are in effect conditions which need to be met for the buyer's bank to pay the seller's bank the amount (s) stipulated in the sales contract at the agreed upon terms (Madura & Fox, 2011).

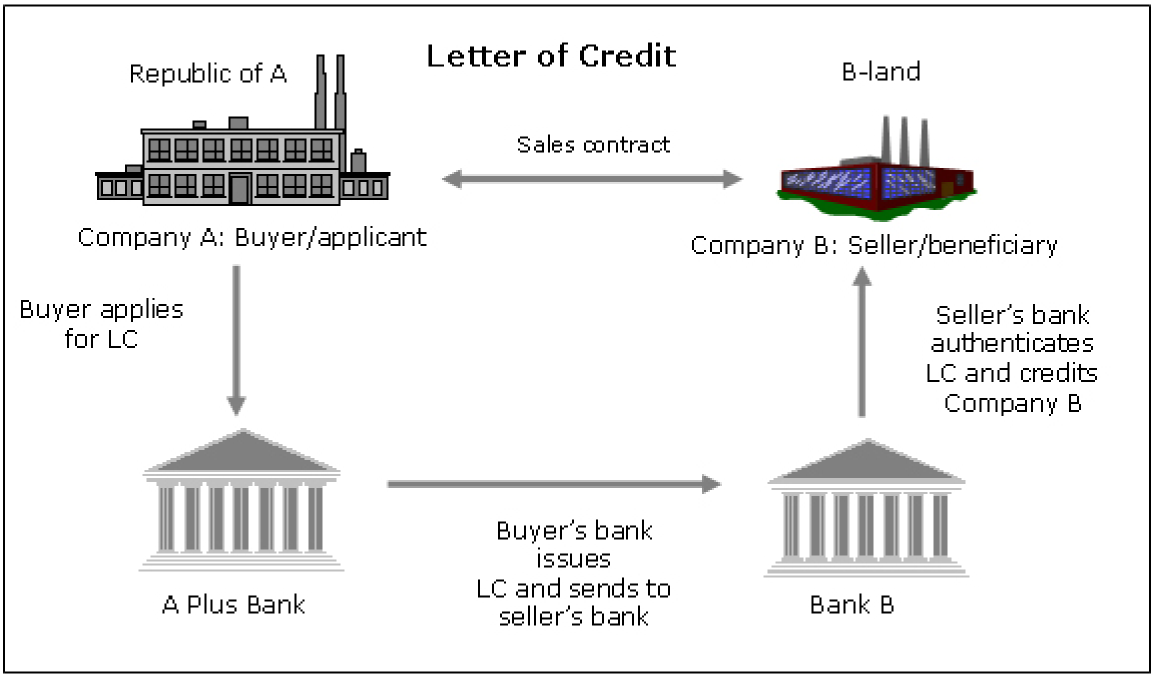

Figure 2: Letter of Credit Representation (Madura & Fox, 2011: 575)

ii. Documentary Collections - payment is made (either directly or at future date at mutually agreed upon terms) in exchange for the customs clearance documents of a particular shipment of merchandise.
iii. Factoring - this involves the ‘selling of a debtors’ book’ to a financial institution at a discounted rate for cash up-front. Factoring finances a smaller continuous stream of receivables with maturities of one to six months.
iv. Forfaiting - this mechanism works in the same way as factoring, but finances single, large transactions with term maturities of between one and five years.
v. Invoice Discounting - similar to factoring and forfaiting, invoice discounting amounts to ‘selling an invoice’ to a financial institution at a discounted rate for immediate cash payment (Beard & Thomas, 2006).

Chauffour and Farole (2009) list similar mechanisms, but split them up into the four categories of inter-firm finance; traditional bank finance; trade finance mechanisms; guarantee mechanisms and credit insurance. They also compare the different risks associated with the different mechanisms (see Appendix C). In the last century trade finance has often been referred to as confirming. A financier would provide the payment confirmation for goods shipped and therefore before a supplier would load goods for either marine, air or land transport the trade financier would have to confirm the release of these goods (Burscough, 2012).

2.3.4 *Trade Finance ex post the recent economic recession*

Economic theories in the first half of the 20th century proposed that GDP and trade flows had an elasticity equal to one (Ahn, et al., 2011). Which means that if GDP decreased by one unit then trade would also decrease by one unit (Fourie & Mohr, 2009). However, in the fourth quarter of 2008 this theory was severely questioned as international trade fell in much greater proportions than the fall in the GDP’s of the trading nations. Exporters and importers tend to use trade finance to a much larger degree because of the time delays and risks associated with international trade. Therefore, international trade flows are more sensitive to financial forces and highly prone to financial shocks. Two principal reasons for international trade's high elasticity to financial changes are: firstly – interest rate movements and secondly – lending institutions willingness to grant facilities (Ahn, et al., 2011). Interest rates may be described as the price of loanable funds and are a function of the demand and supply of money; the risk associated with repayment and a number of other, less important economic variables (Lettau & Wachter, 2011).

In the recent global economic downturn certain financial shocks have affected the availability of trade finance adversely and thereby reduced international trade exponentially. After the Lehman's Brothers collapse in September 2008, bank lending rates increased sharply around the world. These costs were naturally passed on to trade finance funding as well and so made international trade less attractive (Ahn, et al., 2011). Now, some years after the 2008 shock, countries around the world have systematically decreased their interest rates in order to stimulate spending and therefore GDP.

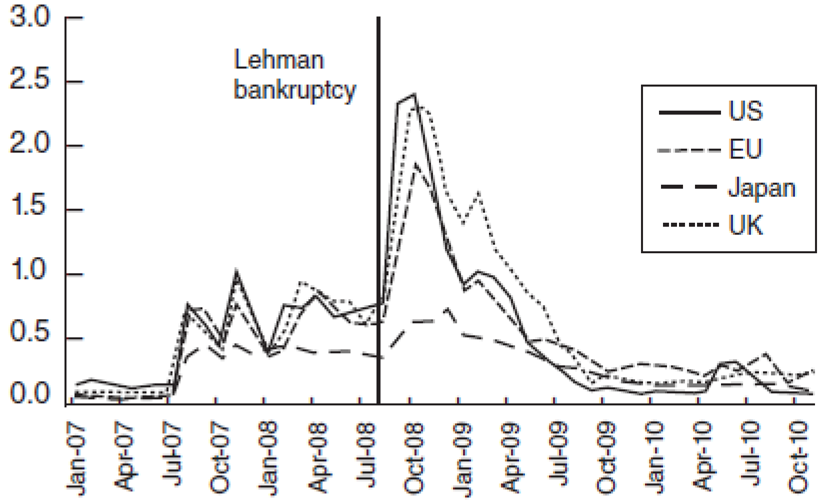

Figure 3: LIBOR Interest rate spread following the Lehman Brothers bankruptcy (Ahn, et al., 2011)

More importantly, in the current economic recession, actual default and the fear of a future inability to repay loans has caused banks to tighten their lending policy in general, and specifically with regard to trade finance. In a survey conducted, it was found that more than 90% of the banks in advanced economies and 70% in emerging markets said they had made their lending criteria more conservative with respect to trade transactions (Dorsey, 2009 : 18). Defaulting borrowers also increase the cost of lending as institutions need to charge more to cover the higher proportion of monies not repaid.

Due to the sensitivity of trade finance to financial shocks, the current recession has affected the availability of trade finance and so directly decreased the volume of trade around the world. There was said to be a trade finance shortage in 2009 of up to USD500 billion globally (Chauffour & Farole, 2009). This predicament caused the countries present in the 2009 G20 summit in London to pledge USD250 billion in trade finance instruments to alleviate the financial difficulties faced by international trade (Ahn, et al., 2011).

2.3.5 *Research Question 1*

Is there currently a shortage of trade finance, provided by banks and non-bank institutions, to adequately support internationally trading businesses, and particularly SME's?

2.4 Limitations to the provision of trade finance

Banks have in the past been the most important providers of external finance for businesses around the world. They often play an important role in the funding of a company, its' growth and the development of the entire economy (Degryse, et al., 2008). Different types of funding can be obtained through banking lending channels; from long term asset and even equity finance to short term working capital facilities (Hartley, et al., 2006). Banks do provide trade finance but do not traditionally supply it as a product all on its own. It is generally offered within a broader working capital facility or as an add-on feature to an already existing portfolio of banking products (De la Torre, Martínez Pería, & Schmukler, 2010). For example a bank may offer a factoring facility (one example of a trade finance mechanism) to an existing client in addition to the transactional account they have provided – as well as long-term property and / or plant and equipment finance. While bankers and non-bank trade financiers do compete with each other, the latter is niched towards specifically trade finance, and the former is typically a bigger player in a much broader financial products market.

Certain aspects of a typical bank's credit assessment techniques and bureaucratic structures lead them to be more suited to fund larger businesses (Nilsen, 2002). Also, in an economic downturn bankers tend to often become more conservative in their credit lending decisions due to the risk of default and rigid scoring models (Boyes, et al., 1989). Due to these limitations of bank finance an opportunity may exist for other financial services providers to cater to the trade finance needs of small and medium sized companies (Kim, 2010). However, non-bank trade finance providers also have their limitations. Most notably, they are more expensive than commercial banks and it also seems their presence is not well enough known in the South African market to reach a wide base of potential borrowers (Burscough, 2012).

2.4.1 *Credit assessment favours larger businesses*

Bank credit lending decisions are most often based on scoring models established through discriminant analysis (Boyes, et al., 1989). Discriminant analysis is a technique whereby two or more unrelated entities are evaluated by examining several variables simultaneously (Klecka, 1980). For example one potential borrower is compared to one or more other potential borrowers through a number of different variables – for instance balance sheet strength; length of time in business and history of credit repayment. The lender decides who to loan to through the analysis and comparison of these factors between potential customers. The overriding goal is to determine whether or not potential borrowers belong to the population of 'would be' defaulters (Boyes, et al., 1989). The premium charged on the credit facility is then set to cover the bank's cost of capital; administrative and other operating costs as well as the bad debt losses resulting from the future defaulters (Firer, 2008).

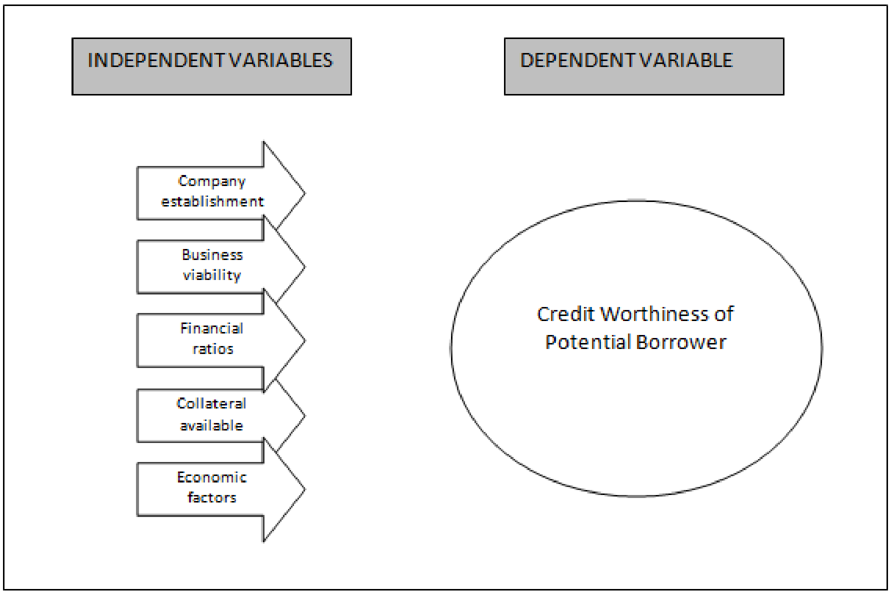

Figure 4: Discriminant analysis (Hassan, et al., 2012)

Larger, longer established companies tend to score higher than smaller, newer businesses on the variables assessed. Bigger firms have generally grown over time to build up balance sheet strength through profits earned and also developed a positive trade history with credit providers. Bigger firms are therefore more likely to qualify for bank finance than their smaller counterparts (Fisman & Love, 2003). Research conducted by Jeffrey Nilsen (2002) seems to confirm this by proposing that larger firms tend to make more use of bank loans, whereby smaller firms show a higher use of the less formal channels of trade finance.

2.4.2 *The limitations of bank lending*

As banks typically provide a wide array of financial services they tend to develop large, integrated, multinational networks. A trend is developing around the world, where a small number of very large banks dominate the banking sector in most countries (Anderson & Joeveer, 2012). While this is a pro in terms of economies of scale and reduced costs it can also necessitate complex and bureaucratic systems for control purposes. These then may result in time delays on lending decisions and an inability to specialise (Kim, 2010). Fisman and Love (2003) have noted that an efficient financial market is essential for business opportunity and economic growth. However, a large, efficient, bureaucratic institution may not always be able to operate in niche areas and offer certain unique financial products. International trade is one area where multinational banks are losing market share to a growing industry of financial intermediaries who can assist traders with specialised trade finance facilities. Banks do provide working capital through general overdraft facilities but they often do not cater to a specific trade finance requirement.

Due to the wide range of financial products offered, banks tend to utilise standard security instruments – such as personal sureties and a cession of the borrowers' debtors book. They do not often use inventory as a tangible asset to secure lending facilities (Burscough, 2012). For a trading business, often the inventory held is the biggest asset on that company's balance sheet (Hartley, et al., 2006). Therefore, by not securitising through inventory a bank may not be able to provide a trading company with a large enough working capital facility.

In economic downturns the frequency of credit default increases, and lenders in general will avoid more risky clients. Therefore, emerging market participants and SME's in established markets will find it more difficult to access bank finance in these times (Chauffour & Farole, 2009). As banks offer a broad range of financial products to a high volume of clients their credit lending decisions generally follow a scoring model which will track the peaks and troughs of a cyclical economy (Boyes, et al., 1989). In a recession bank lending defaults tend to increase in relation to the severity of the downturn. Due to this banks often overcorrect and become very conservative and severely limit whom they lend money to, leaving the market drastically under-funded (Ahn, et al., 2011).

2.4.3 *The limitations of non-bank trade finance*

The single most important limitation of a specialist non-bank trade finance institution is the cost of the finance offered to the market. Institutions with bank licenses generally can access well-priced loans provided directly by a country's government or through inter-bank lending channels (Nilsen, 2002). This means that traditional banks are generally set up to be able to borrow funds straight from their government or from each other at relatively (to other sources of similar finance) cheap rates. A non-bank trade financier does not have their own banking license, and so cannot source their funding on the same basis. There are various mechanisms that can be used to raise capital, but invariably it is very difficult to match the preferential rates that an institution with a bank licence can access (Burscough, 2012). The additional cost bourne by the non-bank trade finance company must be passed on to their client, so often making the cost of finance more expensive than traditional bank funding. The higher costs associated with non-bank trade finance means that the funding is only available to companies who trade in goods with high gross profit margins, as they need high margins to be able to afford the higher rates charged.

In addition to the limitation of cost, it seems to be the case that the South African market is not well aware of the option to borrow monies from a non-bank trade financier. Due to the fact that banks are the most common providers of all credit they are sometimes thought of as the only suppliers. Even if potential borrowers can afford the cost they often do not know about the possibility of non-bank trade finance (Burscough, 2012).

2.4.4 *Research Question 2*

What are the limitations behind the provision of trade finance in South Africa at the moment?

2.5 The current financial environment of SME's in South Africa

It is difficult to categorise an SME in terms of asset ownership or turnover due to the wide differences in business sectors (Mutezo, 2005). For example; a small manufacturing company may have an annual top-line turnover of around R1 million, but a small importer acting as an agent for a wholesale distribution channel may operate off very low margins and turn in excess of R100 million quite easily – with both employing roughly the same number of people and earning the same net profit after expenses are deducted. By general definition, an SME is an owner-managed or owner-controlled business, with a staff compliment of between 5 and 50 people for smaller entities and 51 and 200 for medium organisations (Mutezo, 2005).

SME's are considered to be an important component of economies around the world. "In South Africa, SME's contribute 56% of private sector employment and 36% of the gross domestic product" (Fatoki & Smit, 2011 : 1414). The SME sector has been targeted by the South African government as a crucial way in which to reduce income inequalities and unemployment in the country. However, the creation of new SME's in South Africa is thought to be difficult and their failure rate – of 75% – is one of the highest in the world (Fatoki & Smit, 2011). Mutezo (2005) sights the main obstacles to SME success as follows:

- Insufficiency of technological and managerial knowledge
- Scarcity and inability to access financial resources
- Inadequate skill and lack of basic education of labour
- Lack of market information

Fatoki and Smit (2011) narrow it down to say that the primary reason for South African SME's failing is that they are unable to access the finance required to run their businesses. South Africa does have a relatively well established financial services sector, when compared to similar sized economies and even the rest of the world. However, certain financial constraints have skewed the allocation of credit towards bigger business and away from SME's (Bell, Farrell, & Cassim, 1999). A number of reasons are given as to why SME's cannot access credit easily (Fatoki & Smit, 2011), but the fact remains that South Africa's current financial structure does not sufficiently enable them. Trade finance provided by non-bank financial services providers may be a crucial alternative for SME's engaged in international trade.

2.5.1 *PESTEL analysis of the macro-environment*

An examination of the various factors affecting SME's in South Africa can help explain the financial environment faced by these organisations. The government seems to have acknowledged the importance of SME's and has set up a number of agencies and programmes to assist them. The Industrial Development Corporation (IDC) and Small Enterprise Development Agency (SEDA) are two such institutions set up to fund businesses and thereby further the political and social goals of the country (Edigheji, et al., 2010). The global economic downturn has affected South Africa more by association than by our own structural weaknesses. Particularly in trade, the country has suffered through the declines of its richer, more developed trading partners in Europe firstly and the United States secondly (Malouche, 2009). With lender confidence dropping world-wide, South African banks have followed their international counterparts in more stringent and conservative lending policies (Chauffour & Farole, 2009). This has made it difficult for many businesses and especially SME's to access the finance required to run their businesses. A positive recent development is South Africa's inclusion into the BRIC countries (Brazil; Russia; India and China), which is thought to bring significant economic and trade related opportunity in the future (Carmody, 2012).

On the legislative side the Financial Services Board of South Africa is instituting a higher degree of monitoring and better risk mitigation practices on banks and other financial services providers, which could make the lending process more bureaucratic and credit more onerous to access. Banks and insurance companies, in particular, will face higher capital adequacy ratios, meaning they will have to hold more capital to lend out or insure the same amount of business that they have in the past (Malouche, 2009). This may swing the propensity of banks to lend to larger, less risky organisations and even further away from SME's. However, it could also possibly provide an opportunity for non-bank trade finance institutions who do not necessarily have to meet the higher regulatory requirements.

2.5.2 *Financial resources available to SME's*

SME's in theory have the same opportunity to apply for finance as bigger organisations in South Africa. However, the reality is that banks and larger lending institutions would rather lend to big, well established companies – where the perceived risk of default is lower, and the volume of business is higher (Boyes, et al., 1989). Fatoki and Smit (2011) outline the following reasons as to why SME's have difficulty in accessing sufficient working capital debt:

i. Lack of collateral
ii. Lack of business information
iii. Lack of managerial competencies
iv. Poor state of macro-economy
v. Crime and corruption
vi. Lack of networking
vii. Inefficient legal system

Since the financial crisis in 2008 most companies have witnessed a tightening of lending in general (including trade finance), with SME's having been affected more severely than larger businesses. SME's typically have a lower credit standing, less capability to provide security and less equity in the form of both owner investment and retained earnings. This causes banks to follow a 'flight to quality strategy' and lend more to larger corporations who can weather a drop in demand and losses for a longer time than smaller companies (Malouche, 2009). In 2009 a World Bank survey indicated 30% of SME's stated that their own lack of finance was due to them being crowded out by larger firms (Chauffour & Farole, 2009). Therefore, it seems that traditional bank finance has always been problematic for SME's and has gotten even harder since the recent financial crisis.

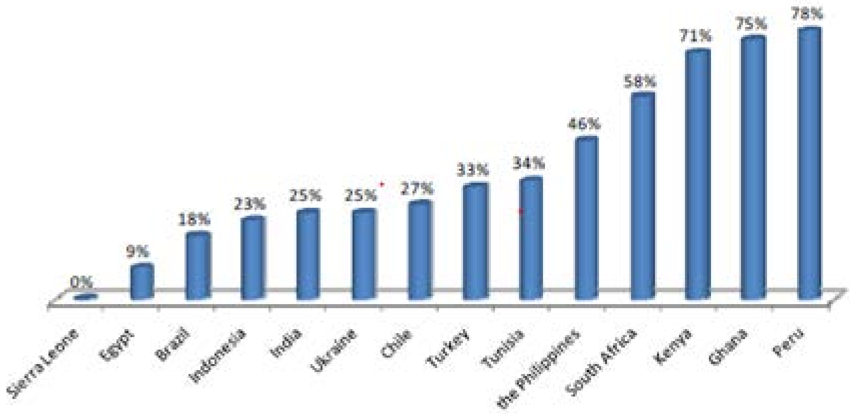

Figure 5: Percentage of firms in developing countries that have declared access to trade finance as a major obstacle to doing business (Malouche, 2009)

Without the opportunity to access traditional debt markets SME's are often faced with only two options: seek debt in informal and expensive markets; or dilute shareholding by drawing in equity investors (Mutezo, 2005). Either option is not attractive for the long term sustainability of an SME. There are a few specialised trade financiers operating in the South African market who understand the longer cash flow cycle of a trading company and can provide working capital debt or inventory finance at affordable costs. Reichmans (Pty) Ltd (part of Investec); Sasfin Bank Ltd; Blue Strata Trading (Pty) Ltd; Lombard Trade Finance (Pty) Ltd and Chester Finance (Pty) Ltd are some of the main players in the market. The first two – Reichmans and Sasfin – do operate with a bank license, while the others do not.

Each of these specialist trade financiers lends money to in some direct way enable trade. Funding is more geared to the longer cash flow cycles of imported and exported goods – as overseas suppliers are paid upfront before transport of the bought product. However, the finance can also be used for local purchases;

and / or debtors finance. Generally higher facilities – when compared to traditional bank finance – may be granted for two main reasons:

i. Security over the funded stock is obtained
ii. The trade financier specializes in funding the trade of goods and, with this expertise, can better understand and match a company's short term working capital needs

On the down side the finance is mostly more expensive than traditional bank finance due to the trade financier borrowing the money it lends out from bank channels in the first place.

2.5.3 *PPP to increase the availability of trade finance for SME's*

Traditional bank finance seems to be more readily available to larger businesses, especially post an economic recession (Ahn, et al., 2011). Specialist non-bank trade financiers are often more able to financially support and grow smaller companies engaged in the trade of goods. However, their scope is reduced by the cost of the finance and so only a limited number of SME's are funded by non-bank trade finance in South Africa.

Banks obtain the money they lend out from government or inter-bank channels at very competitive rates (Nilsen, 2002). In order to obtain funds at these costs a trade financier would have to obtain their own banking license. Should a trade finance company partner with government in a public private partnership they could potentially be able to obtain funding at much cheaper prices. With these savings being passed on to the end-user it would make a trade finance product far more accessible to SME's who normally may not be able to afford the cost of the facility.

The proposition put forward is that a non-bank trade financier would bring trade finance expertise and market penetration into the partnership, and the government institution would provide cheaper funding to the non-bank trade financier.

2.5.4 *Research question 3*

Considering the current financial situation in South Africa, is non-bank trade finance a better option than traditional bank working capital finance for internationally trading SME's to adequately fund their operations?

2.6 Conclusion of Literature Review

Due to the time delays and risks inherent in buying and selling goods across borders, the underlying financial mechanism is crucial to the successful completion of an international trade transaction (Beard & Thomas, 2006). While banks are the most common financiers in businesses around the world, they do not seem to adequately support internationally trading SME's for the following reasons:

i. Credit lending institutions have become more conservative post the recent economic recession (Ahn, et al., 2011).
ii. Discriminant scoring models favour larger, longer established businesses (Fisman & Love, 2003).
iii. Expertise lies in general banking facilities and not specialist trade finance lending (Kim, 2010) .
iv. Securitisation does not often include inventory, which is frequently the largest asset on a trading business' balance sheet (Burscough, 2012).

Trade finance provided by a specialist non-bank institution may be able to more easily meet the credit demands of a trading company due to an understanding of trade cycles and the securitisation through the inventory funded. However, these facilities are more expensive than bank finance (Burscough, 2012).

International trade has proved to be an important component of any economy and particularly for developing countries in the last few decades (Bernstein, 2012). The South African government has identified that SME's are crucial for the development of the economy as they employ a large number of people and drive more than a third of national GDP (Fatoki & Smit, 2011). However, access to finance is currently seen to be a major obstacle to these SME's doing business. Credit for internationally trading SME's is further limited by certain, varying factors affecting both bank trade finance and non-bank trade finance. The aim of this research is to see whether non-bank trade finance is a viable alternative to traditional bank finance for internationally trading SME's. Furthermore, the idea of a PPP between government and a specialist non-bank trade financier has been put forward to see if it would better support internationally trading SME's in their financial requirements.

2.6.1 *Research Question 1:*

Is there currently a shortage of trade finance, provided by banks and non-bank institutions, to adequately support internationally trading businesses, and particularly SME's?

2.6.2 *Research Question 2:*

What are the limitations behind the provision of trade finance in South Africa at the moment?

2.6.3 *Research Question 3:*

Considering the current financial situation in South Africa, is non-bank trade finance a better option than traditional bank working capital finance for internationally trading SME's to adequately fund their operations?

3 RESEARCH METHODOLOGY

Research is the logical sequence of events whereby empirical data is gathered and then linked to a study's initial research question and ultimately its recommendations and conclusions (Creswell, 2003). There are three main categories of methodology, and the choice of which to use is dependent on the nature of the research problem at hand (Noor, 2008). The type of research serves different purposes depending on the following three forms of methodology used:

i. Quantitative – the method of collecting, analysing, interpreting and writing the results of a particular study, involving largely numerical data.
ii. Qualitative – the method is similar to that of quantitative analysis, however, the data used is different. In qualitative analysis data is collected in the form of text or representations other than strictly numerical and is therefore open to personal interpretation.
iii. Mixed – aspects of both quantitative and qualitative analysis are employed (Creswell, 2003).

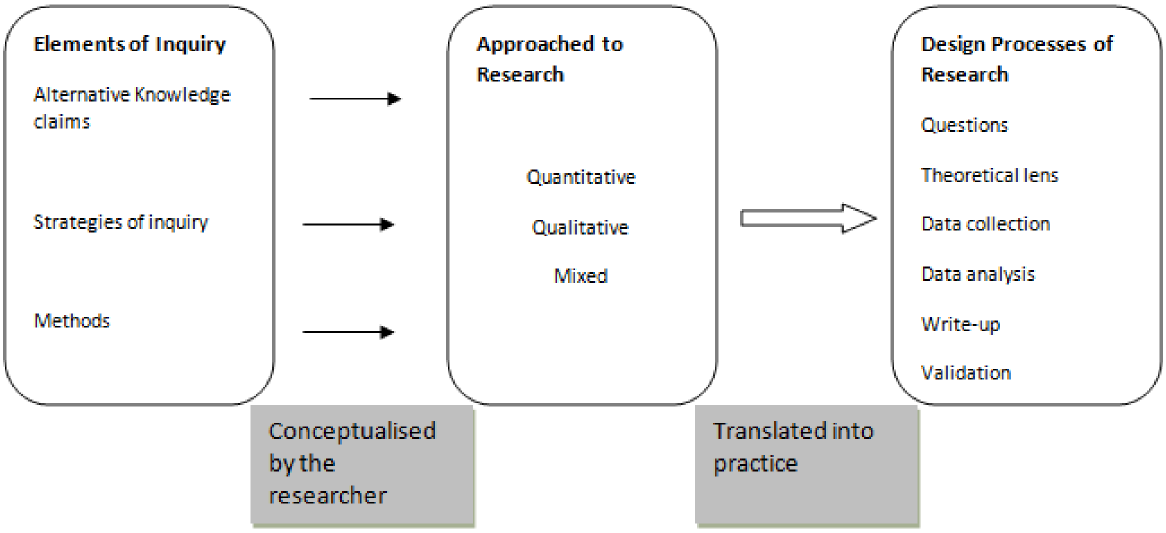

Figure 6: Structure of research methodology (Creswell, 2003)

In the past a vast amount and variety of research has been conducted to analyse trade finance itself. However, very few studies seem to have compared and contrasted trade finance provided by traditional commercial banks as opposed to that provided by non-bank trade financiers. The writings are not clearly split between each source of trade finance, but rather group them together under one central theme of working capital funding. The distinction between the two is not as apparent as it seems, because each provider both competes and complements the other. For example, an internationally trading company may borrow monies from a commercial bank in the form of asset finance and a general overdraft, and also utilise a non-bank trade financier for a specific stock financing facility. Studies often group both providers together when analysing increases or decreases in the availability of credit. It is also difficult to find comprehensive studies that analyse the two providers, link them to internationally trading SME's and evaluate which form of finance is the best for those kind of businesses.

What has emerged from the literature reviewed is that it is currently a challenge for internationally trading SME's to raise the working capital debt they require to run their businesses. At a global level, Chauffour & Farole (2009) claim that a substantial trade finance gap has been left in the market following the recent financial crisis beginning in 2008. Lending criteria have become more conservative, which has affected access to all credit, including trade finance (Dorsey, 2009 : 18). It seems that what bank funding is available, is more readily accessed by larger companies and harder to come by for SME's (Bell, et al., 1999). In South Africa, access to trade finance is further restricted due to the fact that the commercial banks tend to not securitise through stock or goods traded and / or held on a company's balance sheet. This limits a trading business' ability to raise adequate finance as stock is often a large component of their asset base. A specialist, non-bank trade financier does secure through inventory and so can often approve larger credit facilities for internationally trading businesses. However, their offering is not well known in the South African market (Burscough, 2012). The aim of this research is to analyse and compare trade finance as provided by commercial banks and non-bank trade financiers, and then see whether non-bank trade finance can be better utilised by South African SME's operating in the international trade arena.

Quantitative research may be effectively used where the area of study involves a number of defined variables and where the eventual outcome will be a function of those variables. This method is popular when conducting rigorous experiments to prove a pre-determined outcome, or to conduct a survey to determine how the independent variables will act upon one or more dependent variables (Creswell, 2003). Qualitative research methodologies have more relevance when the eventual outcome is uncertain and the variables used in the research are not defined. This method has become popular in the study of various social sciences and in studies where the outcome will be influenced by people's subjective opinions (Marshall & Rossman, 2010). Qualitative research is best used under the following circumstances:

- When dealing with undefined variables
- Where yet unknown findings may come to light

- When dealing with the subjective complexities of humanity
- When context is important and can emerge and evolve as the study progresses
- When the findings are interpretative
- There is a need to reflect upon the data after the gathering of it (Marshall & Rossman, 2010)

In this research a qualitative research methodology will be used. The reason for this is that a number of different variables (from both the demand and supply side perspective) affect the type of finance utilised by SME's in South Africa. While some of these variables are easily defined, there are a number that are not easily identifiable, and likely some that are as yet unknown. Funding decisions – whether to grant or apply for a particular type of funding – are also unavoidably prone to human subjectivities. Quantitative research would be a more rigid, structured approach and not allow for these varied, as yet undefined variables and human subjectivities to come to light.

A qualitative approach would overcome quantitative shortcomings in the following manner:

- Open ended, and unstructured questions posed in a semi-formal interview will allow for human subjectivity and undefined variables to be identified
- The complex situation can be dealt with in as holistic a manner as possible
- Once gathered the data can be reflected upon to identify what may transpire (Marshall & Rossman, 2010)

The specific research methodology of qualitative inductive content analysis will be used in the study and outlined in this section. Semi-structured interviews accompanied by a questionnaire will be the research instrument. The interviews will be specifically designed to address two separate samples in greater populations, namely:

i. A sample from the population of internationally trading SME's based in South Africa; and
ii. A sample from the population of the providers of trade finance in the country – both from traditional commercial banks and non-bank trade financiers.

In the next section the procedure for collecting data will be described and the limitations of the study will be examined together with the validity and reliability of the collated information.

3.1 Research methodology / paradigm

A qualitative research methodology will be used to gather data and attend to the research questions posed. Creswell (2003) define the following criteria of a qualitative model which make it suited to this field of study:

i. Qualitative research is emergent rather than tightly prefigured. This means that the method of the research is loose enough to allow for new information to emerge during the data gathering process. While fairly broad, the current literature does not seem to directly address the question of whether South African SME's could make better use of non-bank trade finance in their international trade operations. Qualitative research should allow as yet unidentified factors to emerge and hopefully go some way to answering this question.

ii. The research is fundamentally interpretative, which allows the researcher to interpret the findings in a subjective manner. While findings may be skewed towards the interpretation of the researcher, this will be necessary to analyse new, emergent information coming from the interview process.
iii. The method is interactive and humanistic. It will require the researcher to connect with participants, allow for free discussion to firstly understand the situation and secondly create an environment in which all relevant aspects of the issue can emerge.
iv. The researcher will need to view the study holistically. While information will be gathered at a microeconomic one-on-one basis, it then needs to be collated and related to the issue at both a micro and macroeconomic level.

The specific technique used within the methodology will be that of inductive content analysis. Content analysis entails the systematic interpretation of the content of data gathered by a process of identifying themes or patterns in that data (Krippendorff, 2004). These themes or patterns emerge from the raw data gathered and are then used to better understand the area of study. Once all the data has been gathered the themes will be ranked according to importance and unpacked in relation to the research questions posed. Good qualitative research should demonstrate sensitivity to context; commitment, rigour, transparency, be coherent; and have impact and importance (Cassell & Symon, 2004).

Table 1: Strengths / weaknesses of qualitative analysis (Creswell, 2003)

Strengths	Weaknesses
Flexibility to allow for the emergence of new information	Prone to the subjective influence of the researcher
Connect with participants in their natural environment to understand their reasoning and decision making	Non quantifiable and therefore may be hard to verify

Facilitate understanding and meaning at a macro level	May not be specific enough and sometimes difficult to relate to the research question at hand
Deal with complex issues and situations with the possibility of as yet unidentified information emerging	Time consuming to gather information and therefore sample size is often smaller than quantitative analysis

Certain assumptions must be made and the choice of a qualitative methodology relies on these assumptions being correct. Firstly in the gathering of the data, it is assumed that participants will be comfortable enough in their natural setting to divulge relevant aspects about the study. Secondly, it is assumed that new information will emerge to explain if and why non-bank trade finance would be a better mechanism for funding internationally trading SME's in South Africa than the solution offered by traditional commercial banks.

3.2 Research Design

The design of the research will be one of an interpretative study. Research will be conducted through the means of face to face, semi-structured interviews supported by pre-determined questionnaires. Once data is gathered it will be interpreted and related to the research questions and overall topic of the paper. The interview is arguably one of the most common methods of gathering data in qualitative research. Its purpose is described as follows: "… to gather descriptions of the life-world of the interviewee, with respect to (the) interpretation of the meaning of the described phenomena" (Cassell & Symon, 2004 : 11). This means that the interviewer will attempt to see the research topic from the perspective of the interviewee and so better understand how and why they have come to have this perspective and how it may influence their actions in the future.

The organization of the interviews will be semi-structured. When the outcome and arising aspects of an interview are uncertain, often the best manner to conduct the interview is in a semi-structured way to allow for the emergence of new data (Creswell, 2003). A set of predetermined questionnaires will be set up to support the interviewer. However, each interview will be allowed to progress outside of the scope of the questionnaire, but in relation to the research topic. In that way the outcome will not always be certain and the research questions may be answered through new information coming to light. In depth interviews can be very effective if the interviewer develops a connection with the interviewee and so shares their perspective of the topic at hand (Marshall & Rossman, 2010). The purpose of the interviews will be to gather data from the sample groups and identify relevant variables (whether already known, or newly introduced by the interviewee). This information can then be interpreted in order to meet the research objectives (Cassell & Symon, 2004).

The semi-structured nature of the interview should hopefully allow for a relationship to develop between the interviewer and the interviewee. It should create trust and confidence in the interviewee, enabling them to divulge important and possibly new information relating to the research topic. It also allows the flexibility to deal with complex issues and again, possible new issues arising (Creswell, 2003). The disadvantages are that the interviews will be time consuming and rely on a certain level of skill of the interviewer. This means that necessarily small samples will be interviewed within each population on the demand-side of trade finance and the supply-side of trade finance. Also, the outcomes may be overly influenced by the views of the interviewer. Marshall and Rossman (2010) further outline six challenges that will need to be overcome:

i. Planning a design that is systematic and manageable, yet flexible
ii. Integrating the subjective arguments of the interviewees into one aligned strategy to respond to the research questions
iii. Ensure the study is valid and reliable
iv. Maintain ethical standards throughout
v. Consent will need to be obtained from the interviewee
vi. Confidentiality must be respected should it be required from the interviewee

3.3 Population and sample

3.3.1 *Population*

Two populations will be analysed in the research of this paper. The first will be all of the internationally trading SME's in the South Africa economy. The second, the providers of trade finance in the same market – both traditional commercial banks and non-bank financial institutions. The aim of the research is to determine whether or not trade finance is a more viable – and indeed better – form of funding for internationally trading SME's than traditional working capital bank funding. The characteristics of the members of the populations are important as they will determine who is and who is not part of the group (Ritchie & Lewis, 2003).

In the population of internationally trading SME's the following characteristics will have to be present:

i. The organisation must be an SME. By definition, an SME is an owner-managed or owner-controlled business with a staff compliment of between 5 and 200 people (Mutezo, 2005)
ii. A business registered in South Africa
iii. A business who either imports into or exports out of South Africa

The population of the providers of trade finance will be made up of the following two organisations:

i. A bank registered in South Africa with the Financial Services Board (FSB), and
ii. A non-bank financial services provider also registered with the FSB, which specialises in providing trade finance to South African businesses.

With more than 70,000 SME's operating in South Africa (Goldstuck, 2010), it would be difficult to gather data from each one. A representative sample is therefore identified and analysed in order to extrapolate the findings from this sample onto the population as a whole (Ritchie & Lewis, 2003). There are far fewer banks and financial services providers than SME's in the country. Kwangu (2012) sites 11 locally controlled banks; 5 controlled offshore and a further 15 branches of different foreign banks all operating in South Africa. However, really there are only a few prominent players in the bank industry – namely: Standard Bank of Southern Africa Ltd; ABSA Bank Ltd; the First National Bank Ltd; Nedbank Ltd; and Investec Plc. In terms of non-bank financial services providers the numbers are higher and harder to define as they offer a variety of different financial products and services. Again, due to the time consuming nature of qualitative research, only a sample of this bigger population will be chosen to be interviewed.

3.3.2 *Sample and sampling method*

A sample is meant to be statistically representative and in effect a small-scale model of the population from which it is drawn. "This approach is essential so that information generated by the sample can be used to provide statistical estimates of the prevalence or distribution of characteristics that apply to the wider population" (Ritchie & Lewis, 2003 : 78).

In this research two samples will be taken from the above mentioned populations. The first will comprise of internationally trading SME's. Eight business owners located in Johannesburg; Pretoria; Durban and Cape Town will be interviewed in-depth on a one-on-one basis in order to gather the relevant information from the sample. The sample will be made up of SME's that make use of a wide range of funding: from traditional bank funding, to specific non-bank trade finance, as well as internal shareholder / member funding (i.e. no use of debt whatsoever). The

SME's will not be randomly chosen from the general population. They will all have the characteristic of having some form of connection to the interviewer. In order to balance the data gathered, SME's will be selected from different industries, different geographic locations and also with different funding structures – as mentioned above. The data gathered should therefore appropriately reflect the characteristics of all internationally trading SME's in South Africa.

The second sample will be made up of four of the providers of trade finance in South Africa. A mixture of local and foreign controlled banks, as well as one non-bank financial services provider will be chosen. As these organisation's operations are generally national the meetings will be conducted in Johannesburg.

In addition to these interviews an attempt will be made to set up an interview or communicate with Mr Lumkile Mondi, the Vice President and the IDC – or another representative of the IDC. The reason for this will be to investigate the possibility of a PPP between Lombard Trade Finance and the IDC (or some other government body) to more effectively provide sustainable trade finance to developing SME's within South Africa.

Participation in the interviews will be obtained by the interviewer through existing connections from current and previous business dealings. Most of the interviewees will be familiar with the interviewer. This should create an atmosphere conducive to free and open discussion which is essential to allow emergent information to come to light. A structured questionnaire – applicable to each separate sample – will form the basis of the interviews. However, input from the interviewees, over and above the questions asked, will be encouraged in order to better understand both the demand and the supply of the trade finance situation in the country. On the demand-side, the SME's financial needs, frustrations and opportunities, as well as the general market situation will be assessed. On the supply-side, the provider's willingness and ability to provide trade finance to internationally trading SME's will be evaluated.

Table 2: Profile of respondents

Description and type of respondent type	Name of respondent	Location	No. to be sampled
Internationally trading SME: Import and export of bitumen products, making use of bank and non-bank trade finance	BSS (Pty) Ltd	Johannesburg	1
Internationally trading SME: Import and export of equine products, making use of neither bank nor non-bank trade finance	Bombers Equestrian CC	Durban	1
Internationally trading SME: Import and export of children's and ladies' apparel, making use of non-bank trade finance only	Earthchild Clothing (Waterfront) (Pty) Ltd	Cape Town	1
Internationally trading SME: Business importing flanges and making use of bank and non-bank trade finance	Flange Mart CC	Pretoria	1
Internationally trading SME: Import of steel wire and related products, making use of both bank and non-bank trade finance	Maxishare Import-Export Agency CC	Johannesburg	1
Internationally trading SME: Import of raw aluminum, making use of bank and non-bank trade finance	Nk Cutting CC	Pretoria	1
Internationally trading SME: Import and export of propshafts and related motor vehicle spare parts, making use of non-bank trade finance only	Propshaft Rebuilders (Pty) Ltd	Durban	1
Internationally trading SME: Import of air and water monitoring instrumentation, making use of both bank and non-bank trade finance	SI Analytics (Pty) Ltd	Johannesburg	1
Traditional locally controlled commercial bank	Nedbank Ltd	Johannesburg	1
Traditional locally controlled commercial bank	Standard Bank of South Africa Ltd	Johannesburg	1
Branch of foreign owned trade bank	Standard Chartered Bank Ltd	Johannesburg	1
Non-bank trade finance provider	Lombard Trade Finance (Pty) Ltd	Johannesburg	1
Government owned national development financial institution	Industrial Development Corporation	Johannesburg	1

3.4 The research instrument

The primary instrument that has been chosen to gather data will be that of a semi structured, in-depth interview, guided by an open ended questionnaire. Jane Ritchie and Jane Lewis (2003 : 139) compare the method of interviewing a chosen subject to a "…miner who unearths… nuggets of data or meaning out of a subject's pure experiences…". The aim of this research is to discover whether non-bank trade finance is a viable and potentially better form of funding than traditional bank finance for internationally trading SME's in South Africa. This question has not been answered conclusively and it seems that there may be new information – not covered by the current market literature – that may still come to light. The purpose of an open-ended interview guided by a predetermined questionnaire will be to tap into the experiences and opinions of the individuals interviewed in order to allow new "valuable nuggets" of information to arise and hopefully answer the question at hand.

There are a number of key features which need to be present in the in-depth interview process:

i. The structure needs to be combined with flexibility
ii. The interview needs to be interactive in nature
iii. The researcher / interviewer needs to be skilled in order to probe and achieve a certain depth of answers in terms of penetration, exploration and explanation of the issues at hand
iv. The interview should be generative in that it allows for new information to materialise if possible (Ritchie & Lewis, 2003)

The design and layout of the interview will be as follows:

i. Interviewer starts the interview by introducing the topic
ii. Discussion is guided by predetermined questions

iii. The interviewee is allowed to ask questions of their own or turn the discussion along new lines, as long as they are related to the research topic
iv. Both the interviewer and the interviewee can introduce new material on an ad hoc basis should it be relevant
v. Interviewee's responses can be examined in depth if need be
vi. Interviewer to conclude the interview (Cassell & Symon, 2004)

The use of an in-depth interview is very popular in qualitative research. It often addresses the softer, psychological or emotional issues that are present in human environments. If a good rapport is established between the interviewer and interviewee useful information can often be shared, which would not ordinarily have come to light (Ritchie & Lewis, 2003). This will hopefully be an ideal methodology to connect with business owners and understand their position as well as the factors that influence the financing of their businesses. Similarly, the interviewer should also be able to understand the drivers behind the trade finance providers in South Africa – if and how they meet the financial needs of internationally trading SME's. The disadvantages of the interview process are that it is very time consuming and often requires a high degree of skill on the part of the interviewer. This will mean that the samples interviewed are necessarily small which can introduce inconsistent or even irrelevant information (Ritchie & Lewis, 2003). In order to counter this, the samples have been carefully chosen as cross-sections of each population, operating in both different locations and industries across the country.

3.5 Procedure for data collection

Interviews will be arranged at the interviewer's request, and take place at a location of the interviewee's choice to put the interviewee at ease. The duration will be set at one hour. However, as the interview will be only semi-structured, a flexible time frame will allow for more or less time if required. The interviewer will be required to have a background in the subject matter at hand in order to understand and benefit out of the information offered. Three questionnaires have been set up (Annexures B; C and D) in order to provide a framework in which the interviews may take place. Often a questionnaire is crucial in order to guide the interview and obtain answers to specific questions. However, it should not restrict the interview process and should allow for flexibility (Creswell, 2003). When entering an interview a contract is in effect set up between the interviewer and the interviewee. The rights of the interviewee must always be respected. An undertaking of confidentiality must be given in writing if so requested by the interviewee (Ritchie & Lewis, 2003).

The interviews will not be recorded. However, notes will be taken throughout the interview process and specifically when direct questions are answered or new information comes to light. Notes on body language will be taken in order to illustrate positive or negative feelings towards certain questions. Following each interview the interviewer will summarise and attempt to capture in writing – as fully as possible – the entire interview process for analysis at a later stage.

3.6 Data analysis and interpretation

The data analysis and interpretation section is of crucial importance as the findings and closing recommendations of the research will be based on it. Where the literature review sets the foundation of the study by outlining existing thoughts and theories, the analysis and interpretation of the data should hopefully give rise to specific – and hopefully new – information and go some way towards answering the research questions posed. The method of analysis used will be inductive content analysis. Hanington and Martin (2012) describe content analysis as the systematic description of the content of written, spoken or visual data into themes or patterns which are more easily understood.

Content analysis has two primary forms: inductive and deductive analysis. During inductive content analysis relevant categories are derived or emerge from the data being analysed, and these categories are then used to examine the material and answer the research questions (Hanington & Martin, 2012). For example, when data has been gathered from the 12 respondents in this research, hopefully common themes or patterns will emerge that can then be used to explain the credit lending environment faced by internationally trading SME's in South Africa at the moment. Deductive content analysis predetermines the categories to be discussed prior to the analysis of the data. Therefore, it is less commonly used in qualitative research as the scope of the research would be largely defined and set out into predetermined categories and the gathering of data would be done to see which of these categories carry more weight in explaining the material in the research (Hanington & Martin, 2012). Inductive reasoning takes a number of specific observations and develops a general pattern in order to explain an occurrence. Deductive reasoning moves from a general, expected pattern and uses specific observations to prove whether this pattern does prove true in the real world (Maxfield & Babbie, 2011).

In this study, deductive analysis could be used if the researcher already knew that there were only a certain number of influencing factors or categories that decided whether non-bank trade finance would be a better form of funding for internationally trading SME's than traditional bank funding. However, currently the question has not been answered as to whether non-bank trade finance is a better form of funding for these kind of SME's in South Africa, and a number of new themes or patterns may come to light. The intention of the research is to allow for new information to arise in order to address the issue at hand. An inductive process would be a better technique to be used in this research, and therefore has been chosen.

The analysis and interpretation of the data will be carried out through the following steps:

i. Determine patterns and themes
ii. Rank them according to importance
iii. Analyse their implications to the field of study / research problems and questions (Hanington & Martin, 2012)

3.7 Limitations of the study

There will be certain limitations associated with the type of research methodology chosen. These are limitations to the research conducted and the gathering of data, and not limitations to the study and findings thereof – although they may have an impact on the overall outcome.

The main limitations are outlined below:

- 8 internationally trading SME's will be interviewed - 7 of whom already make use of trade finance provided by a non-bank institution. This is a small sample out of a total possible population of around 70,000 SME's operating in South Africa (Goldstuck, 2010). Results may be skewed in favour of these 8 interviewees and not representative of the population as a whole. In order to overcome this limitation the respondents will be chosen from different industries and different locations in the country in order to establish a cross-section of the population.

- 4 trade finance providers will be interviewed – out of a total population of at least 31 different banks and a much higher, indeterminable number of financial services providers (Kwangu, 2012). To overcome this limitation institutions with different operational mind-sets, and varying control structures (i.e. local or foreign) have been chosen.

- The data obtained will by necessity be biased and subjectively influenced by both the interviewer and interviewee (Ritchie & Lewis, 2003). The interviewer must be skilled in his or her interview technique and well versed in the subject matter. Secondly, he or she must not unduly guide the interviews in any one direction, but must allow for free discussion and the interviewee's opinion to come to the fore. As to the interviewee being biased, this is the reason a qualitative methodology has been chosen: for the interviewer to use a background in trade finance to analyse a number of subjective opinions from both the users and suppliers of trade finance's perspective in an attempt to answer the research questions posed.

- As interviews will not be recorded there is the possibility that details may be lost or data may be interpreted incorrectly by the interviewer after the interview has taken place. This is an important limitation and care must be taken to capture all the relevant details of each interview as fully as possible during and immediately after each sitting.

- The interview process is time consuming and therefore costly (Hussey & Hussey, 1997). Hence necessarily small samples have been chosen.

- The interviewee's responses may be motivated by other factors, thus skewing the data obtained. For example, the 7 SME's utilizing non-bank trade finance may be positively or negatively inclined towards that product and so distort their answers. This needs to be taken into consideration when collating all of the responses.

3.8 Validity and reliability

Ritchie and Lewis (2003) state that validity and reliability have enormous relevance for qualitative research as they help to define the strength of the data.

In essence they describe data that is valid as “well grounded”, and reliable data as “sustainable”. Therefore validity speaks to the accuracy of the data and reliability to whether the data can be trusted or not. The aim of research is to gather data in order to analyse a particular field of study and address certain questions asked in relation to the study. The validity and reliability of the data is crucial to the outcome of the research – without it the study could lose both its accuracy and trustworthiness. Reliability is a necessary precondition to validity, and validity speaks to the accuracy of the data (Goodwin & Goodwin, 1996).

In this study, the data gathered from the interview process needs to be both valid and reliable. The limitations mentioned previously need to be overcome so that the data can be consistent, applicable and accurate. Once gathered, the data will be analysed through inductive content analysis, and it needs to firstly be trustworthy, and secondly to relate accurately to the problems and research questions within the study (Ritchie & Lewis, 2003).

3.8.1 *External validity*

External validity relates to the ‘generalizability’ of findings. In simple terms it means whether or not the constructs or theories gained from the sample data are applicable across the whole population being studied (Goodwin & Goodwin, 1996). In this study 2 separate samples of respondents will be interviewed on an in-depth, one-on-one basis. In order to keep the data obtained from these interviews as externally valid as possible the respondents chosen will be unrelated and come from diverse industries and different geographic locations. Therefore by covering a variety of industries and geographic locations in the South African SME sector the data gained from the relatively small sample should be applicable to the greater population of SME’s in the country. While the financial services providers will all be based in Johannesburg, their operations and control structures will vary.

This means the data gathered should also relate to the greater population of trade finance providers as a whole.

3.8.2 *Internal validity*

Internal validity is the degree to which the data obtained accurately reflects the field of study (Cassell & Symon, 2004). It is the accuracy or extent to which the findings actually relate to the subject matter. The outcomes of the research must apply to the questions posed and aim of the entire study (Goodwin & Goodwin, 1996). The data and emerging theories and patterns must actually relate to the over-riding question of whether non-bank trade finance provided by specialist trade finance companies is a better source of funding for internationally trading SME's in South Africa than traditional bank funding. The internal validity is the degree of accuracy of whether this is achieved or not.

As per the limitations above the data obtained will be necessarily biased and subjectively influenced by both the interviewer and interviewee (Ritchie & Lewis, 2003). Care must be taken to guide the interviews and responses in the direction of the study at hand. Also, other factors may motivate an interviewee's responses, thus skewing the data obtained. When identifying the theories and patterns from the emerging data only common trends that relate directly to the research questions at hand must be taken into consideration.

3.8.3 *Reliability*

Ritchie and Lewis (2003) describe the reliability of data as the consistency or sustainability of that data – if the data and research findings obtained are repeated in another study using the same or similar methods then the research is reliable. It speaks to the trustworthiness of the data. Before validity can be judged the data must be reliable (Goodwin & Goodwin, 1996).

In this study the reliability of data will be maximised by carefully taking note – during and after – of the information supplied in the interview process. The data will be checked for errors and relevance, and only applicable data taken into consideration. The interviews will be conducted on an even as possible basis. For example, similar time must be allowed for each interview and every interview must take place under similar conditions – at the interviewer's business premises and during working hours. All interviews will be handled by one interviewer. In this way data obtained should be consistent and reliable.

4 RESEARCH PLANNING

4.1 Time-table

Table 3: Time-plan for completion of research report by 30 September 2014

	date	date	date	date	date	Date
Finalise proposal	06/02/2013					
Gain approval	15/04/2013					
Gather data		01/08/2013	31/03/2014			
Do data analysis			01/03/2014	30/04/2014		
Write report				01/05/2014	31/08/2014	
Finalise report						30/09/2014

4.2 Consistency matrix

Table 4: Consistency matrix

Evaluate the viability and attractiveness of trade finance as an alternative to traditional banking finance for internationally trading SME's in South Africa					
Sub-problem	**Literature Review**	**Hypotheses or Propositions or Research questions**	**Source of data**	**Type of data**	**Analysis**
To determine whether non-bank trade finance is a viable alternative to traditional commercial bank finance for internationally trading SME's in South Africa.	(Ahn, 2011) (Ahn, Amiti, & Weinstein, 2011) (Beard & Thomas, 2006) (Burscough, 2012) (Chauffour & Farole, 2009) (Hill, 2010) (Jacks, Meissner, & Novy, 2011) (Madura & Fox, 2011)	Is there currently a shortage of trade finance, provided by banks and non-bank institutions, to adequately support internationally trading businesses, and particularly SME's?	Responses from semi structured interviews Literature review Articles in the media	Qualitative data	Inductive content analysis
	(Boyes, Hoffman, & Low, 1989) (Chauffour & Farole, 2009) (Fisman & Love, 2003) (Hill, 2010) (Kim, 2010) (Nilsen, 2002)	What are the limitations behind the provision of trade finance in South Africa at the moment?	Responses from semi structured interviews Literature review Articles in the media	Qualitative data	Inductive content analysis

Evaluate the viability and attractiveness of trade finance as an alternative to traditional banking finance for internationally trading SME's in South Africa					
Sub-problem	**Literature Review**	**Hypotheses or Propositions or Research questions**	**Source of data**	**Type of data**	**Analysis**
	(Ahn, et al., 2011) (Bell, Farrell, & Cassim, 1999) (Chauffour & Farole, 2009) (Fatoki & Smit, 2011) (Malouche, 2009) (Mutezo, 2005)	Considering the current financial situation in South Africa, is non-bank trade finance a better option than traditional bank working capital finance for internationally trading SME's to adequately fund their operations?	Responses from semi structured interviews Literature review Articles in the media	Qualitative data	Inductive content analysis

5 PRESENTATION OF RESULTS

5.1 Introduction

In this chapter the results of the data gathered from the in-depth one-on-one interviews will be presented. In order to better understand these results, the demographic profiles and quality of the respondents will be described. Thereafter, factors will be identified from the results that specifically relate to the research questions posed in chapter two. The factors will then be ranked according to their importance and then fully discussed in chapter six.

5.2 Demographic profile of respondents

In this qualitative study samples from two different populations were interviewed. The first sample was a group of internationally trading SME's that used some combination of the following debt instruments: working capital (including trade finance) provided by a commercial bank; a non-bank trade finance facility; a mixture of both or neither type of funding – in order to run their businesses. The second sample was a chosen set of financial institutions that provide working capital and trade finance funding in different ways. Through this research, both the demand and supply side of the trade finance situation in South Africa is examined.

5.2.1 *Internationally trading SME's*

Eight internationally trading SME's were interviewed. The sample was chosen with care in order to represent a cross-section of the population of internationally trading SME's based in South Africa and trading across borders. Particular demographics were relevant to the study because they relate to what type of funding is being used by these SME's to fund their operations and also how easy it has been for them to access this finance. How these demographics link to the research questions posed and the topic of the study will be more fully examined in chapter six.

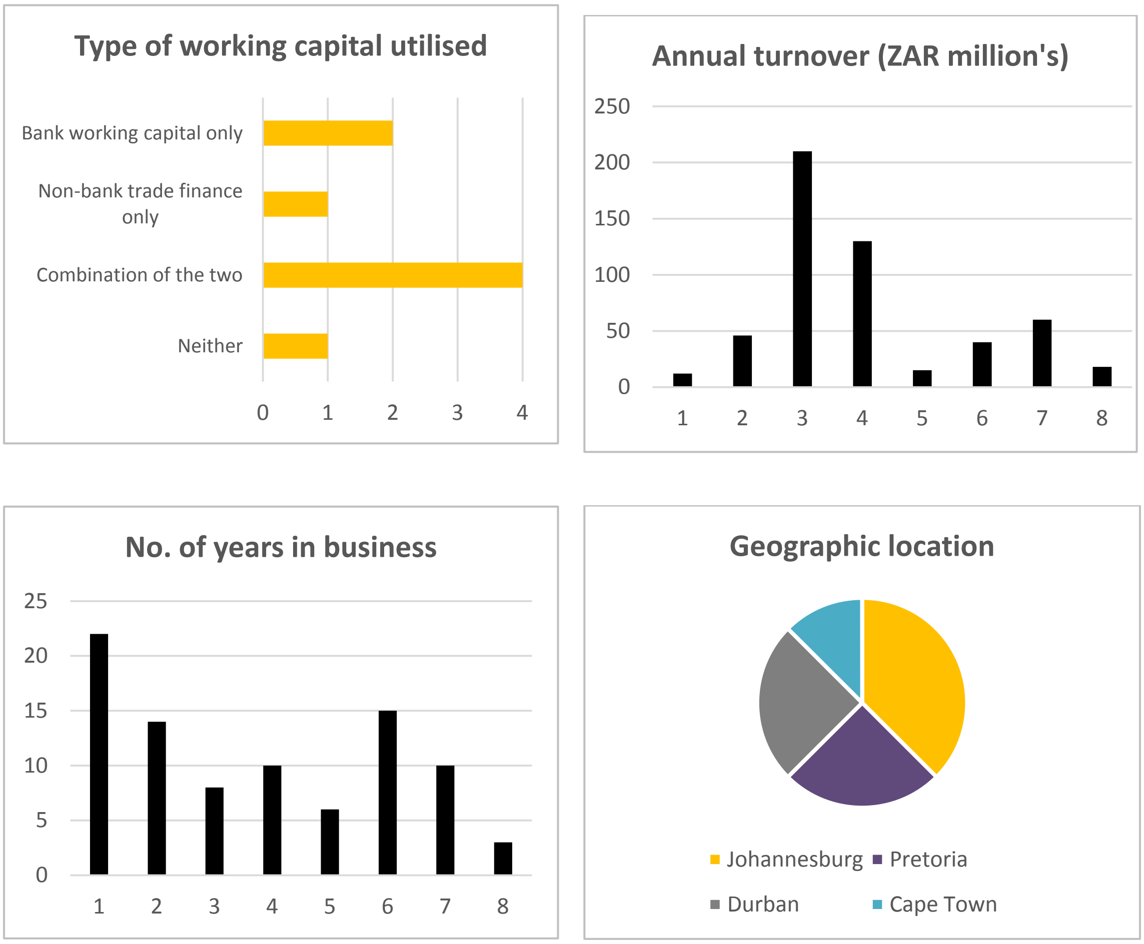

Figure 7: Demographics of SME's interviewed

5.2.2 *Providers of trade finance*

Four providers of trade finance were interviewed. Of these four, two were 'big-four' South African Banks with a mainly national but also an international presence; one was the local branch of a foreign owned multinational bank; and one a non-bank trade finance company operating only in South Africa. An attempt was made to interview a representative of the IDC, which is a South African government owned, national institution set up to assist businesses in conjunction with current political agendas. While this attempt was unsuccessful and a direct one-on-one interview with the IDC was not possible, discussions were had around the possibility of a PPP between the IDC and the non-bank trade financier.

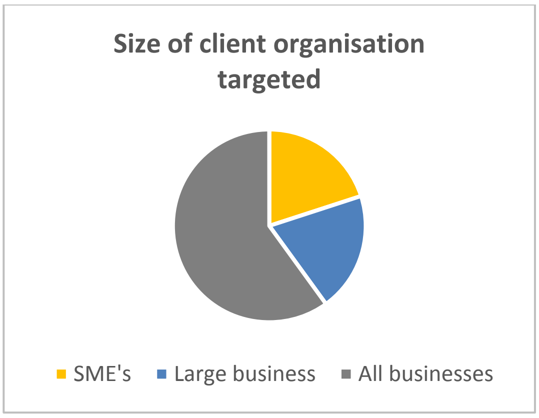

Figure 8: Demographics of the providers of trade finance interviewed

5.3 Factors identified from the results

A number of different factors were identified through the semi-structured interview process that related specifically to the topic of the research and the research questions posed. Discussions with key individuals from the sample of the internationally trading SME's provided insight into the demand for trade finance. The providers of trade finance outlined the supply-side situation for trade finance in South Africa. Many of these factors were anticipated as the interviewer is familiar with the topic at hand. However, a number of new, unidentified factors emerged due to the open ended structure of the interviews.

The factors have been listed below in table 5 and will be fully discussed in the next chapter. Importantly, only the factors that were considered relevant to the research questions posed were taken into account. Lastly, all of the factors were ranked according to their perceived importance, and run from number 1 to 12 in the table below – with the first factor considered to carry the most weight and the last the least.

Table 5: Factors identified that address the demand and supply of trade finance for internationally trading SME's in South Africa

Rank	Factor	Origination of factor	Research Question (s) addressed
1	Access to finance as an obstacle to doing business	SME's	1
2	Growth requires financial resources	SME's / Trade Finance (TF) Providers	1 / 3
3	Lending climate	SME's / TF Providers	1 / 2 / 3
4	Matching the correct type of finance with use	SME's / TF Providers	2 / 3
5	Operational limitations of financial institutions	TF Providers	2
6	Security	SME's / TF Providers	2 / 3
7	Cost of finance	SME's	2 / 3
8	Relationship	SME's	2 / 3
9	Credit assessment	TF Providers	2
10	Financial market knowledge	SME's / TF Providers	1 / 2 / 3
11	Other barriers to accessing finance created by international trade	SME's / TF Providers	2
12	Financial planning and discipline	SME's / TF Providers	None - Emergent

5.4 Summary of the results

Through aggregating the information gathered in the interview process a number of specific factors have been identified that directly relate to the topic of the research. The respondents in the SME sample have provided insight into the demand of trade finance for internationally trading small and medium businesses in South Africa. The respondents in the trade finance providers sample speak towards the supply of trade finance and also general working capital finance in the country. By analysing these factors from both perspectives the researcher will attempt to decide whether non-bank trade finance is a viable alternative to traditional working capital finance for internationally trading SME's, or if it at least has a greater role to play than it currently does.

6 DISCUSSION OF RESULTS

6.1 Introduction

In the previous section of the study the results from the qualitative research were presented in the form of factors and ranked in their order of importance. This section will discuss each of those factors and compare them to the findings of similar studies outlined in the literature review and then link them to the research questions posed.

The aim of the research was to answer the following three questions:

- Research Question 1 - Is there currently a shortage of trade finance, provided by banks and non-bank institutions, to adequately support internationally trading businesses, and particularly SME's?
- Research Question 2 - What are the limitations behind the provision of trade finance in South Africa at the moment?
- Research Question 3 - Considering the current financial situation in South Africa, is non-bank trade finance a better option than traditional bank working capital finance for internationally trading SME's to adequately fund their operations?

The questions were chosen specifically to firstly identify whether there is a shortage of finance for internationally trading SME's; then consider the reasons for a shortage (if one exists); and finally to identify whether non-bank trade finance is a better option for internationally trading SME's to fund their trading operations as opposed to the more commonly used forms of traditional bank finance.

6.2 Factors identified from the research

6.2.1 *Access to finance as an obstacle to doing business*

Of the eight SME's interviewed, every one said that access to finance is currently an obstacle to doing business, or that it has been an obstacle at some time in the past. Out of these interviewees, six said it was their biggest hurdle. Other obstacles such as uncertain demand for product, inconsistent supply of product, and exchange rate fluctuations were also common.

As outlined in the literature review a company's capital structure is the mix of equity and debt used to finance assets which in turn generate profit (Parson & Titman, 2009). Debt is an essential component of this capital structure and a useful tool to raise funds once equity has been used up. It can be easier to raise debt in the short term, and may reduce the cost of capital as it is often cheaper than equity (Hartley, Firer, & Ford, 2006). From the interviews with the owners and / or managers of the SME's in the sample set, it was confirmed that debt is a very important instrument for the running of their businesses. Small to medium enterprises do not always have access to large equity reserves in the form of shareholder funds or profits earned over time that larger companies may have. In addition to this, an internationally trading business has a longer cash flow cycle than a locally trading business as it takes time to move goods across borders. Frequently payments for goods imported or exported are made upfront due to the risks associated with international trade (Beard & Thomas, 2006). This was the case, with most importing SME's paying a deposit (typically between 10% and 50%) on the ordering of their goods and the full remaining balance on shipment of goods from the supplier's country. If the

SME's interviewed could not raise adequate debt then their purchases would be limited by the amount of funds the owners can invest. Therefore debt was considered an important instrument in the funding of these internationally trading SME's.

It was also put forward earlier that finance in general has been harder to access for all businesses since the financial crisis beginning in late 2008. Lending institutions have reduced their appetite for risk and tightened approval criteria in the face of the global recession. This has impacted directly on the volumes of trade around the world as finance is a critical enabler of this trade (Chauffour & Farole, 2009). The same was echoed by the SME's interviewed who had been around before 2008. Many of them found that the credit application process had become more arduous in terms of information required by financial services providers, and also that the decisions on approval or decline on credit were taking more time than they had before the global financial crisis.

Some of the factors discussed below do speak towards why finance has become more difficult to obtain since the 2008 / 2009 financial downturn. However, other factors have nothing to do with the change in economic conditions, and relate more to why internationally trading business are dependent on raising debt, and why it is difficult for them specifically to raise this finance.

6.2.2 *Growth requires financial resources*

All of the SME's interviewed had been established for three years or longer. Therefore, they all had existing business models and products that have been introduced and are adapting over time as market demand changes. Over the preceding years these companies had built up some form of financial means (whether equity and / or debt) to fund their trade. However, when the possibility of growth – in the form of a new product line or simply increased demand for existing products – presented itself, additional financial resources were required to fund this growth. In a trading business the largest income generating asset is the stock purchased and sold for profit. Financial resources are required to purchase this stock and bridge the cash flow gap between purchase of goods and the monies received after their sales. The financial requirement in an internationally trading business is again compounded due to the time delays in the transport of goods and the upfront payment terms. Some of the SME's experienced seasonal or project based demand which spiked at regular (in the case of seasonal) or irregular times (in the case of projects and tenders). In these instances the business' financial resources had to be necessarily flexible upwards and downwards when more or less stock was required.

All eight of the SME's interviewed answered "Yes" to the question of whether their business has missed out on possible sales in the past due to insufficient financial resources. Demand for product is often very hard to predict. If a business overbuys it can be left with a high stock holding, which ties up working capital, or worse, stock which cannot be sold and must be discounted or written off completely. However, if too little stock is bought, the seller risks losing a sale – their customer will buy elsewhere and thereafter possibly even move to another supplier permanently. The decision to buy stock must always be balanced with the cost of holding that stock, the risk of not being able to sell it again, and the risk of losing out on sales if the stock is not held. This was one of the most important and fundamental choices faced by all of the businesses interviewed.

Firer (2008: 98) claims that "… there is a direct link between growth and external financing." Furthermore, Hartley, Firer & Ford (2006: 115) illustrate when exactly additional capital is required in order to fund the life cycle of a product – in figure 9 below. If this capital is not obtained it may jeopardize the successful distribution of a product, and by extension the profitability and sustainability of an entire company. The figure shows three separate product life cycles within one company. However, each of the cycles could represent the complete life cycle of a business with only one product introduced to the market and grown over time. In each cycle, finance is required soon after the product gains wider acceptance in the market and demand increases. The need for funds diminish as profits are earned and so long as those funds are retained in the business.

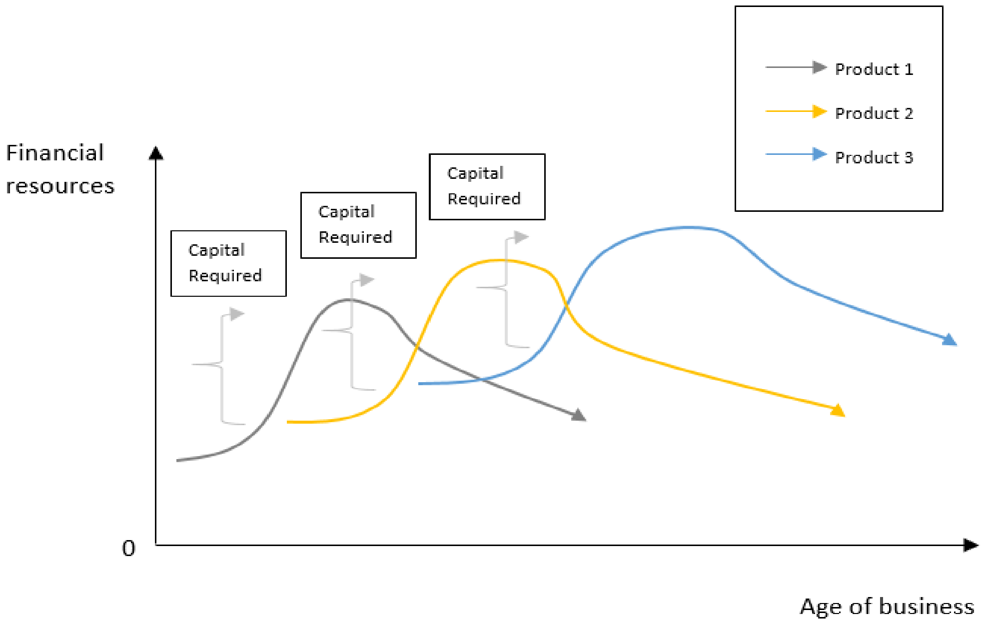

Figure 9: Financial resources required to fund product and company life cycles (adapted from Hartley, Firer, & Ford, 2006: 115)

All of the SME's interviewed recognized that they had been in need of additional finance to fund growth in their sales at certain times in the past. However, while occasionally it had been possible to raise short term debt in time, more commonly it had been very difficult to plan and access adequate and flexible funding. A trend that was identified was that when increased demand for product was experienced, it was difficult to match the required financial resources to this growth. Two main problems came to light: Firstly accessing bank finance in particular was a slow process. It took time to gather and submit all the required documentation and then the bank credit assessment process seemed to be a long process. Secondly, the commercial banks seemed to loan money on the back of existing security and balance sheets, and funding growth necessitates a forward looking approach to lend on the strength of future sales and earnings. Therefore, it was difficult to raise bank trade finance on future possible growth projections.

It was pointed out by SME's that were making use of both traditional bank finance and non-bank specialist trade finance that a non-bank trade financier could more readily cater to the short-term financial requirements of growth in an internationally trading business. As a trade financier offers only a limited number of financial solutions that relate directly to the trade of goods they have the resources in expertise and time to understand an internationally trading business' needs and act quickly to fill those needs. A number of the SME's obtained additional facilities from a non-bank trade financier – over and above their general bank overdraft – to specifically fund these spikes in trade. Discussions with a non-bank trade financier corroborated this: it was said that they often fund growing businesses that require additional working capital over and above what their client's bank is able to grant.

Some of the SME's interviewed foresaw that they would not necessarily make use of the debt facilities they currently had forever. In time they believed they would build up their own equity through profits earned and move away from debt instruments. Discussions with the non-bank trade financier brought to light that certain clients used them extensively over their growth periods and then tapered down their borrowings or cancelled their facilities completely when growth slowed or they had sufficient equity reserves. However, other businesses continued to use the debt they could raise for extended periods of time. In these cases either the businesses were not trading profitably enough to build up reserves; they were paying their profits out in dividends; or they were using them to fund growth in other areas.

To conclude, it seems that a non-bank trade financier can offer internationally trading businesses additional or higher facilities in a shorter time than their commercial bank counterparts. In times of growth access to quick, flexible finance can be crucial. The non-bank trade finance does come at a higher cost (as discussed below), but if the returns from the increased sales can more than cover these costs, then they may be acceptable. Although the SME's interviewed were grateful for the additional finance when needed, they also reasoned that when they no longer required it they would return to traditional lines of cheaper bank funding and not make as much use of the non-bank trade financier.

6.2.3 *Lending Climate*

As mentioned above, and specifically relating to the first research question, there is a perceived shortage of trade finance available. The availability of trade finance has deteriorated since the financial crisis of late 2008 and 2009 and this has limited the ability of companies to trade (Chauffour & Farole, 2009). Of the SME's interviewed, some have had facilities reduced and even cancelled by their long standing financial services providers and almost all of them have said it has been harder to gain approval for new or increased facilities in the last few years. A few interviewees have said that the climate seems to be improving in the last six to twelve months, as their businesses have been approached by their existing and other finance providers for new facilities. However, it is the researcher's opinion that this is more a function of those companies performing well and so being targeted as good candidates for credit, than the overall lending climate becoming more favourable at the time of writing.

From the interviews with all of the providers of trade finance it is apparent that they view the current economic conditions as tough. This has directly resulted in a change in credit assessment, and a more risk averse attitude. The traditional banks in South Africa have tightened their scoring models in general, and importantly, are more concerned about default in smaller businesses. There is a consensus that smaller businesses do find it harder to survive depressed economic times and so it is more risky to lend to them. For the providers focusing on larger customers only, lending criteria have also become constricted, although they have said they cannot be too stringent for fear of losing clients to their competitors. Also, where facilities could be readily approved for bigger, corporate clients they were often not required by these borrowers. In the depressed market environment the providers found that many of their bigger clients were not aggressively expanding into new product lines or new geographic locations. Therefore, they could operate with the financial resources they had and were not utilising new or even existing facilities.

An interesting observation is that non-bank specialist trade finance providers seem to have done well and grown their lending book under these circumstances. As the larger institutions rigidly tighten general lending criteria they risk turning away good borrowers along with the bad. The non-bank trade financier was a smaller, more flexible lender, with specific expertise in trade and so could take on good quality business if they have the capability to distinguish which clients would make it through the bad times.

6.2.4 *Matching the correct type of finance with use*

An important factor that has been identified from both the SME and the provider perspective is that the correct type of finance should be matched to the requirement of the borrower. There are a vast number of different financial products available, catering to broad and varied uses, and provided by various types of financial services institutions. For borrowers and lenders it is important to match a financial solution to a definite need. Information that emerged particularly in the discussions with the SME's, is that credit facilities differed widely with regard to terms of repayment; costs; security requirements and other features. Often the SME's were not using the best financial product for their need – they were utilising whatever finance they could raise at the time. On the providers' side, legislature and group financial structures determine that funds from different asset classes need to be lent out on certain terms and for specific uses. Therefore, the correct type of finance should be applied for both demand and supply reasons.

The primary function of an internationally trading SME is to buy and sell goods – either directly or after some value-add process. Therefore, more often than not, the biggest cost to a trading business is the stock they purchase (Beard & Thomas, 2006). In interviewing the sample of SME's, this was certainly the case. However, the international component of their businesses introduced complications with regard to the finance required. Imported stock generally had to be paid for in one of the following ways:-

i. By direct telegraphic transfer (TT) payment in full before shipment; or
ii. A deposit of between 10% and 50% of the cost of the goods on order and balance on shipping of goods; or
iii. A Letter of Credit (L/C), which is a form of international payment guarantee.
iv. On occasion foreign suppliers would allow open credit terms of between 30 and 90 days from shipment of goods before payment needed to be made. These arrangements were rare and negotiated over time and through a good relationship between buyer and seller.
v. It was also possible to have a combination of a percentage of the cost of goods paid by TT and the balance secured and paid later by an L/C.

In the case of direct payment finance was obviously required when payment was due – often before the goods left the foreign country of origin. When an L/C was utilised the norm for a commercial bank would be to collateralise the L/C with 100% cash upfront – thereby still tying up working capital. The non-bank trade finance provider would typically not collateralise with cash when establishing an L/C, but would block the capital value of the L/C off their client's lending facility. In either payment mechanism (TT or L/C) the cash flow cycle from payment of stock to receipt of monies from end customer for an importer is therefore long, and can be depicted as follows:-

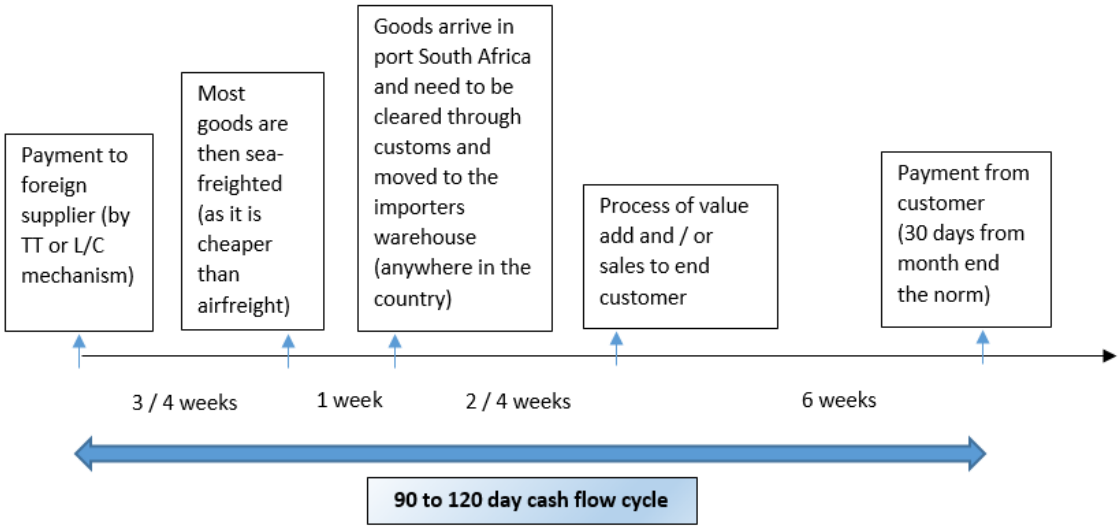

Figure 10: Typical importer's cash flow cycle (from SME interviews)

In order to fund the import and sales of goods a company needs to bridge a cash flow gap of between 90 and 120 days (12 and 16 weeks) on average – from outlay of funds to receipt of the proceeds from the sale of those goods. A commercial bank typically provides working capital lending in the form of a bank overdraft which is repayable at 30 days from month end. This kind of finance does not cater to the extended cash flow cycle of an internationally trading business shown in Figure 10. Common trade finance products provided by commercial banks are factoring and invoice discounting (fully explained in Appendix D). However, both of these products only release funding for the borrower once goods have been delivered and an invoice raised. Therefore, the leg from upfront payment to foreign supplier through to the delivery of goods to a South African buyer (and raising of an invoice) will not be bridged.

The non-bank trade financier interviewed operated by paying the foreign supplier upfront, and then required payment from the South African importer (their client) at the end of the 90 or 120 day cycle. This made their product more attractive to the internationally trading SME than a traditional commercial bank overdraft or the factoring / invoice discounting solutions also offered by the banks as it bridged the full cash flow cycle of an internationally traded good. Financial institutions that specifically understand international trade and do match this extended cash flow cycle are often better suited to fund these types of businesses.

From a supply of funds perspective new Basle II and Basle III legislature requires that short term lending is backed by short term assets. Therefore, short term lending (anything under 12 months, for example a bank overdraft) needs to be matched by short term deposits held, and a long term mortgage bond on a property must similarly be matched to long term deposits held. This legislature has come in recently, and complicates the operations of large financial institutions that lend over a range of short; medium and long terms. This has become particularly onerous for the large, diversified commercial banks, and affected the non-bank trade financier to a much lesser degree. A full investigation into the restrictions on the supply of credit is outside of the scope of this study.

6.2.5 *Operational limitations of financial institutions*

In comparing the three banks interviewed and the non-bank trade financier, a very different scale in operations was observed. The banks were all multinational organizations with a large number of employees offering a large variety of financial products. Due to the large size and complexity of these institutions, they relied heavily on systems and bureaucratic decision making processes. The non-bank trade financier was a smaller organisation with an extremely niched focus on trade finance only. Their reliance seemed to be more on experienced and knowledgeable staff than systems and a rigid decision making process.

This fundamental operational difference between the two types of funders had both positive and negative impacts on the internationally trading SME's that sought finance with each provider. The pros and cons have been outlined in table 6 below.

Table 6: The impact of the operational differences between bank and non-bank trade finance providers

Pros of commercial banks	**Cons of commercial banks**
• Fund a variety of assets, for example property, plant and equipment and general working capital. • If all the lending is provided by one source a greater understanding of the client may be reached and so higher facilities approved. • Cheaper pricing achieved by not just access to Reserve Bank lending, but also economies of scale and subsidised facilities. If one line of lending (for example property finance) is attractive, a bank may discount another product in the portfolio (for example the client's bank overdraft for working capital finance) in order to retain a customer.	• Rely on bureaucratic processes, systems, and administrative staff. • Staff may not have a good understanding of client's specific needs with regards to trade finance for three reasons: 1) they rely more on systems than a high touch relationship; 2) staff deal with a high number of clients and so do not have the necessary time resource to have a close relationship with their client; and 3) lack of expertise in international trade, as staff manage a number of products within one lending portfolio for each client. • Decision making is slower as bureaucratic processes are followed. • Lack of understanding may lead to lower facilities being approved. • Many SME's interviewed had difficulties in the past with commercial banks when issues concerning technical trade products arose, for example L/C's.
Pros of non-bank trade financiers	**Cons of non-bank trade financiers**
• Higher ratio of staff to clients. Therefore, higher touch, closer relationships may result in a better understanding of the client's business. • May result in higher facilities being	• Offer a very limited type of funding – only trade finance. • Necessitates having to work with more than one credit provider. • Complications can arise with rights over security instruments when more

approved. • Decisions regarding the approval or decline of new or increased credit facilities seem to be much quicker. • Better levels of service delivered in the particular area of trade finance (relate to above mentioned point on L/C's specifically). • Staff expertise in the area of trade finance may result in additional beneficial advice being given to client over and above the financial product delivered.	than one provider is involved. Often the SME's interviewed had granted their commercial bank a first cession of their debtor's book and their non-bank trade financier a second cession. This weakened the security instrument for the second provider. • Limitation in systems – clients may not experience uniform treatment as the relationship is governed more by individuals than a standardised system. • Higher cost - due to the cost of non-bank finance only certain businesses can qualify for this type of funding. If the margin in the good traded is too low a non-bank trade financier will automatically be excluded as the cost of the finance would be too expensive.

6.2.6 *Security*

From the interviews conducted with both the commercial banks and non-bank trade financier it transpired that very little unsecured lending takes place at a business level. For a general working capital facility a bank will typically secure through the personal sureties of the owners of the business and a cession over the debtors' book. Thereafter, they may look towards additional tangible security from easy-to-value assets such as a specific bond over property, plant or equipment; a cession over some cash or near-cash investment; or sureties from related parties who in turn hold some tangible value.

A very important distinguishing point between the commercial banks interviewed and the non-bank trade financier is that the banks will only infrequently securitise through the stock or inventory that a business holds. The following reason for this were given:-

i. It is difficult to determine the true worth of stock unless the evaluator has direct knowledge of, and experience in dealing with that type of stock.
ii. The value of stock is directly linked to a buyer. While some stock is very easily sold in most markets (for example commodities; petrol; diesel and cell phone airtime), other stock attracts a discerning and sometimes infrequent buyer (for example sophisticated machinery or high end fashion ladies' shoes). In the second instance the worth of the stock is more intangible as it depends on a willing and able buyer.
iii. Securitising through stock is an arduous process. The total value of stock on a business' balance sheet may be made up by hundreds, even thousands of different items. Also, there is continual 'flow' in these items as the older units are sold and new units of stock bought. Therefore a specific bond – like a lender would register over property or a particular piece of plant and machinery – cannot be registered. A General Notorial Bond (GNB) must be registered that grants the holder rights to movable assets in the business to whom they are lending funds. Should the lender then need to perfect the bond to acquire and sell the stock to offset the debt, numerous movable stock items would need to be claimed and sold off. The danger is that before a lender can perfect a bond over movable assets, these assets can be moved and disposed of by the business in debt. The lender must necessarily maintain a close and good relationship to ensure that these stock assets are protected. A bank – by virtue of the high volume of clients they deal with – cannot always stay as close to the businesses they fund as they would like to. This was corroborated by a large proportion of the SME's interviewed who said that their bank visited them on a once annually basis, and sometimes less frequently. The SME's also confirmed that their banks rarely took GNB's or any other security over their stock holding.

The non-bank trade financier had a different business model to the commercial banks. They specialise in funding the trade of goods and although there are a number of different products that fall under the umbrella of trade finance (outlined in Appendix D), they are all related and similar in the underlying transaction being financed – which is the trade of goods. The two principal forms of security taken are: firstly, the actual stock financed, and / or secondly, the debtor's book of the borrower once the stock has been sold. The reason for this is because they both relate directly to the trade transaction that is being financed. Therefore, what sets a specialist trade financier apart from a traditional bank is the security taken over the actual stock. As a trade financier only offers a limited number of financial products – and all of them relate to trade – they necessarily have the resources of staff expertise and time to overcome the challenges faced by a traditional bank and detailed above. Personal sureties and any other form of tangible security (mentioned above under the bank's requirements) may also be taken in addition to security over stock and debtors.

This point is crucially important in understanding the difference between traditional lines of commercial bank funding and the non-bank trade financier's product. Often the largest asset on a trading business' balance sheet is the stock they buy and sell for profit, and as their banks do not normally securitise through this asset they can only qualify for inadequate credit facilities. Once they approach a specialist trade financier, the value in stock can be unlocked to provide additional and much needed funding.

6.2.7 *Cost of finance*

On an annualised cost comparison, working capital trade finance provided by a traditional bank was cheaper than that provided by a non-bank trade financier. The reasons given were in line with the literature review and may be recorded as follows: firstly, a tendency around the world is to allow traditional commercial banks to have access to cheap funding from government or inter-bank channels (Nilsen, 2002). This is the case in South Africa where financial institutions that operate through a bank license can borrow from either the South African Reserve Bank or from other banking establishments (inter-bank channels, basically borrowing from another bank) at rates linked to the Repo rate. The Repo rate was essentially described as the rate at which the South African Reserve Bank lends out funds to commercial banks in the country. At the time of conducting the interviews the Repo rate was set at 5.50%. These commercial banks then lend monies out to their clients at rates linked to the Prime interest rate – with the difference being the administrative and risk premiums and profit margin charged. The Prime interest rate at the time of writing was 9.00%. This rate is also set by the Reserve Bank. A financial institution operating without a bank license does not have access to Repo rate finance and must borrow from a banking institution (or some other lender) at a Prime linked interest rate. They would then have to add their own margin for administrative and risk of default costs and their own profit. Secondly, higher risk lending automatically drives up the price. As banks in South Africa are the most prevalent and often cheapest form of finance, the lower risk and more able borrowers will apply for funding from them before they go to non-bank institutions. This leads to non-bank institutions lending to a more risky portfolio of clients which necessitates an additional premium to be charged to cover a higher default percentage in repayment.

All of the SME's interviewed had the option to apply for finance at a bank and / or non-bank institution. Monies borrowed from the former would be linked to Prime, and finance from the latter would necessarily be higher for both of the above mentioned reasons. Generally speaking working capital overdrafts (including trade finance funding) from commercial banks were priced between Prime and Prime plus 4% per annum. The non-bank trade financier's charges were certainly higher than this by a few percentage points per annum.

When unpacking these costs with the SME's some surprising facts came too light. Although a bank overdraft is almost always cheaper than a non-bank trade finance facility on an annualised basis, the reality may be that actual bank costs paid are higher. This is explained as follows: because a bank overdraft is a general facility that can be used for a multitude of purposes a borrower may become accustomed to the luxury and in fact see the monies lent as a permanent extension of their capital base. The result is that a business often uses the maximum (or close to) amount available in their overdraft on a continual basis, and pays the full annualized cost. Trade finance lending is often transactionally based as it funds the import of goods into the country, or a specific trade deal. The funds are then repaid when the transaction is complete and so costs are not paid permanently. Therefore, although higher on an annualized basis, if a trade finance facility is used only periodically the costs paid on a facility should be lower than a permanently utilized bank overdraft.

Another interesting factor that arose was that cost was not considered to be as important as one would imagine. If the products that the business was trading had high enough margin to cover the cost of the borrowing then actually having access to the finance in the first place was more important than its cost. Seven out of eight of the SME's interviewed had high gross profit margins (between 25% and 45%) in the goods that they sold. The reason many of them were importing goods in the first place was because they could be made cheaper elsewhere in the world. If they did not have the financial means to purchase their stock they would not be able to buy it in the first place and then sell it. However, if they did have access to a credit facility they could use the funds to trade and make a profit. If their gross profit margin was high enough (typically over 20%) then the cost of the non-bank trade finance was acceptable as they were making profit over and above the costs paid. Many of the SME's were also able to build-in an additional finance cost into the selling price of their goods, and pass the cost of the finance on to their end client. To conclude, the access to the finance was often more critical than its price.

6.2.8 *Relationship*

A common key differentiator between bank finance and non-bank finance was the relationship between lender and borrower. As already mentioned, banks lend out an array of financial products to a high volume of clients. The specialist trade financier interviewed had a much smaller book than the commercial banks and offered more or less the same product to all of its clients. The result was that the non-bank trade financier could dedicate more staff time per client than a bank could. Of the SME's using both bank and non-bank trade finance, many were visited on a monthly basis by the non-bank trade financier and only occasionally (on a bi-annual or annual basis) by their bankers. It must be said that this was not the case for all of the SME's interviewed as some did receive more than adequate attention from their bank.

This high touch aspect of a non-bank trade financier had the following implications for the internationally trading SME:-

i. Ensured a better understanding of the borrower's business and so financial needs could be more easily and more quickly understood and possibly met.
ii. Higher facilities were often granted as the risks of the business and future transactions are better understood.
iii. A high level of service from the non-bank trade financier.
iv. As non-bank trade finance staff have a more niched experience they could occasionally impart knowledge, information, or simply a better way of doing things with regard to international trade.

In certain technical aspects of international trade the SME's interviewed found it easier to deal with a non-bank trade financier than a commercial bank. Letters of Credit in particular, but also payments to a number of different countries around the world, all require a degree of technical knowledge. Some of the interviewees undoubtedly had good experiences with their bankers in these areas, but on balance more had better experiences with their non-bank trade financier. Again, the business models of the two different types of institutions were a reason for this as the banks relied on systems and administrative staff catering to a wide variety of products and the non-bank trade financier relied on staff specifically experienced in international trade. This ease of doing business was both a marketing tool for the non-bank trade financier and also a reason for the internationally trading SME's to pay a higher premium for the finance utilised.

The high touch relationship was also necessary from the non-bank trade financier's side. It allowed the funder to stay close to their client, and so mitigate their own risk in the face of a downturn in performance. Specifically with regard to the security held, it was beneficial to know when to close an account and attempt to recover funds through a security instrument. The relationship also made the GNB over stock possible, as mentioned under the section on security. The closer the relationship and more up to date the information on the borrower, the better equipped the funder was to make decisions to continue supporting a struggling business or to not support it any longer and perfect security held to mitigate their bad debt losses.

6.2.9 *Credit assessment*

Discriminant analysis models described earlier in the literature review by Boyes, et al., (1989) were utilised by all of the lenders – in some form or another – to approve or decline potential borrowers. These models were too detailed and varied to delve into for the scope of this research. The discussions were more focused around how the SME's interviewed qualified / or failed to qualify for the working capital finance they required to run their businesses. To this end the following three elements arose as critical influencers of the credit assessment process and then final approval or decline of a credit facility:-

i. Assessment of underlying security
ii. The funding of international trade and assessment of the transaction at hand rather than the existing security
iii. Size and maturity of the borrower's business

The commercial banks in South Africa tended to lend monies out based on the underlying security at hand. Very few large facilities are put in place – especially at a business level – without tangible security backing the lending. One new entrant into the market, Capitec Bank, is specialising in unsecured lending, but their focus to date has been more towards private individual borrowers than businesses. As mentioned above, the commercial banks lend out a wide variety of products. Each one is structured to be backed by the underlying asset that the product is financing. For example a mortgage bond over property and plant and equipment finance. In the case of a general working capital facility the personal sureties of the owners of the business and the debtors' book is generally taken as security. The credit assessment is therefore closely linked to the value and quality of the debtors' book. Again, as discussed previously, the South African commercial banks rarely looked to the stock purchased and traded for security. Therefore, facilities approved by commercial banks were still limited by the assessment of tangible security.

The multinational bank interviewed was aligned to support international trade around the world. They therefore understood international trade transactions and were more readily able to fund businesses on the security of the underlying stock. Similarly, the non-bank trade financier interviewed also specialised in lending to trading businesses in South Africa and would securitise through stock.

The important difference between the commercial banks on the one side and the multinational trade bank and the non-bank trade financier on the other, is that the latter would more readily assess the trade transaction at hand and not just the borrower's current balance sheet and existing underlying security. They would both consider the borrower's ability to perform and then lend on the back of this rather than strictly on the available, existing security. The ability to perform was the borrower's capability to complete a transaction successfully – either import or export a certain product, get paid, repay the debt and make a profit. The expertise and experience of the people owning and running the SME's seemed to carry much more weight particularly in the non-bank trade financier's credit assessment process than it did in the commercial bank's lending models. To sum up: both the multinational trade bank and the non-bank trade financier were able to approve higher facilities for internationally trading businesses due to the fact that stock counted as security in their credit assessment models. The non-bank trade financier went further and placed more value on the people in their credit assessment process. If the owners and / or management of their potential borrowers demonstrated an ability to perform well it could out-weigh a lack of current security and again higher facilities could be approved.

The size of the business applying for credit was an important factor in all of the lender's scoring models. Undoubtedly, the longer a business had been established for and the greater the balance sheet strength, the better the lenders' chances were of their requested credit facilities being approved. As mentioned earlier, the criteria required for lenders to approve credit has become more stringent in the last six years since the worldwide financial crisis. This seems to have affected smaller businesses more adversely as lenders prefer to approve credit for bigger, better established clients. Larger enterprises often have greater reserves of cash or other assets that have built up over time, and / or a greater ability to raise additional finance from shareholders than a smaller company may have. They can also cut costs or reduce scale of operations more easily than a small business might be able to. This makes them more robust and able to survive longer in poor economic conditions. Therefore, smaller and newer businesses were considered higher risk borrower's in economic downturns by all of the providers.

In the context of this study it was investigated which type of business each of the lenders targeted. The multinational bank interviewed had a fairly rigid policy of only targeting very large (and, if possible, international) businesses. They sought to lend out large facilities above certain minimum value criteria, and as their footprint was global, their ideal target client was one that traded across multiple borders. They would only very rarely consider lending to a small or medium enterprise. While the commercial banks operating in South Africa would lend to absolutely all sizes of business, it was mentioned that in these economic times, approvals were harder to gain for smaller borrowers. The institution's risk appetite had constricted in the face of a higher proportion of defaults (in general, but especially in smaller companies) in the last five or so years. However, smaller businesses were definitely still taken on, and one bank in particular said that in the last twenty years a larger share of their market growth had come from SME's rather than from big corporate companies. The non-bank trade financier specifically targeted SME's. Their view was that bigger companies would score higher on commercial bank credit assessment models and so be more capable of accessing bank finance than their smaller counterparts. They often found themselves funding a particular business for a period of time while that business grew. Once it had sufficient equity or cash from profits earned, their clients tended to either fund themselves or move to cheaper finance from a bank. Therefore, it seems that especially in recent times, the non-bank trade financier's credit assessment model was suited to smaller businesses that showed potential to be successful in the future.

One SME's experience was quite interesting to note: they struggled to obtain sufficient finance from their commercial banker when they were still relatively small and newly established. The business therefore complemented their bank overdraft with a trade finance facility provided by a non-bank trade finance company. Then, after some years of trading, they were able to qualify for a much larger bank facility and no longer required the non-bank trade financier (as the bank finance was cheaper). It seems as if the SME had grown sufficiently – in turnover; profits retained and the size of facility required – to more easily qualify for bank funding.

6.2.10 *Financial market knowledge*

A common point raised by the SME owners and managers interviewed was that their expertise lay more in the goods that they traded than in financial products. They would not always have full knowledge of the financial options available to their businesses. As commercial banks are without a doubt the most prevalent lenders, they are often thought of as the only lenders in the market. There was a perception that although other credit providers may exist, they may be very expensive and even possibly unethical in their behaviour – in terms of high and / or hidden charges, or excessive security requirements.

These thoughts were confirmed by the lenders interviewed. The non-bank trade financier claimed that one of their biggest barriers to doing business was that their presence was not well enough known in the marketplace. In discussing their offering with potential clients for the first time it would often be the case that the SME owner or manager could certainly benefit from the lending solution, but that they had simply not known about the possibility in the past. The discussions with the commercial banks extended this further to say that the SME owners or managers that approached the bank for finance did not know enough about bank processes and requirements to easily qualify for the facility they sought. Larger businesses have the resources to employ individuals with financial expertise to guide them as to the best options available. However, smaller enterprises will often not have the human resources budget to employ financial staff, and may need to rely on word of mouth or their own past experiences to guide them.

All of the providers of finance felt the market as a whole would benefit if all business owners and managers – for large and small businesses – were better aware of their financial options in the market. One interviewee had thought for a long time that the market could be better educated on how financial service providers operated and what is required in order to qualify for credit facilities. He believed the onus should not be on the lender or on the borrower only, but on both – for financial service providers to actively educate the market, and also for business owners to be more proactive about their own financial knowledge.

6.2.11 *Other barriers to accessing finance created by international trade*

In the discussions with the SME's interviewed certain other factors came to light that were unique to internationally trading businesses. This information was relevant to the type of funding the SME utilised as it directly impacted their need for a certain type of finance and also their ability to access it.

As mentioned, one of the instruments used to secure a trading company's lending facility is their debtors' book. South African businesses selling goods on credit terms across borders necessarily had debtors' based outside of the country. All of the lenders interviewed agreed that a foreign debtors' book was considered more difficult to collect, and so presented a weaker form of security than a locally based book. Many of the SME's interviewed both imported and exported the goods they traded, and the ones with a high percentage of foreign debtors did find it more difficult to gain access to the finance they required. This issue seemed to be more serious with the commercial banks as they placed more emphasis on their client's debtors' book for security. In one instance a company with a large proportion of their debtor's based in Africa had been struggling for some time to raise adequate working capital credit from their bank. The non-bank trade financier was able to grant a substantial trade finance facility to this company because they placed more value on the businesses ability to trade successfully and repay the debt than on the strength of the underlying security.

Other issues that arose were the time delays, transport and forex complications in international trade transactions. Importing and exporting goods requires a specific know-how in a number of factors such as legislative and compliance requirements; transportation logistics; VAT and duty payments; foreign currency conversions and more. While all of the providers of trade finance could advise on these matters, it remained the responsibility of the business engaged in the international trade to make the right decisions. These factors often determined which businesses were successful and which weren't – regardless of the product traded. They affected the business' ability to gain access to finance regardless of the provider.

6.2.12 *Financial planning and discipline*

The final factor arising from the research and to be discussed, is that financial planning and discipline is especially crucial for an internationally trading business. As put forward in the literature review, Ahn (2011) claimed that 90% of all international trade involved a financial product in some form or another. The long cash flow cycle of international trade often necessitates finance from a third party to enable the buying and / or selling of that good across borders. The SME's interviewed confirmed this, but added that even with sufficient credit facilities in place, the use and repayment of those monies needs to be very carefully managed in conjunction with the operations of their businesses.

While all of the SME's claimed that they had certainly missed out on possible sales and revenue due to insufficient credit facilities, many of them also said that it was possible to have too much credit. Restricting the access to cash focused their businesses in two main ways:-

i. Quality of business – with limited financial means only a limited amount of business can be conducted. Therefore, the best product must be sourced at the cheapest price and sold on for the highest margin to the customer that is most likely to pay. This sounds like common sense and how every business should be run. However, when brought into a practical context of the everyday operations of the SME's interviewed, a number of owner / managers said that restrictive finance forced them to choose between selling to one client or another. The better quality customers were chosen as the best way to profit from their limited resources. If unrestricted financial resources were available to a business it may be tempted to buy and sell far more product, and if the quality of those sales are poor it could ultimately result in bad debt and a serious downturn in profitability.

ii. Working capital management – limited funding in a business forces that business to manage their available working capital as best they can. Debtors are pushed to pay on time and stock is moved from warehouses and sold as quickly as possible. With unlimited access to credit a business may not manage these assets as carefully, and sooner or later that business would begin to run at a loss. For example, holding stock comes at a cost (the interest on the debt used to purchase that stock, or at the least the opportunity cost of not using that finance elsewhere), and if too much stock is held that cost can rise and potentially jeopardise the business.

In this way conservative credit policies of banks and non-bank trade financiers compelled sound business practises.

A problem that did emerge from the interviews was that inefficiency or delayed decisions on credit applications could result in difficulties for a potential borrower. Some of the SME's said that the application process for new or increased facilities and particularly with commercial banks, could be a very long and drawn out process. It was common for applicants to wait for three months or longer for credit decisions to be made. As business is fluid and must go on, the owners and managers of the SME's have to act and plan for possible future transactions while the application process is still underway. If, after some time, the application turns out to be unsuccessful the SME may have committed to a future transaction in some way that may be difficult to cancel. In this way risk may be introduced into the business.

It is the researcher's view that the fault here cannot lie alone at the door of the credit provider. They are in no way obligated to provide lending facilities, and sound credit assessment may take time. Also, if applicants for finance better understood the processes and turnaround times of financial providers they would be able to plan their financial resources better themselves. However, it goes without saying that quicker decisions made by a credit provider will certainly assist to alleviate this problem. The SME's that utilised non-bank trade finance seemed to benefit from a high touch relationship and faster, clearer decisions (whether approved or declined), and so avoided this potential problem.

The longer terms of non-bank trade finance also made planning easier for the SME's. As the terms matched the cash flow cycle, the monies borrowed were used to purchase goods, which were in turn sold, and the proceeds used to settle the original debt. In this way the lending was based per transaction, making the financial planning and discipline less complicated. On a bank financed overdraft, with repayment terms of 30 days from month end, monies borrowed to purchase goods had to be repaid before those goods were sold. Therefore, a preceding transaction would have to fund a current transaction again and again on an ongoing basis. This is a normal way of operating for many businesses but does make financial planning more difficult, especially if there are spikes and troughs in trading cycles.

6.3 PPP with the IDC

“The Industrial Development Corporation of South Africa Limited (IDC) was established in 1940 by an Act of Parliament … to spearhead the development of domestic industrial capacity, especially in light of the shortages of manufactured goods experienced as a result of the disruption of trade between Europe and South Africa during the Second World War” (Unknown, 2013 : 2). The entity essentially assists with the support and development of certain industries in line with public industrial policy and job protection and creation. They do this mainly by providing businesses with financial capital through either repayable term loans or equity investments. Advisory and or other services may also be offered. The sectors of the economy focused on and in line with government priorities are: manufacturing; infrastructure; mining and agricultural value chains; green technologies; tourism; and healthcare (Unknown, 2013).

One of the greatest challenges faced by a non-bank trade finance provider is the cost of their funding. As the institution does not operate through a bank licence they are not able to borrow from the South African Reserve Bank at the Repo rate. They operate as a tertiary funder after the Reserve Bank and a commercial bank, and so the interest rates charged to their clients are necessarily higher than what a commercial bank can charge. As the IDC was set up to assist enterprises in the country along the lines of current political agendas, it was considered whether a public private partnership (PPP) between the IDC and a non-bank trade finance provider would be beneficial to internationally trading SME’s in South Africa. The IDC would bring cheaper funding to the partnership, while the non-bank trade financier would bring staff expertise and market penetration.

Together a cheaper trade finance solution could be offered that is affordable for a larger number of internationally trading SME’s, and in particular those that could ordinarily not afford non-bank trade finance costs.

The researcher was not able to interview a representative of the IDC directly in relation to the proposed PPP. However, the non-bank trade finance company interviewed did have some experience with how the IDC operates through dealings shared with mutual clients. One business (not interviewed, but to whom the non-bank trade financier did previously provide with a credit facility) used the IDC for specific plant and equipment and vehicle finance, and the non-bank trade financier for import specific trade finance.

The interest rates the IDC charged their clients were often substantially below even the rates charged by commercial banks. Therefore, the IDC could alleviate the non-bank trade financier’s problem of high cost of finance to their clients. However, a number of challenges were brought to light: Firstly, where would the risk of default of a potential borrower lie – with the IDC or with the non-bank trade financier? Should a borrower default, who would carry the cost of the bad debt write off? Secondly, while the IDC did run profitably it was essentially an organisation run to support the objects of public industrial policy and job protection and creation. The non-bank trade finance was run to maximise its own return on shareholder equity. It would be difficult to marry these two enterprises. Thirdly, international trade is not necessarily in line with the IDC’s public priorities. There is often not a high labour component in internationally trading businesses and also the sector may be thought of as ‘transient’ – meaning there is often no long term investment or development in industry. Trading businesses import goods from where they are made available more cheaply and / or export goods into areas where they are more expensive. In certain instances long term relationships may develop between trading partners, but in most cases trade is opportunistic. Therefore, international trade does not necessarily align to the IDC’s agenda of enabling long term sustainable industrial development or decreasing unemployment.

In the non-bank trade financier's opinion, the IDC would not be the best candidate for the kind of PPP proposed above. While there is certainly merit in the idea, a full investigation into this kind of solution was not within the scope of this study.

6.4 Conclusion of Results

6.4.1 *Research Question 1*

Is there currently a shortage of trade finance, provided by banks and non-bank institutions, to adequately support internationally trading businesses, and particularly SME's?

As finance is a crucial enabler of international trade, its restriction will limit the ability of trading businesses to carry out their operations. The ability to raise debt was considered especially important for internationally trading SME's for two main reasons: Firstly, internationally trading businesses have to bridge the cash flow cycle from the outlay of funds to pay for stock to the inflow of payment from their customers after the sale of those goods. While this is normal for any trading business, the distances involved and information asymmetries (which necessitate upfront payment) of international trade made the cycle longer than for a locally trading enterprise. Secondly, small and medium businesses did not always have access to the financial resources that larger entities often had through retained earnings and shareholder funding. Short term working capital debt or trade finance was considered essential for these businesses to operate. Additional finance was also often necessary for growth and the inability to access debt could limit trade and a company's life cycle.

The owners and / or managers in the sample of internationally trading SME's confirmed that access to finance was one of their largest obstacles to doing business. Every one of them claimed that they had in some way, and at some time, missed out on an opportunity to trade due to them not being able to raise external debt necessary to fund possible transactions. While this has always been the norm – access to finance cannot be unlimited – the SME's interviewed have said that credit has definitely been harder to come by in the last five or so years. They believe the lenders in general have become more conservative and risk averse and that this has limited their ability to raise debt. This was confirmed in the discussions with the providers of both general working capital finance and specific trade finance. Lenders have tracked the international trend of becoming more conservative since the financial crisis of late 2008 / early 2009. Higher rates of default and generally tougher economic conditions have led to credit assessment policies becoming stricter. This has indeed made it harder for all businesses to gain access to credit, but especially for smaller entities because these institutions perceive the failure rate of SME's to be higher than a larger, better established business in poor economic conditions. That being said, the financial institutions in South Africa are certainly still looking to extend credit facilities to able borrowers. However, the research has shown that besides the current conservative lending environment there are other factors that specifically limit the provision of trade finance by both commercial bank and non-bank institutions.

Therefore, due to the current economic conditions and a number of structural factors influencing both banks and non-bank trade financiers, there is currently a shortage of trade finance provided to internationally trading businesses. The situation seems to affect SME's to a greater degree.

6.4.2 *Research Question 2*

What are the limitations behind the provision of trade finance in South Africa at the moment?

Once it was ascertained that there is a shortage of trade finance available to internationally trading SME's, the next purpose of the research was to investigate why this was the case. A number of limitations were identified and discussed from both a demand and a supply-side perspective.

On the demand side eight internationally trading SME's were interviewed. The following factors were identified and unpacked through the gathering of data in the interview process and analyses of the data thereafter:-

i. Financial market knowledge – while specialist bank and non-bank trade finance providers do exist in the South African market, the businesses requiring the finance do not always know about their existence. From the interviews conducted this was found to be especially relevant for SME's. Larger organisations had the resources to employ financial and other managers to investigate the best possible financial options available to them. Smaller companies were often owner managed and run, and operated fairly lean, with staff involved in the trade of their goods and directly related activities. This resulted in SME's often being unaware of the various financial products available to them. The non-bank trade finance provider also stated that one off their biggest challenges was making the product they offered more widely known in order to reach their target client. In addition to this applicants for credit were often uneducated as to the process of credit approval; what was required and the timeframes involved. This could delay the credit assessment process if required information was not available.

   Therefore, a limited knowledge of the financial options available and the best processes to follow in order to apply for credit was restricting access to trade finance for internationally trading SME's.

ii. Financial resource planning – Additional finance in the form of trade finance debt was considered especially important to fund growth in trading businesses. However, it does take time for credit providers to assess, approve and put required credit facilities in place. Poor planning could leave the businesses interviewed with insufficient working capital to cater to increased demand for finance in times of growth. This was particularly relevant for companies facing seasonal or project based demand for their goods.

iii. Incorrect financial product utilised – general bank overdrafts were the most common form of working capital debt utilised. These facilities did not match the cash flow cycle of an international trade transaction.

On the supply side four providers of working capital debt (including trade finance) were interviewed, and the follow factors emerged:-

i. Incorrect financial product provided - Commercial banks tend to offer a general working capital solution in the form of a bank overdraft instead of a specialised trade finance solution. With repayment required 30 days past month end the terms did not match the extended cash flow cycle of an internationally traded good. Factoring and invoice discounting solutions were also provided by the commercial banks. However, this released funding only after goods were sold and an invoice generated. These products would not assist a business importing stock and paying the foreign supplier upfront for those goods, before shipment.

ii. Security – Often a trading business' biggest assets were the stock held and the debtors' book due to them on monies owed from their clients. The research showed that commercial banks placed the most reliance on a borrower's debtor's book for security on credit facilities. They did not often secure through stock or inventory held by the borrowing business. The reasons given were that it was firstly onerous to value stock accurately, and secondly hard to control and monitor that stock. Businesses could easily move or sell stock before a lender perfected their security, thereby weakening the asset and security held. Therefore, as stock was not taken as security often inadequate trade finance facilities could be approved by the commercial banks.

Internationally trading businesses also sold their product across borders and so had debtors based outside of South Africa (in other African countries most frequently). This further limited their access to finance as commercial banks felt foreign debtors held less value than debtors based in South Africa. The reason for this was because it can be harder to collect and / or proceed legally against a debtor based outside of the country.

iii. Cost – Commercial banks had access to Repo Rate lending from the Reserve Bank and inter-bank channels and so were most often the cheapest lender in the market. Government entities, such as the IDC, were able to offer even lower cost lending, but only to certain businesses in line with government political and economic agendas. Non-bank trade financiers were more expensive than bank lenders on an annualized rate. This was the case because without a bank licence, they borrowed from commercial banks at Prime linked interest rates, and lent out to their clients after adding their own additional margin. Therefore, where a non-bank trade financier could possibly grant larger and better suited (to international trading) facilities, their pricing excluded them as an option as they were unaffordable.

iv. Operational limitations – Both commercial banks and non-bank trade finance providers have operational limitations that stand in the way of a fully efficient financial market. At a general level, the commercial banks seem to rely more on bureaucratic processes, systems and administrative staff to manage aggregated credit portfolios. This allows them to cater to a high volume of clients and offer a variety of financial products, but may limit them in other ways. International trade was found to be a specialised area, dependant on certain securities and staff expertise. Internationally trading SME’s found that decisions on requests for new or increased credit facilities often took a long time and were delayed over and over again. Also, as the bank processes were rigid and staff time resources did not always allow for a full understanding of their client’s business, internationally trading SME’s could sometimes be granted insufficient credit facilities.

The non-bank trade financier was more suited to fund international trade, but only provided this one solution. Therefore, a business requiring other finance (for example property or vehicle finance, etc.) would necessarily have to make use of more than one credit provider. This could prove onerous in terms of administration and possibly even limit credit provided by one or the other institution as the security available had to be shared by the non-bank trade financier and the commercial bank.

v. Credit assessment – As mentioned earlier, the criteria required for lenders to approve credit has become more stringent in the last six years since the worldwide financial crisis. This seems to have affected smaller businesses more adversely as lenders prefer to approve credit for bigger and better established clients.

As the commercial banks did not specialise in trade, credit assessment criteria would be based on existing balance sheet security and not so much on potential future transactions. Therefore, only existing business and incremental growth could be funded. Businesses experiencing sharp spikes in growth would struggle to obtain the finance required.

vi. Relationship – The point of relationship came across particularly strongly. As the commercial banks provided general lending facilities, and relied more on systems and bureaucratic processes than high touch expert staff, they did not always have a close enough relationship with their clients. This resulted in a limited understanding of the borrower’s business and meant insufficient credit facilities could be approved in certain cases. This was especially relevant for an internationally trading business which faced very unique and varying situations and requirements in their need for trade finance.

6.4.3 *Research Question 3*

Considering the current financial situation in South Africa, is non-bank trade finance a better option than traditional bank working capital finance for internationally trading SME's to adequately fund their operations?

To answer the above question with one sweeping statement would not be possible. The research conducted in this study has shown that both commercial banks and non-bank trade finance institutions have advantages and disadvantages in how they operate and what they offer to the market. Internationally trading SME's who require funding also have many differing needs and influences acting on them that determine what type of finance they could and should access. What does seem to be the case, is that while banks undeniably provide the bulk of working capital finance, the role for non-bank trade financiers to fund internationally trading SME's is under estimated.

The banking industry in South Africa is very well set up and provides businesses with many kinds of funding instruments. The commercial banks do also provide specialized trade finance, but due to certain limitations, they can often not provide internationally trading SME's with adequate working capital debt. The non-bank trade financier interviewed offers only trade finance and competes with the commercial banks through a high ratio of (knowledgeable and experienced) staff to clients; allowing longer terms of repayment on working capital debt; and taking security over the stock or inventory funded. This has three important implications for an internationally trading SME that does utilise non-bank trade finance:-

i. The terms of repayment on the finance are more suited to an international trade transaction;
ii. credit decisions on new or increased facilities can be returned more quickly; and possibly most importantly,
iii. larger trade finance facilities may be approved.

A non-bank provider is limited by the cost of their finance, and by the fact that they offer only one type of funding solution. Therefore, while a non-bank trade finance facility may be a better financial product to fund international trade, it does not eliminate the need for traditional bank funding in a business. An internationally trading SME will most likely always have the need of a traditional bank overdraft to fund their operations because it is well priced and can be used for general funding purposes. A non-bank trade finance facility can be an extremely beneficial complimentary solution, to be used in conjunction with other bank funding products. It can be used to specifically fund international trade transactions and / or growth in a business where only inadequate bank finance can be approved. Non-bank trade finance should only be used by businesses where the goods traded have sufficient profit margin to cover the cost of non-bank trade finance.

In the current financial climate it does seem that the commercial banks are less inclined to take risk on smaller businesses. A non-bank trade financier is more likely to be able to offer higher or additional credit facilities in this environment due to their close relationship with a potential borrower, the fact that they would securitise through stock and place more importance on the future success of a potential transaction, rather than just the underlying security at hand. Therefore, in poor economic conditions, it seems an internationally trading SME could more easily raise required trade finance from a non-bank trade finance lender than a traditional commercial bank.

To answer the third research question: It is the researchers opinion that an internationally trading SME should not completely replace bank working capital funding with a non-bank trade finance facility. However, non-bank trade finance can be used as a very effective complimentary product – over and above traditional bank finance – to specifically fund international trade. In times of growth non-bank trade finance can be an ideal way to raise required funding when commercial bank lines have reached their limit. In addition to this, in the currently tough economic conditions, it seems likely that internationally trading SME's could more easily access the finance they require from a non-bank trade financier than the traditional banks operating in South Africa.

7 CONCLUSIONS AND RECOMMENDATIONS

7.1 Introduction

While there are many different providers of working capital finance, the purpose of this research was to determine whether non-bank trade finance is a more viable alternative too traditional working capital bank finance for internationally trading SME's in South Africa. Access to enough of the correct type of finance was found to be one of the biggest challenges faced by internationally trading SME's in the country. This position seems to have worsened since the 2008 / 2009 financial crisis and ensuing global downturn, and furthermore, affected smaller businesses to a larger degree.

Non-bank trade finance and traditional working capital bank funding each have advantages and disadvantages in their respective uses. Traditional bank working capital facilities are cheaper and can be used for more general purposes. However, it was found that non-bank trade finance can be utilised by internationally trading SME's to raise much needed additional short term debt in order to fund the trade of their goods. The terms of repayment for non-bank trade finance better match the extended cash flow cycle of an internationally traded good. As these institutions understand trade and securitise through the goods financed, larger – or additional facilities – can be raised. This is particularly important when traditional banking lines of credit are tight and / or to fund extraordinary growth in a trading business. Therefore, while non-bank trade finance should not necessarily replace traditional working capital bank funding, it can be used as an effective complimentary product to specifically fund the trade of goods.

7.2 Conclusions of the study

7.2.1 *Current financial climate faced by internationally trading SME's*

The data gathered in the interviews with both the internationally trading SME's requiring trade finance and the providers of this kind of funding did align to the readings in the literature review. Lenders in general have become more conservative post the worldwide financial crisis of late 2008 / early 2009 and the currently depressed economic conditions in South Africa. This has particularly affected SME's as they are viewed as a higher risk than larger, better established organisations. The latter often has access to financial reserves through retained earnings built up over time or access to shareholder funding, and can more easily cut down on operations and costs to survive longer in a tough business environment.

Furthermore, traditional bank funding does not seem to be well suited to finance an internationally trading business. The most common form of working capital finance provided by the commercial banks in South Africa is a bank overdraft, securitised by the personal surety (ies) of the owner (s) of the business and a cession of the debtors' book. This is a good solution for general working capital purposes as it can be used to fund any short term need, for example salaries; rent; and stock; etc. However, security is not often specifically taken over the goods bought, held and then sold. This results in inadequate facilities being approved as stock is often one of the largest assets on a trading business' balance sheet. Also, the terms of repayment do not match the extended cash flow cycle of an internationally traded good. The commercial banks do offer trade finance, but more on an invoice discounting or factoring basis. This makes credit available only after goods are sold and does not help a business which needs to pay for their imported goods upfront. Therefore, internationally trading SME's are currently finding it very difficult to raise the working capital debt they require to fund their operations from the commercial banks in the country.

Non-bank trade financiers do operate in the market and specialise in funding internationally trading businesses. They compete with the commercial banks in offering working capital in the form of trade finance to these kind of enterprises. Through staff experienced in international trade; a high staff to client ratio and securitising through the goods traded; they are often able to grant higher credit facilities (than the commercial banks would) to an internationally trading organisation. However, as they borrow from the commercial banks to lend out monies to their clients, the cost of non-bank trade finance is typically higher than traditional bank finance. Also, the presence of these institutions is not well known in the market as many internationally trading SME's are unaware of their offering.

This combination of factors means that internationally trading SME's face a tough financial climate. Funding in general has constricted in depressed economic conditions, traditional bank funding does not adequately support international trade, and non-bank trade financiers are expensive and not well enough know to effectively fund the market.

It was not conclusively proved whether a public private partnership between the IDC and a non-bank trade financier could alleviate the problem of cost for the non-bank trade finance offering to be more attractive and so more widely utilised.

7.2.2 *Specialist non-bank trade finance as a viable alternative to traditional working capital bank finance for internationally trading SME's*

The commercial banks in South Africa supply working capital finance in the main through bank overdrafts and / or invoice discounting and factoring facilities. These instruments are often used for trade finance purposes – the buying and selling of goods – but not limited to trade finance only. They are often used for general working capital purposes. These types of funding do not cater to the extended cash flow cycle of an internationally traded good, and due to the fact that security is not often taken over stock, insufficient credit is made available to a trading business. However, finance from a commercial bank is likely to be cheaper than a non-bank institution due to their ability to borrow monies at Repo rate structures. In addition to this a business will have need for bank funding to finance other assets such as property, plant and equipment in the long term and general working capital in the short term.

A non-bank trade financier competes with commercial banks in supplying short term working capital debt, but their facilities can be used for only trade finance purposes. The following important differentiators set these institutions apart from commercial banks:-

i. Larger facilities can be approved due to the fact that the non-bank trade finance company securitises over the stock financed; staff have expertise in trade; staff have the time resource to understand a potential client's business, needs and potential for repayment; and staff can take risk on the underlying transaction and the borrower's ability to perform and not just the existing security.
ii. Terms of repayment on credit facilities can be set to match the extended cash flow cycle of an internationally traded good.
iii. Quicker credit decisions can be made as staff specialise in trade finance only.
iv. A close relationship is established between lender and borrower which is essential to protect the lenders security and also beneficial to the borrower as larger facilities can be approved in quicker turn-around times.
v. Service delivery in international trade transactions is better as staff have expertise in this area.
vi. The cost of the finance is more expensive than a commercial bank as the non-bank trade financier borrows their funds at Prime rate structures.

To conclude, internationally trading SME's can often raise higher credit facilities from a non-bank trade financier than they could from their commercial banks. The repayment terms are also more suited to international trade. However, the funding is expensive and must be used for the sole purpose of funding trade.

It is the finding of this research that non-bank trade finance is not an exclusionary alternative to traditional working capital bank finance, but rather should be used as a complimentary product in conjunction with traditional bank finance. An internationally trading business can use bank funding for general working capital purposes and raise an additional trade finance facility through a non-bank trade financier to specifically fund international trade. This applies only if the borrower has sufficient margin in the goods traded to cover the additional cost of the non-bank trade finance.

In the current economic conditions faced by businesses in South Africa a non-bank trade financier could have a greater role to play as commercial bank lines of credit are tight. In this environment an internationally trading SME should make more use of non-bank trade finance if they cannot raise adequate bank finance. Also, in times of growth, these organisations can again utilise a non-bank trade financier to fund increases in trade where a commercial bank is not inclined to take additional risk, or is too slow in approving required credit.

7.3 Recommendations of the study

After analysing the data gathered in this research, the following recommendations are offered to internationally trading SME's requiring working capital funding, and the financial institutions providing it:-

i. Internationally trading SME's should make use of both traditional lines of commercial bank credit and also a specialised trade finance facility provided by a non-bank trade finance company.
ii. Smaller businesses in particular, can more easily raise working capital in the form of trade finance through a non-bank trade finance company than through a commercial bank. As these businesses grow larger they will be more favourably considered by commercial banks, and can then access lower cost finance.

iii. Extraordinary growth in an organisation requires financial resources. Internationally trading organisations should fund this growth through a non-bank trade financier when required and move back to traditional commercial bank funding when more normal trading conditions are resumed.
iv. SME should become more aware of the financial options available to them, and how financial institutions in general work to approve credit facilities. The onus of this education should lie both on financial institutions and the SME's themselves.

7.4 Limitations of the study

Fairly small sample sizes were interviewed from both the demand and supply of trade finance perspective. This was necessary as the interviews were time consuming and necessarily open ended to allow emergent information to come to light. However, at least one or more non-bank trade financiers could have been interviewed to increase the reliability of the data.

Of the internationally trading SME's interviewed, while some of them both imported and exported their goods traded, the predominant characteristic was to import goods and sell the bulk of them locally in South Africa. The financial solution offered by the non-bank trade financier was geared to this kind of trade. If more companies with a higher predisposition to export were interviewed it would have expanded the scope of the study and possibly, also the differences between traditional commercial bank finance and non-bank trade finance.

The research did not investigate other options to fund working capital requirements. A pure comparison was made between traditional commercial bank funding and non-bank trade finance. A more comprehensive study could have included the possibilities of raising additional owner finance / equity; government subsidies; insurance products; etc. This would have necessarily increased the scope of the study.

The researcher was experienced in trade finance and the funding of internationally trading businesses. This would have brought in a certain amount of personal bias and possibly affected the discussions in the interview process as well as the analysis of the resulting data.

7.5 Suggestions for further research

This paper examined the trade finance industry in South Africa from the demand side of internationally trading SME's and the supply side of two South African commercial banks, one international commercial trade bank, and one non-bank trade financier. One suggestion for further research could be to examine if there are other options to fund internationally trading SME's in some operationally better and more cost effective manner. It stands to reason that international trade will only proliferate as technology improves communication and transportation. The funding mechanism for this trade will certainly be crucial to trading businesses in the future. Research into creative models and new, innovative solutions could bring tremendous returns if a more successful funding alternative was developed.

Other existing options to finance internationally trading SME's could be investigated in further research. For example: government subsidies; additional shareholder capital; etc.

As cost is one of the biggest challenges faced by the non-bank trade financier, research into a different mechanism, or partnership that would reduce this cost would be another suggestion for further research.

Lastly, the findings of this research could be compared to similar international studies (if they do exist). In this way the South African market may be able to benefit from lessons already learned abroad.

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APPENDIX A – ACTUAL RESEARCH INSTRUMENT

Date XXXX

Dear XXXXXX,

As per our discussion dated xxxx, I am a current student at the Wits Business School in Parktown, Johannesburg. I am in the process of completing my Masters in Business Administration (MBA) degree. As part of the course work I am required to write a research report on a topic of my choice.

The research topic that I have chosen is: **Non-Bank Trade Finance as a Viable Alternative to Traditional Bank Funding for Internationally Trading Small and Medium Enterprises in South Africa**. The aim of the research is to see whether specialist trade finance companies have a greater role to play in funding internationally trading SME's in South Africa, than they have in the past.

In order for me to gather relevant market data I would appreciate a 1 hour interview with you at a convenient time and date, at your offices. The interview will be structured around the attached questionnaire, but conducted on an open-ended, interactive basis. The information obtained will hopefully address my research topic. However, the interview can also be an opportunity for you to better understand the financial challenges and opportunities that face your business and the South African market as a whole.

The contents of our discussion will be for academic research purposes only. All information submitted will be held in the strictest confidence and reserved for the publishing of these findings only. All responses may also be submitted anonymously is so desired.

Thank you for your time and the opportunity to research the topic at hand.

Yours sincerely,

Menso Kwint

011 551 0623 / 072 022 2227

MensoK@Lombardins.com

APPENDIX B - RESEARCH INSTRUMENT: SEMI-STRUCTURED INTERVIEW QUESTIONNAIRE: QUESTIONS TO BE ASKED OF INTERNATIONALLY TRADING SME'S

1. From the options below, what has been the biggest obstacle faced by your business?
    a. Access to finance
    b. Staffing resources
    c. Uncertain demand for product
    d. Consistent supply of inventory or raw material
    e. Exchange rate fluctuations
2. Does your business have sufficient short-term working capital in order to fund the current and expected future operations?
3. Has bank lending in the form of short term working capital been easy to access in the past?
4. If bank credit has been difficult to access, what were the main reasons given for the delays in approval, or rejection of facilities required?
5. What factors in the past have limited your business' access to finance (if not answered in question 4.)?
6. What are the main advantages and disadvantages of bank finance?
7. Could your business benefit from additional, well-structured and well-priced credit facilities?
8. Has your company missed out on possible business (sales) in the past due to insufficient financial resources?
9. What are the main advantages and disadvantages of non-bank trade finance?

APPENDIX C - RESEARCH INSTRUMENT: SEMI-STRUCTURED INTERVIEW QUESTIONNAIRE: QUESTIONS TO BE ASKED OF THE PROVIDERS OF TRADE FINANCE IN SOUTH AFRICA

1. Does your organisation see a clear difference between specific trade finance (to facilitate the trade of goods) and general working capital finance?
2. Is trade finance seen as a desirable and profitable product offering?
    a. If no, why not?
3. Does trade finance comprise a substantial portion of your organisations total business?
    a. If no, why not, and
    b. Is there a focus to expand into this area in the future?
4. What are the core differences – in your opinion – between a trade finance solution and a general working capital facility?
5. What sector of the market does your organisation target – small, medium or large businesses?
6. In your opinion, is it easier for larger, longer established businesses to gain access to required lending facilities?
    a. If so, what are the reasons for this?
    b. If so, is this likely to change as economic conditions change and markets become more robust?
7. How could your clients, in general, improve their chances to gain access to the financial resources they require?

APPENDIX D - OVERVIEW OF TRADE FINANCE PRODUCTS

Category	Product	Description
Inter-firm finance	Open account	Contract is settled between importer and exporter without third-party security or risk management arrangements, either directly or (most commonly) through transfers between their banks; one party (normally the exporter) extends credit by way of accepting payment after a certain period (usually 30–90 days).
Traditional bank finance	Investment capital	Medium-term finance for investment in the means of production (for example, machinery).
	Working capital	Short-term finance provided to cover ongoing costs (addressing mismatch in timing between cash receipts and costs incurred) including payment of suppliers, production, transport costs, etc.; also used to cover risks of (or real) delays in payments, the effects of currency fluctuations, etc.
Trade finance mechanisms	Letter of Credit - sight	Provided by importer's bank to exporter's bank; when exporter fulfils LC conditions the relevant documents of proof are submitted to the exporter's bank who submits them to the importer's bank, who remits funds to exporter's bank which then pays exporter (importer subsequently remits funds to importer's bank). This is designed to mitigate the counterparty risk inherent in open account transactions.
	Letter of Credit - usance	Operates similarly to LC - sight, but payment is made to exporter's bank on given terms, e.g. 30; 60; 90 days.
	Supplier credit	Extended or deferred payment terms offered by the supplier to the buyer, but typically linked with bank financing to enable an exporter to receive cash on delivery (for example, factoring).
	Buyer credit	Term financing provided to finance cash payments due to supplier.
	Countertrade	Addresses liquidity (in particular, access to foreign exchange, and so is particularly relevant in emerging economies) by promoting two-way trade of equivalent value merchandise (for example, barter, buy-back, counter-purchase)
	Factoring, Forfaiting and Invoice Discounting	Factoring is a financial service offered that purchases an exporter's accounts receivable at a discount and assumes the risk of non-payment; addresses both liquidity and risk mitigation. Forfaiting is similar to factoring but typically involves medium-term accounts receivables for exporters of capital goods or commodities with long credit periods. Invoice discounting is similar to factoring and forfeiting, but the financial institution purchases a seller's invoices at a discounted rate.
Guarantee mechanisms	Advance payment guarantees	Security provided to importer when exporter requires mobilization payment; this is usually a matching amount callable on demand.
	Performance bonds	Security provided to importer (normally in the case of capital goods export), callable in the event of exporter's failure to perform (compensates for costs of finance, re-bidding, etc.)

	Refund guarantee	Security provided to importer when importer is required to make stage payments during manufacturing by the exporter (normally in the case of large capital goods export), callable in the event of non-delivery of goods.
	Hedging	Security (for example, through a financial instrument issued by a bank) to offset market (rather than counterparty) risks, including fluctuations in exchange rates, interest rates, and commodity prices.
Credit insurance	Export credit insurance	Insures exporters against a range of risks including: non-payment, exchange rate fluctuations, political risk, etc.; Can be used to securitize other forms of trade and non-trade finance from banks.
	Export credit guarantees	Instruments to protect banks providing trade finance; facilitates the degree to which banks can offer trade finance products (for example to SMEs without sufficient export track records).

Source: (Chauffour & Farole, 2009 : 133)