

CHAPTER 2

Trade finance in the Mekong-3



Bank transactions during the COVID-19 pandemic in Cambodia.

Key findings

- Local trade finance markets in the Mekong-3 were worth nearly US\$ 152 billion in 2022. Vietnamese banks supported about 21 per cent of exports and imports with trade finance, a substantial contribution which represents 22 per cent of total banking assets in the country. The local banking sector in Cambodia supported a much smaller share of the country's import and export operations, some 3 per cent of total trade, accounting for only 2.5 per cent of banks total assets. Data collected for the Lao People's Democratic Republic (PDR) are rather weak, but a rough estimate suggests that local trade finance supports an even smaller share of trade.
- In Cambodia and Viet Nam, the existence of alternative, foreign supply chain finance (SCF) arrangements provided by large multinational companies to their subsidiaries and tier 1 suppliers may explain the limited share of trade finance provided by local banks. The extent and nature of these arrangements is not captured by the data.
- Local banks have a limited role in supporting trade arising from the production of consumer electronics, textiles and clothing by foreign-owned firms. Greater involvement is found in locally owned sectors of wholesale and retail trade, agriculture and fishing, and intermediary industrial products (metals, plastics). Local banks are also more likely to support intra-regional trade than global trade.
- Supply and demand constraints impact the availability of locally provided trade finance. On the supply side, 60-80 per cent of banks surveyed identified disruptions to mobility and operations due to the COVID-19 pandemic as the main constraint. The banks also report the need for technical and financial assistance to create trade finance capacity for instruments that they do not provide. On the demand side, the high cost of finance, along with collateral requirements and unfamiliarity with trade finance are highlighted by survey.
- Banks offer mostly traditional trade finance instruments such as letters of credit, guarantees and pre-export loans. Short-term working capital lines are often used as a substitute to trade finance, particularly in Cambodia, while SCF supplied by local banks in Cambodia and Viet Nam accounts for only 2 per cent of available trade finance. Promisingly, a quarter of surveyed banks intend to introduce SCF in the next two years.
- Trade finance usage differs significantly across different types of firms. Large firms (at least 100 employees) are over 65 per cent more likely to use external trade finance than firms with 5-99 employees. Perhaps more counterintuitively, foreign-owned and high-tech manufacturing firms tend to use trade finance much less often: domestic companies are twice as likely to use trade finance than foreign-owned companies. Similarly, the share of wholesalers and retail traders using trade finance is almost twice that of firms in high-tech manufacturing.



This chapter uses new primary data collected by the IFC through two surveys covering the supply side (banks) and the demand side (exporters and importers) of trade finance. The 2023 IFC survey of trade finance in the Mekong-3 covers the banks currently in operation in the region. The 2023 IFC firm-level survey of trade finance is based on a nationally representative sample of firms engaged in international trade in Viet Nam.

Local trade finance markets

Based on the data collected from local banks, the current value of the local trade finance market is estimated to be US\$ 1.6 billion in Cambodia and US\$ 150 billion in Viet Nam (see Table 2.1). There is insufficient data to estimate the local trade finance market in the Lao PDR. However, rough calculations indicate it to be around US\$ 0.5 billion – less than a third of Cambodia’s market.¹

There is a significant difference in magnitude among finance markets in the Mekong-3 – Viet Nam accounts for 98 per cent of the total – and the extent to which local financial sectors contribute to supporting trade flows. Local banks supported 21 per cent of trade flows in Viet Nam, 3 per cent in Cambodia and possibly less in the Lao PDR (see Table 2.1).

As described in Chapter 1, Viet Nam’s share of trade (exports plus imports) expanded to 185 per cent of GDP² in 2022, which reflects its growing participation in global supply chains. The mobilization of domestic financial assets for trade facilitated the fast expansion of trade operations in Viet Nam. The estimated share of trade finance in the total banking assets of Viet Nam is about 22 per cent – a large share by any international estimate.

Although the local trade finance market in Viet Nam supports only one-fifth of total trade flows, the survey did not cover SCF arrangements provided by foreign banks to subsidiaries of foreign firms in Viet Nam producing goods for export. Only a global survey involving, for example, global banks and banks from China, Europe, the Republic of Korea and the United States could capture additional trade finance flows.



Local trade finance markets in the Mekong-3 are worth nearly US\$ 152 billion.

Bank-intermediated trade finance as share of total bank assets



Source: IFC–WTO staff calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

SCF programmes have recently been introduced by local banks. KPMG, a major consulting firm, estimates the potential of the SCF market in Viet Nam to be close to US\$ 50 billion annually. However, only a minor part of such potential has yet been exploited.³ According to the survey, SCF supplied by local banks accounts for only 2 per cent of the total estimated trade finance.

The local trade finance market in Cambodia is smaller both in absolute and relative terms (see Table 2.1). The estimated trade finance portfolio of banks was about US\$ 1.6 billion, out of US\$ 52 billion in trade flows in 2022. Cambodia shares a common characteristic with Viet Nam of having a high trade-to-GDP ratio, which exceeded 210 per cent in 2022. Support by the financial sector to the integration effort of Cambodia is therefore important for the competitiveness of its traders in international markets. However, the survey confirms previous analysis (Kingdom of Cambodia, 2018), according to which the 3 per cent share of trade supported by formal trade finance instruments was relatively small by international standards. These differences may result from a range of triggers, such as:

- underreporting in the survey owing to a narrow interpretation of trade finance by respondent banks;
- the existence of foreign financing flows sourced outside Cambodia;
- intra-company financing from abroad;
- the existence of temporary imports – where garment factories are directly provided with inputs for local processing before re-exporting to the country of origin.

TABLE 2.1

Bank-intermediated trade finance in the Mekong-3

	Total	Cambodia	Lao PDR	Viet Nam
No. of banks surveyed	143	61	39	43
No. of respondent banks	61	33	8	20
Respondent banks' share of total banking assets	75%	81%	61%	74%
Share of respondent banks involved in trade finance	87%	82%	88%	95%
Total merchandise trade (US\$ billion)	798	52	15	731
Size of bank-intermediated trade finance (US\$ billion)	152	1.6	0.5*	150
Average share of bank-intermediated trade finance	19%	3%	<3%	21%

Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3 (see Box 2.1). * The estimated size of bank-intermediated trade finance in the Lao PDR is based on data received from three banks providing this information. Total bank assets for the Lao PDR refer to the 2021 due to unavailable estimates for 2022.

While foreign finance was outside the scope of the survey, it should not be assumed that such financing arrangements are systematic. Survey interviews indicated both a variety of financing models and no financing at all. In some cases, the import of inputs is provided by the parent company and does not involve any financing. In other cases, foreign suppliers require cash-in-advance payments, with either local banks or foreign banks of the suppliers offering overdraft or working capital credit lines to local factories (normally fully collateralized by property) to purchase the imported goods. Local producers may also apply for collateralized lines of credit via the subsidiary of the bank operating with the main exporting country.

Trade finance instruments

Local trade finance is mainly supplied by large banks, through traditional trade finance instruments and working capital. Scale matters in trade finance, as international trade operations of banks require infrastructure, such as correspondent banking relationships (CBRs), and skills in handling trade finance

instruments and associated risks. There are clear leaders in the Mekong-3.

In Viet Nam, the five largest banks by assets account for over 50 per cent of the trade finance market by US dollar value, and the ten largest banks account for over two-thirds of total estimated trade finance assets. Although the banking sector has historically experienced high levels of concentration in East Asia (Lapid *et al.*, 2023), the shares of assets of the top three banks have declined considerably in Cambodia and Viet Nam over the last decade and are below levels of more advanced countries in the region such as Malaysia, the Philippines or Thailand. Despite remarkable progress, the Lao PDR still records high levels of concentration of banking assets, which reflects its level of financial development.⁴

Certain subsidiaries or branches of international banks might not have large domestic asset portfolios in the Viet Nam. However, compared to their local banks' assets, they have rather important trade finance assets. The survey generally finds that a relatively wide range of trade finance products and solutions are offered by banks in the Mekong-3 (see Figure 2.1).

The 2023 IFC survey of trade finance in the Mekong-3

Following the model of the IFC Global Trade Finance Program (GTFP) survey and the expanded regional survey of trade finance in the Economic Community of West African States in 2021, the IFC surveyed banks in Cambodia, the Lao PDR and Viet Nam on the state of trade finance for 2022. The survey included around 30 questions to collect a wide range of information about the cumulative asset volumes of trade finance recorded by local banks for 2022, the trade finance products offered, their prices and the sectors of the economy that received trade finance from the banks.

The survey also enquired about constraints to the demand and supply of trade finance, support actions that may help banks to diversify their products, and each country's outlook for trade finance as perceived by their respective banks.

Sample size

The sample included all the banks listed on the central bank websites of the Mekong-3 as of December 2022.



Private, state-owned and foreign-owned banks were included in the sample, conditional on having a local presence in the Mekong-3 and listed with their central bank. The IFC collected the contact emails of the trade finance units of these banks and emailed the survey link directly to them. When contact details of the trade finance units could not be tracked, the IFC used the banks' generic email addresses.

The survey protocol included several follow-up actions to ensure completion and to revise inconsistent responses. In addition, the bank associations in the Mekong-3 shared the survey link with the banks in their network to increase response rates. Banks completed the survey between April and August 2023, and all responses up to 20 August are included in the results.

Bank assets

The assets of the banks that responded to the survey represent 81 per cent of the 2022 total bank assets reported by central banks in Cambodia, 65 per cent in the Lao PDR and 74 per cent in Viet Nam. Information was collected from banks of different sizes, including four of the top five banks in Cambodia and Viet Nam, and medium and smaller banks. In Cambodia and Viet Nam, the three top banks that responded held around 39 and 36 per cent of the total bank assets in the country, respectively. Although the response rate to the survey in the Lao PDR was lower, its largest bank, with over 40 per cent of the assets, is also the main contributor to trade finance data captured.*

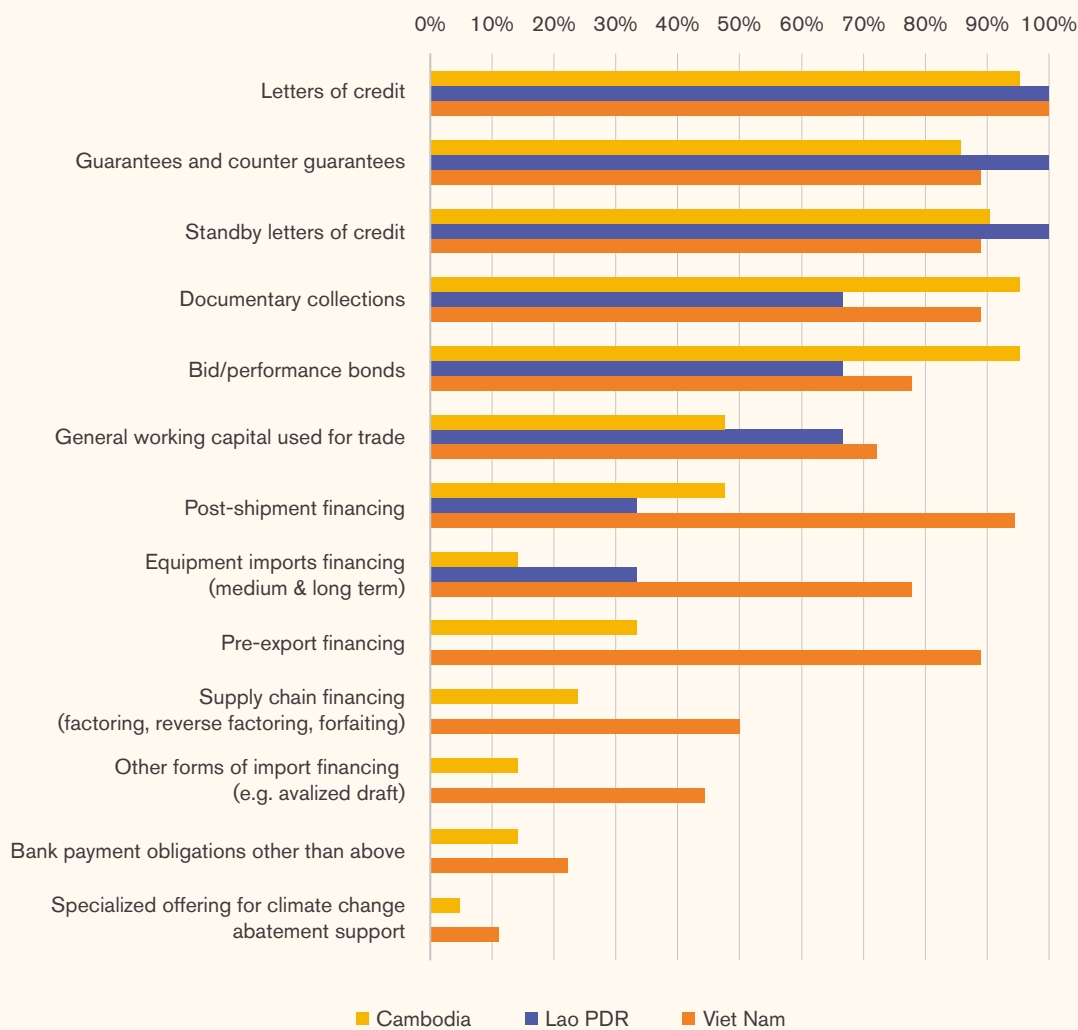
* Annex II contains further information about the relationship between bank size and trade finance portfolio based on regression analysis and the methodology used to estimate assets.



Diamond Island, the commercial hub in the heart of Phnom Penh, Cambodia.

FIGURE 2.1

Trade finance instruments offered by banks in the Mekong-3, 2022 (as a share of banks in per cent)



Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

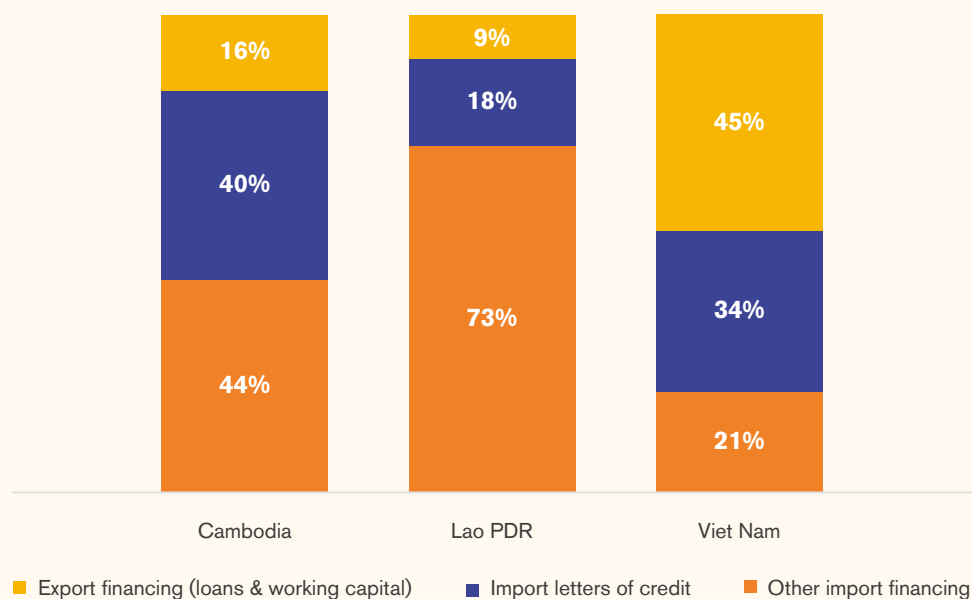
Surveyed banks routinely offer traditional trade finance instruments such as letters of credit, documentary collections and other guarantees on the import side, and loans that largely comprise short-term, working capital and pre-export finance. A third of banks in Cambodia and close to two-thirds of banks in Viet Nam indicate that they are in a position to offer some form of SCF. However, estimates from the survey suggest that

only a few banks in Viet Nam – and even fewer in Cambodia – are really active in providing it to their clients.

The data show that a non-negligible share of each country's imports is paid cash in advance, leaving a fraction of imports to be supported by formal trade finance instruments, mainly guarantees such as letters of credit and documentary collections, but also import loans (see Figure 2.2).

FIGURE 2.2

Trade finance instruments in the Mekong-3 for imports and exports, 2022 (as a share of all instruments, in per cent)



Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

According to the survey, import letters of credit represent about 34 per cent of the 2022 trade finance assets in Viet Nam (see Figure 2.2), which would bring the value of the market for the instrument to approximately US\$ 51 billion.⁵ The share of letters of credit in total trade finance assets is similar to Viet Nam. With an estimated local trade finance market of US\$ 1.6 billion, a 40 per cent share would value letters of credit at around US\$ 0.6 billion in trade finance in 2022, supporting about 2 per cent of imports. In the Lao PDR, letters of credit are provided by one in five of the banks surveyed, supporting less than 1 per cent of imports and highlighting an overall limited use of trade finance products in the country.

While banks can routinely arrange letters of credit and other documentary credits, survey interviews confirm the existence of several obstacles for their use, such as a lack of available documentation to support their issuance, market power from suppliers originating in larger economies (i.e. China, Thailand, Viet Nam) often demanding a pre-payment for their inputs; and

perhaps most importantly, perceived uncertainties owing to collateral requirements.

Other than letters of credit, the survey highlights the importance of working capital used for the purpose of trade. Working capital in Cambodia captured in the survey is estimated to be around US\$ 0.6 billion, representing around 40 per cent of the total trade finance assets in the country and covering 1.2 per cent of the total trade in 2022 (see Table 2.2). The survey shows that US\$ 29 billion in working capital is used in Viet Nam for the purpose of trading. This is a smaller share of trade finance assets than in Cambodia (20 per cent against 40 per cent) and supports 4 per cent of its total merchandise trade.

There are several reasons for the use of working capital. Exporters of finished goods (e.g. garments) are typically paid on a 90-day basis – without the possibility to benefit from cash advances often involved in SCF. Facing pressure from their own suppliers to pay cash-in-advance for their inputs,

TABLE 2.2

Working capital for trade finance, 2022

	Cambodia	Viet Nam
Working capital (US\$ billion)	0.6	29
Working capital as share of total trade finance	40%	20%
Working capital as share of total merchandise trade	1.2%	4%

Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

the only way to avoid being cash-strapped is either to secure working capital lines or to receive trade loans (import and pre-export loans). However, as observed in Cambodia, revolving, short-term working capital lines are preferred for their flexibility against more structured loan agreements. Generally, they are available only to clients with sufficient land or building collateral and are typically more expensive.

For many new small and medium-sized enterprises (SMEs) with limited credit history and no land collateral, these are non-starter conditions. According to local surveys, 70 per cent of SMEs in Viet Nam have difficulty accessing such working capital and must use their own money or borrow from informal sources at higher costs.⁶ In industrial supply chains involving many SMEs, the difficulty to access trade finance through working capital – as a substitute for even more formal and documented forms of trade finance – may be just one of many reasons why the coverage rate by local banks of certain sectors such as textiles and clothing and electronics is so low.⁷

Most of the local banks surveyed report that they do not provide SCF because of insufficient demand from clients. Some of the local banks provide distribution finance, covering mainly domestic flows, with banks remaining the main suppliers of SCF. Major bottlenecks are the lack of reliable local SCF platforms and conservative credit culture.

Trade finance across sectors

Wholesale and retail trade, agriculture and fishing, and intermediary industrial products (metals, plastics) are the main sectors to receive bank-intermediated trade finance (see Table 2.3). Consistent with the two-speed trajectory of

trade growth shown in Chapter 1, local banks have a limited or no role in supporting trade arising from importing inputs or exporting locally produced goods by foreign-owned firms in the electronics sector and, to a lesser extent, textiles and clothing sector. Local bank services are rather oriented toward locally owned activities (e.g. food, fisheries) or import-intensive, fast-growing sectors (e.g. construction).

Which sectors received trade finance by local banks varies across the Mekong-3. Viet Nam's local trade finance supports the greatest number of sectors. Survey results establish that all 18 industries covered benefited from support by at least 50 per cent of the banks, while ten sectors received trade finance from 80 per cent of the banks (see Figure 2.3). The distribution of total trade finance between imports and exports in Viet Nam is relatively balanced (55 per cent to 45 per cent; see Figure 2.2), concentrating on intermediate goods and inputs (e.g. plastics, metals, textiles), agriculture and fishing products, and construction materials.

The distribution is less homogeneous in Cambodia and the Lao PDR, where trade finance is mainly supplied for imports (84 per cent and 91 per cent, respectively; see Figure 2.2). In Cambodia, different banks supported different sectors. Hence, most sectors received trade finance from less than 40 per cent of the banks. The sectors of construction⁸, food products and beverages, and wholesale and retail received most of the trade finance from the local financial sector in Cambodia: 62, 52 and 48 per cent of the banks surveyed supported trade activities in these three sectors, respectively. In the Lao PDR, agriculture, forestry, fishing and wholesale and retail receive the most trade funding: 100 and 68 per cent of the banks, respectively, and the only sectors listed by more than half of the banks.

TABLE 2.3

Distribution of trade finance across the surveyed banks' top three sectors, 2022 (in per cent)

	Cambodia	Viet Nam
Agriculture, forestry, fishing	8.1	27.0
Chemicals	0.0	0.0
Coke & refined petroleum products	3.3	3.0
Computer, electronics	0.0	0.0
Construction	1.4	25.0
Electricity, gas, steam & air conditioning supply	29.2	2.1
Food products, beverages	19.4	0.0
Metals	11.9	16.4
Motor vehicles & transport equipment	0.0	0.3
Other manufacturing	0.0	0.7
Pharmaceuticals	2.4	0.5
Plastics	0.0	1.6
Textiles	0.0	8.2
Transport	0.4	0.0
Wholesale and retail trade	24.0	15.4
Total	100	100

Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

Trade finance for firms owned or led by women

Research indicates that firms owned or led by women are often small businesses and more dependent on trade finance (World Bank and WTO, 2020). Yet, evidence from the Asian Development Bank (ADB, 2016, 2017, 2021) shows that trade finance requests made by women-led businesses have a higher rejection rate and fewer than 20 per cent of the women interviewed had received trade finance.

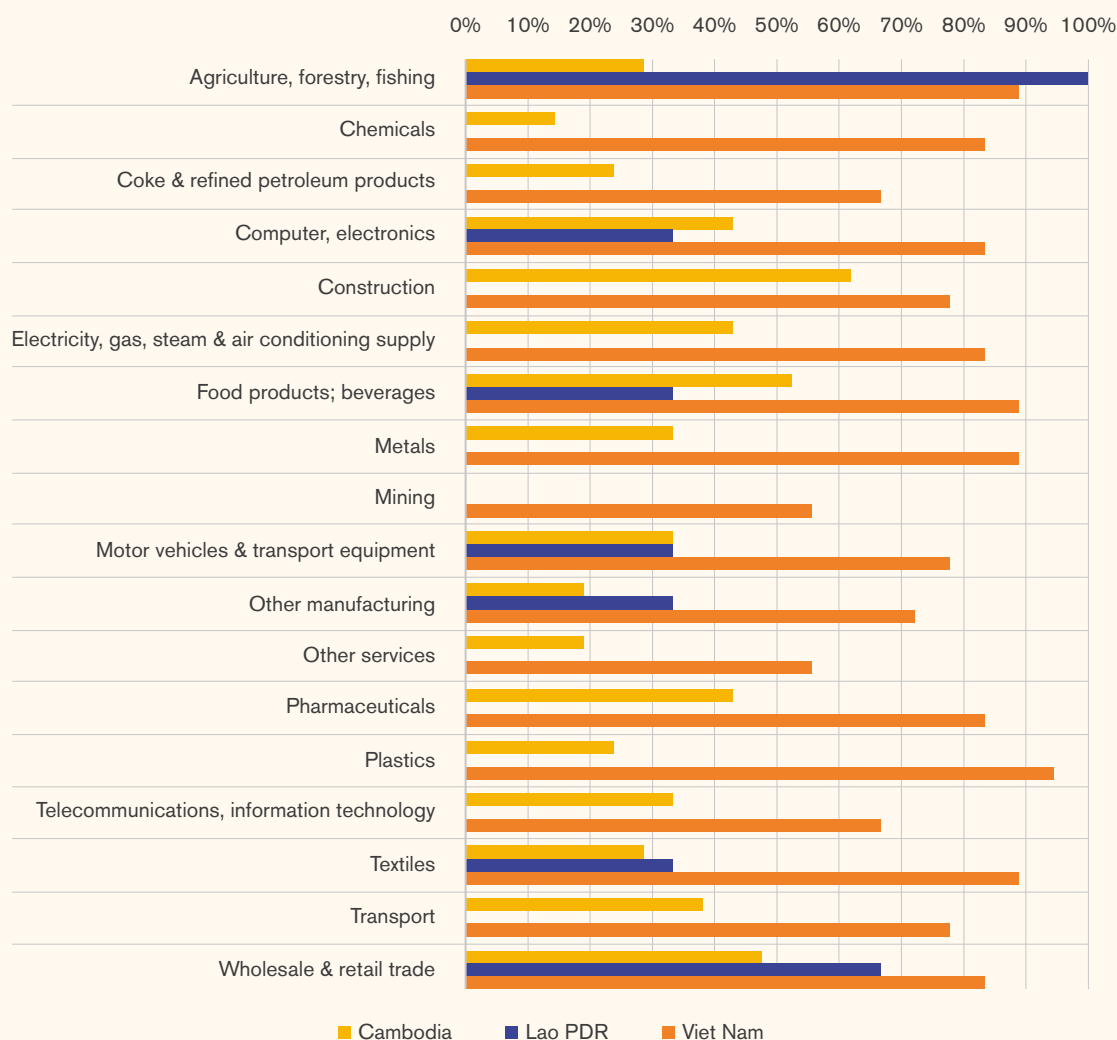
The information collected in the survey reveals that around 51 per cent of the surveyed banks in the Mekong-3 do not track whether or not they provide trade finance to micro, small and

medium-sized enterprises (MSMEs) owned or led by women (see Figure 2.4), which makes it a challenge to discuss with any certainty the gender gap in access to trade finance.

Around 41 per cent of banks report that they provide trade finance to women-owned or led MSMEs and only 7 per cent of the banks do not. These numbers mask some heterogeneity: the gender disparity in access to trade finance is more accentuated in Cambodia and the Lao PDR, where only 37 per cent and 33 per cent of banks, respectively, report allocating trade finance to women-owned or led MSMEs, compared to 47 per cent in Viet Nam. However, few banks reported actual numbers. Of those that did, 3 per cent was the highest share of the bank's total trade finance allocated to women-owned or led MSMEs.

FIGURE 2.3

Bank-intermediated trade finance in the Mekong-3 by sector, 2022 (in per cent)



Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

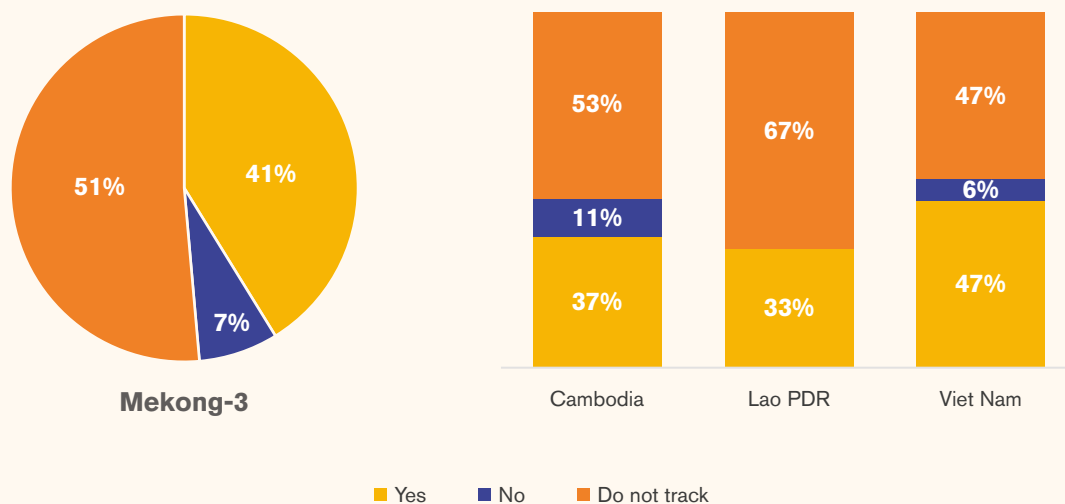
Trade finance for climate-related activities

Despite the urgency of mitigating or adapting to climate change, only a small fraction of the banks in the survey fund climate-related trade activities. In Cambodia, only 11 per cent

of the banks report that they provide trade finance to climate-related activities and 26 per cent do not (see Figure 2.5). In Viet Nam, almost 29 per cent of the banks finance climate-related trade against 24 per cent which do not. In the Lao PDR, 33 per cent of the banks surveyed do not finance climate-related trade activities. Furthermore, large shares of banks surveyed in the Mekong-3 fail to track such data.

FIGURE 2.4

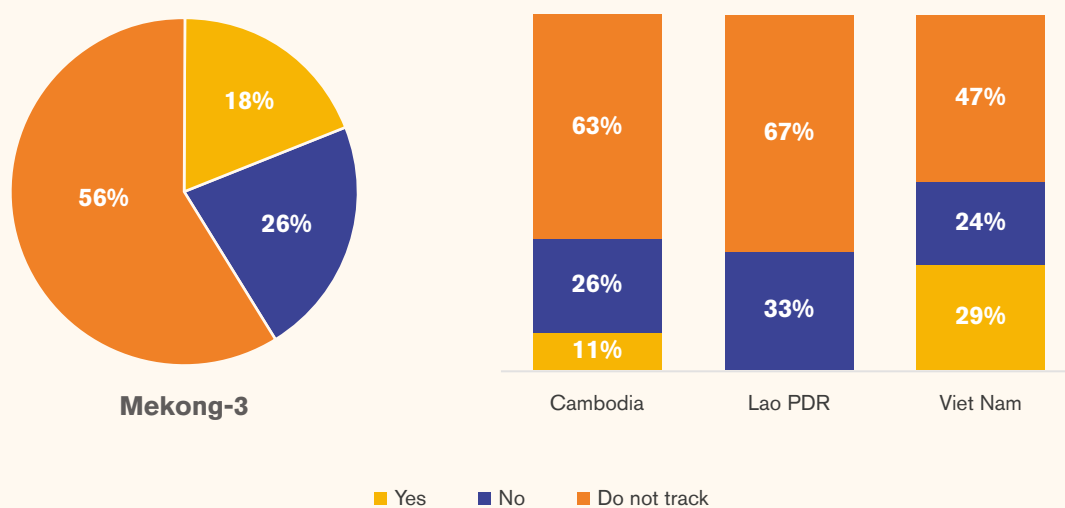
Share of banks in the Mekong-3 providing trade finance to MSMEs owned or led by women, combined and by economy, 2022 (in per cent)



Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

FIGURE 2.5

Share of banks in the Mekong-3 providing trade finance to climate-related activities, combined and by economy, 2022 (in per cent)



Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

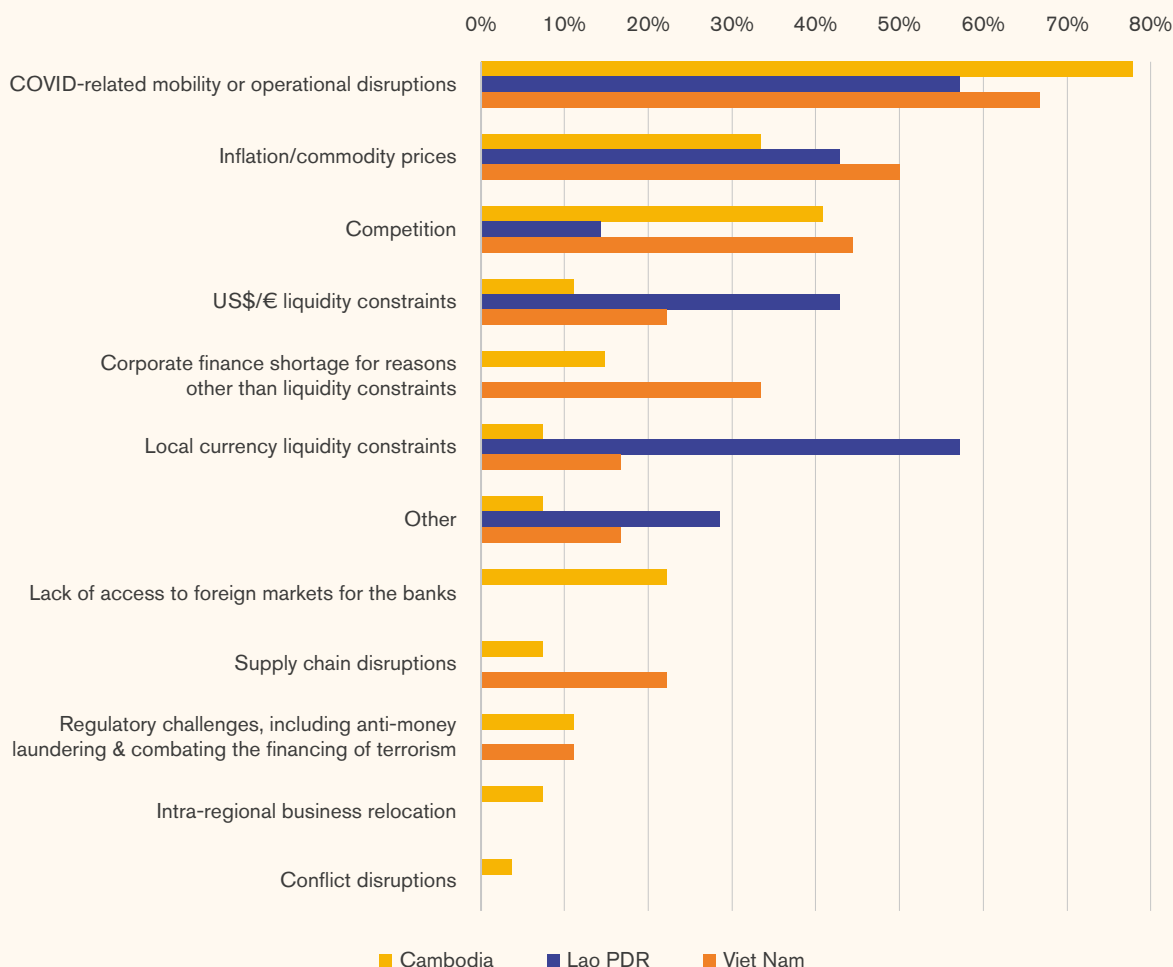
Trade finance constraints

The respondent banks identify constraints relating to the COVID-19 pandemic, the rise of inflation and strong competition between banks as factors which negatively

affected the growth of their trade finance portfolio in 2022 (see Figure 2.6). Around 60-80 per cent of respondent banks identified disruptions to mobility and operations due to the COVID-19 pandemic⁹ as the main constraint. Inflation and competition in the market were mentioned by some 40 per cent of banks in Cambodia and Viet Nam.

FIGURE 2.6

Main constraints to trade finance growth in the Mekong-3, 2022 (share of banks affected by each constraint, in per cent)



Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

Inflation and its heterogeneous dynamics across countries may impact trade finance markets, for example, when transaction ceilings are not adjusted to rising prices of traded goods or by reducing returns over time to working capital loans. In the Lao PDR, unlike in Cambodia and Viet Nam, access to local and foreign currency liquidity are reported as major constraints by 57 and 43 per cent of banks, respectively. Some 11 per cent of banks in Cambodia and Viet Nam report the regulatory environment as one of the top three constraints to trade finance growth, implying that a sound institutional environment is often a prerequisite for productive economic activities (Asteriou *et al.*, 2021).

Nevertheless, banks in Viet Nam are generally optimistic about future trade finance growth, with 78 per cent expecting growth in their activities in the year ahead. Banks' perception in Cambodia is less optimistic; only 56 per cent of the respondents expect an increase in their trade finance portfolio. However, 22 per cent of the banks did not provide information about their trade finance growth expectation. In the Lao PDR, the percentage is smaller, with 43 per cent of the banks expecting an increase within the 12 months following the survey, but with many missing values recorded among the banks surveyed in the Lao PDR.

The respondent banks rated the key constraints affecting their capacity to meet the trade finance demand of their customers on a scale from 1 to 5. The higher the rating, the higher the constraint. Limited availability of low-cost funding is the most constraining challenge, with an average rating of 3.3 out of 5 (see Figure 2.7). Constraints relating to internal risk rating and customer collateral requirements are second, with an average rate of 3.0. Increased correspondent bank requirements, new trade finance products entering the market, insufficient line limits from correspondent banks and a lack of information about market segments all scored above 2.5.

Supply chain finance and reverse factoring

Alleviating these supply-side constraints will help banks to support client requests better. Importantly, promoting modern trade finance instruments such as SCF/reverse factoring (see Box 1.1 in Chapter 1) has the potential to boost bank capacity to meet the demand of their customers. As discussed earlier, the intake of SCF is very low compared to traditional trade finance instruments. Only half of the banks in Viet Nam offer this product, compared to one in four in Cambodia and none in the Lao PDR (see Figure 2.1). The total SCF volume is estimated at US\$ 2.9 billion in Viet Nam, representing in relative terms 2 per

cent of the total trade finance portfolio and only 0.4 per cent of the respondent banks' total assets (see Table 2.4).

The numbers are significantly lower in Cambodia, where SCF is estimated at US\$ 40 million, which is equivalent to 2.4 per cent of the total trade finance assets and 0.1 per cent of the surveyed banks' total assets. Figures for both countries refer exclusively to local bank-intermediated SCF and can be considered a lower bound given that foreign banks and development finance institutions also provide this type of finance in Cambodia and Viet Nam.

The respondent banks report the need for technical and financial assistance to create trade finance capacity for instruments that they do not provide (see Figure 2.8). Overall, the request in Cambodia and Viet Nam is for help with more sophisticated products such as SCF and climate change abatement. Banks in Cambodia would also like to have technical and financial support for pre-export and equipment import financing.

Trade finance rejection rates

Viet Nam has a more dynamic and active trade finance ecosystem, while Cambodia takes a more risk-averse approach to trade finance business. The survey revealed that banks reject an average of 15 per cent of trade finance requests, which accounts for around US\$ 21 billion in unmet demand (see Table 2.5). The rejection rate varies significantly between Cambodia and Viet Nam. While the rate of 12 per cent in Viet Nam is in the same range as the average rate of 9.5 per cent for the emerging markets that participated in the IFC Global Trade Finance Program (GTFP) 2023 survey¹⁰, the 23 per cent rejection rate for Cambodia is twice as high. The 10 per cent rejection rate in the Lao PDR is the lowest of the Mekong-3. However, the insufficient sample size makes it difficult to consider this result representative.

These survey insights depict the different risk appetites and supply-demand balance in these two markets. Box 2.2 provides further evidence on the demand for finance from firms engaged with international trade in Viet Nam.



Rejections of trade finance requests are attributed to a lack of collateral, high credit risk and information asymmetry.

FIGURE 2.7

Key constraints on banks in the Mekong-3 to meet trade finance demand, 2022 (1 = not a constraint, 5 = top constraint)



Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

TABLE 2.4

Supply chain finance and reverse factoring, 2022

	Cambodia	Viet Nam
Supply chain finance/reverse factoring (US\$ billion)	0.04	2.9
Supply chain finance as share of trade finance	2.4%	2.0%
Supply chain finance as share of surveyed banks' assets	0.1%	0.4%

Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

The 2023 IFC firm-level survey of trade finance: How firms in Viet Nam finance trade operations

Firms' ability to finance their operations affects their participation in international trade. The riskiness and longer time lag in cross-border transactions require both financing of working capital over short horizons and insurance to protect against counterparty defaults.

Between June and August 2023, the IFC surveyed a representative sample of manufacturers and traders in Viet Nam that had engaged at least once in international trade between 2019 and 2021. The survey focused on how firms finance international trade, explored their demand for and access to trade finance products and captured heterogeneity by firm's characteristics and pricing conditions. Foreign affiliates indicated that they were producing only for the foreign parent company and did not need additional financing.

Trade finance need

Three out of four firms trading internationally report no need for trade finance. Exporters and importers report predominantly relying on internal funds to finance their working capital over external finance. This overreliance on internal funding is typically interpreted

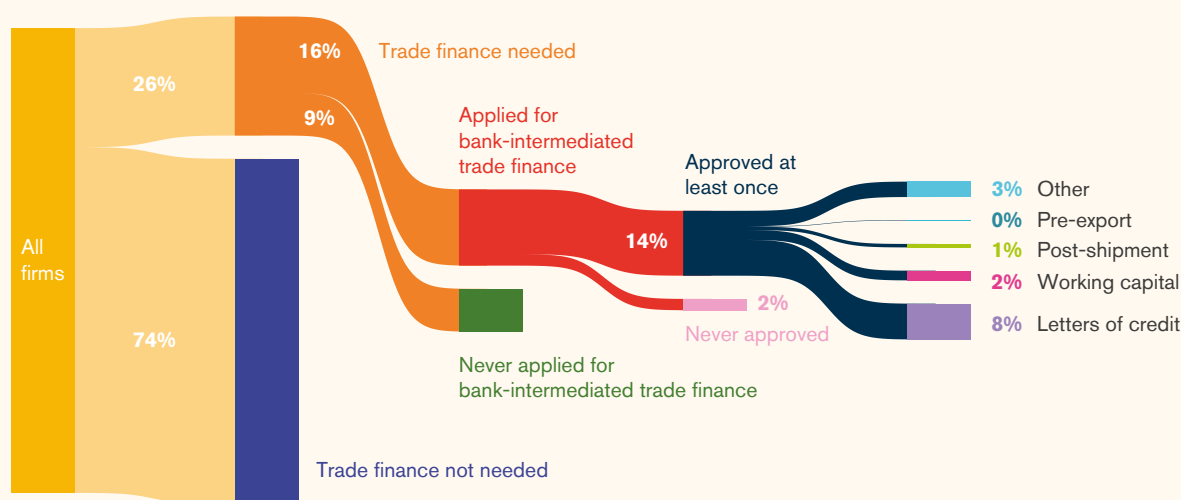
in the literature as evidence of credit constraints (Fazzari *et al.*, 1988, 2000). Despite the potential for trade finance to bridge the short-term capital gap, only 16 per cent of importers and exporters report having used trade finance.

Trade finance instruments

The use of trade finance leans largely towards traditional trade finance instruments. Mirroring the bank survey's results, firms report predominantly leveraging letters of credit (57 per cent), irrespective of firms' size, ownership type (domestic or foreign) or main sector of operations. General working-capital borrowing is the second most used and most demanded trade finance product, echoing the bank's survey results on the importance of working capital for trade.

The demand for other trade finance instruments is more sparse and likely to depend on specific firm characteristics. For example, bid/performance bonds are more likely used by domestic, trading small and medium-sized enterprises (SMEs). Non-traditional trade finance instruments such as supply chain financing are largely non-existent.

Trade finance use in Viet Nam (in per cent)



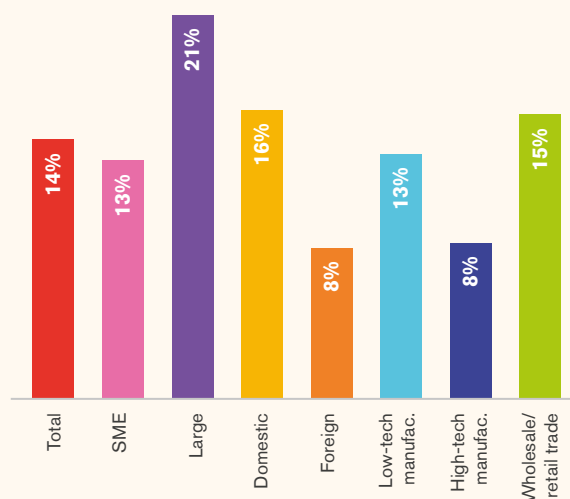
Source: IFC firm-level survey, 2023. The results presented are from an interim sample of 653 firms.

Trade finance use

Trade finance use differs significantly across different types of firm. Large firms (at least 100 employees) are over 65 per cent more likely to use external trade finance than firms with 5-99 employees. Perhaps more counterintuitively but consistent with the bank survey results, foreign-owned and high-tech manufacturing firms tend to use trade finance much less often: domestic companies are twice as likely to use trade finance than foreign-owned companies. Similarly, the share of wholesalers and retail traders using trade finance is almost twice that of firms in high-tech manufacturing.

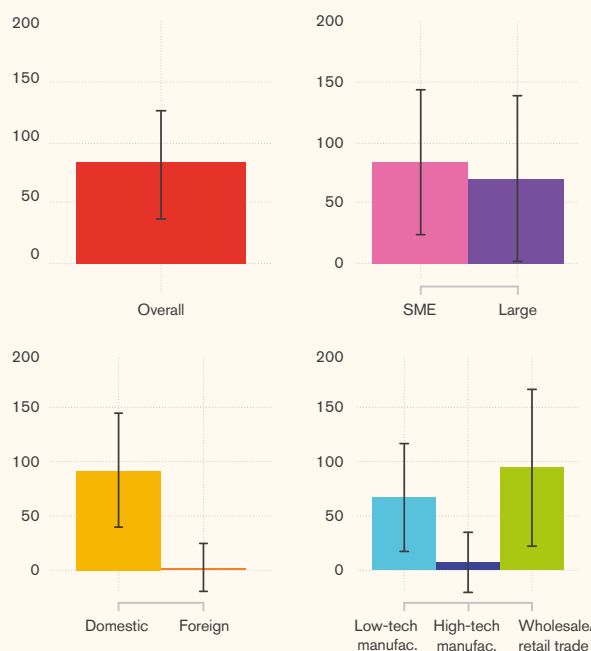
This differential use of trade finance likely reflects differences in the structure of supply chains as well as the differences in the risk-return profiles of firms or transaction types. For example, foreign-invested firms may receive financing from their parent company as well as having access to banks located outside Viet Nam. Firms in high-tech manufacturing, a sector likely dominated by electronics manufacturing, are the least likely to use bank-intermediated trade finance. This sector includes large subsidiaries or affiliates of multinationals that either have a lower need for working capital financing or are able to access finance from their parent companies.

Share of firms using bank-intermediated trade finance (in per cent)



Source: IFC firm-level survey, 2023. Results are unconditional means.

Collateral (in per cent of financing received)



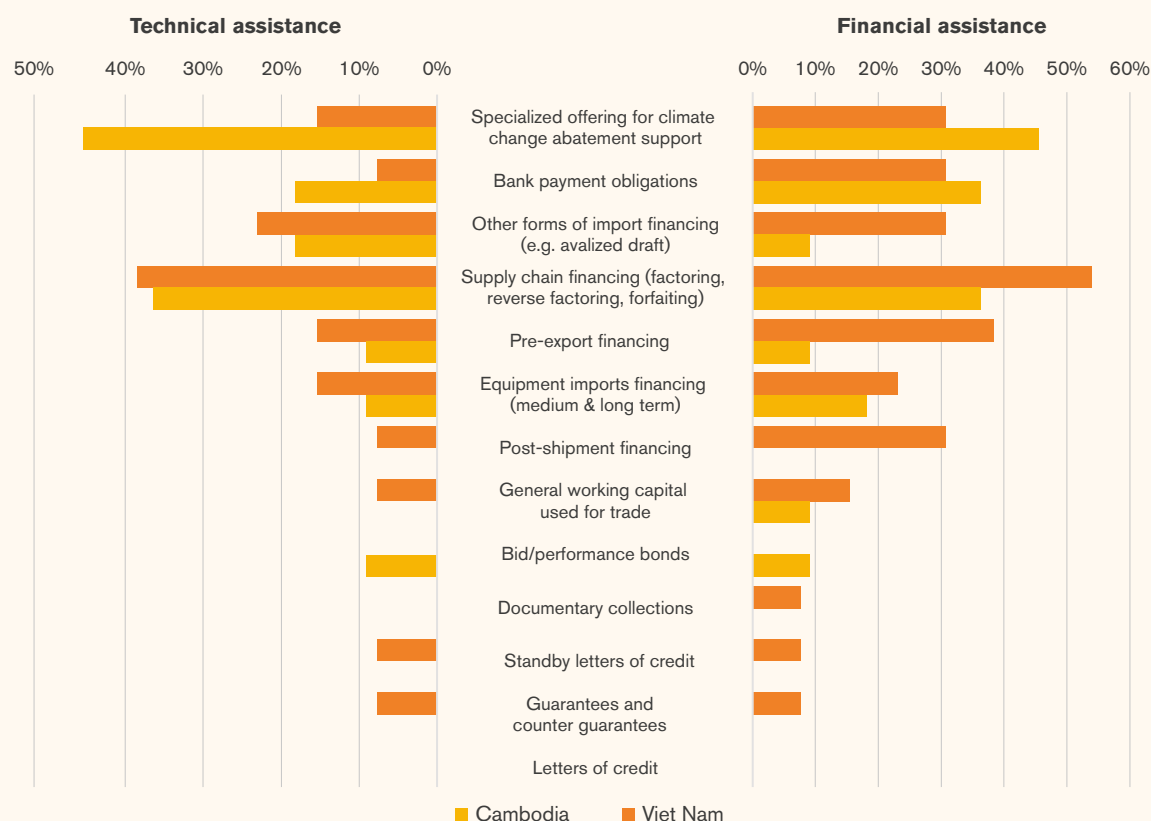
Source: IFC firm-level survey, 2023. Results are conditional on type of trade finance instrument.

Differences in firms' risk profiles are evidenced by the collateral requirements and approval time for trade finance applications. Foreign firms and firms in high-tech manufacturing have lower collateral requirements. The collateral requirement differential between SMEs and large firms is not as conspicuous, suggesting that foreign firms and firms producing electronics are likely to obtain better lending conditions, regardless of their size. More favourable lending terms are not limited to the lower cost of funds. Firms in high-tech manufacturing appear to have their trade finance applications approved significantly faster – at around one-third of the time required by firms in trade or low-tech manufacturing.

The speed in processing does not reflect differences in how firms file their applications. Irrespective of a firm's size or sector, most of the applications are filed on paper. This low usage of online processes, as well as the lack of more modern instruments, such as platforms or supply chain finance, suggests ample scope for improvements in efficiency in trade finance provision in Viet Nam.

FIGURE 2.8

Trade finance technical and financial assistance needs of respondent banks, 2022 (in per cent)



Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

TABLE 2.5

Trade finance gaps and rejection rates in the Mekong-3, 2022

	Total	Cambodia	Lao PDR	Viet Nam
Size of bank-intermediated trade finance (US\$ billion)	152	1.6	0.5	150
Average approval rate of trade finance requests	85%	77%	90%	88%
Average rejection rate of trade finance requests	15%	23%	10%	12%
Size of the trade finance gap (unmet demand) (US\$ billion)	20.8	0.5	0.05	20.3

Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

High rejection rates disproportionately affect SMEs, which are often unable to produce bankable credit files given that they frequently do not have established organizational structures, customarily struggle to produce and maintain records acceptable for financing, or lack sufficient collateral. The main rejection reasons given by the banks surveyed included: insufficient collateral (30 per cent); insufficient documentation (27 per cent); and high credit risk of applicants (see Figure 2.9).

The difficulty in assessing a client's credit risk and loan requests exceeding the client's limit are also important factors. In Viet Nam, an applicant's high credit risk and insufficient collateral are the primary reasons for rejecting a trade finance request, accounting for over half of rejections (see Figure 2.10). In Cambodia, insufficient documentation is the main reason why a third of credit applications are rejected. In the Lao PDR, half of the rejections were because of insufficient collateral, pointing to risk aversion and the low maturity of the local banking system.

Correspondent banking relationships

Broadly defined, a correspondent banking relationships (CBR) is where a bank has an arrangement with a third-party financial institution to receive services and/or act on its behalf in another jurisdiction. A bank's access to CBRs allows them to execute trade transactions regionally and globally. It is an important condition for being able to supply trade finance. Sufficient access to correspondent banking means, for example, that the local demand and clearance of international transactions in foreign currencies can be met, particularly in US dollars and euros, and that letters of credit can be issued and confirmed internationally.

In Viet Nam, around 29 per cent of the banks surveyed have fewer than 10 CBRs and 53 per cent have 10-50 corresponding banking relationships. Three Vietnamese banks display large numbers of 300, 641 and 1,163. The average number of CBRs per bank is 15 (excluding the three outliers). In Cambodia, the range of the numbers of CBRs reported is more homogenous, with a maximum value of 24 and an average of five relationships per bank. Therefore, access to CBRs is more of a constraint in Cambodia than in Viet Nam. Moreover, such access has been stable, with almost three quarters of respondent banks reporting no change in their network in 2022, and 16 per cent reporting an increase in access.



High rejection rates disproportionately affect small and medium-sized enterprises, which often lack sufficient collateral or struggle to produce and maintain financial records.

When asked about their main constraints in accessing CBRs, local banks report the increased regulatory requirements to combat money laundering and terrorism financing, insufficient line limits, increased cost of financing and tenor (i.e. repayment period) restrictions (see Figure 2.10).

Trade finance prices

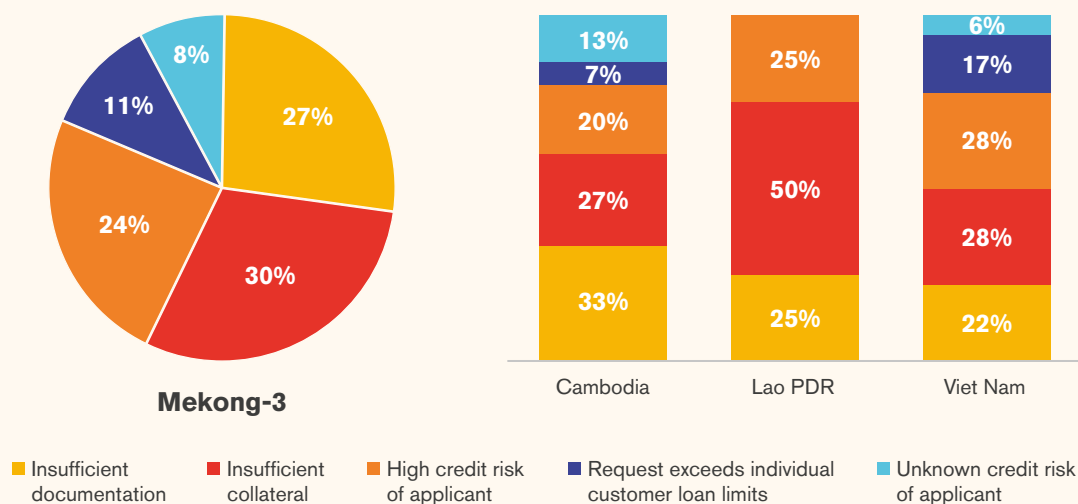
For letters of credit, banks charge fees to compensate for risk, which is affected by the credit history of the client, the country of operation, the nature of the transaction, its duration, as well as any foreign exchange risks. For trade loans, the cost of funds for the bank is an important element of pricing, along with the transaction's overall risk and the market structure.

Letters of credit fees in Cambodia and Viet Nam and interest rates on trade and working capital loans for traders are generally higher than the global emerging market benchmarks, as well as the rates observed in more advanced economies. The average fee for letters of credit in Cambodia and Viet Nam is reported to be 3.25 per cent of the transaction value – compared to a 2 per cent global average for emerging markets and a 0.25-0.50 per cent lower bound typically observed in advanced economies (see Table 2.6).

A short-term working capital pre-shipment finance is priced at around 8 per cent in Cambodia and 7 per cent in Viet Nam, while refinancing rates for import finance is between 6.25 per cent and 8 per cent (see Table 2.7). In Cambodia, prices for some types of letter of credit (post-shipment) can be as high as those of loans, which is in effect, discouraging their use in an already narrow market.

FIGURE 2.9

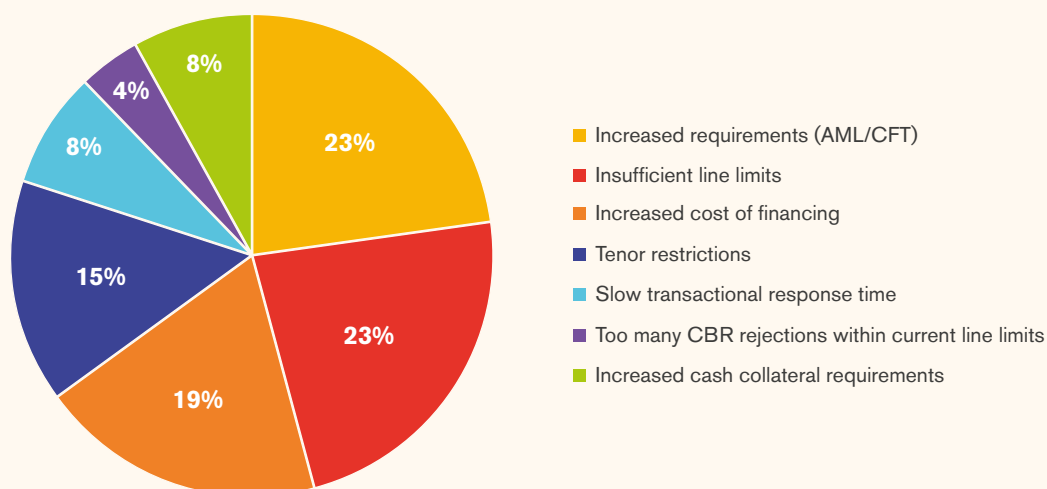
Main rejection reasons reported by banks in the Mekong-3, combined and by economy, 2022 (in per cent)



Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

FIGURE 2.10

Correspondent banking relationship constraints in the Mekong-3, 2022 (in per cent)



Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3. AML – anti-money laundering; CBR – correspondent banking relationship; CFL – countering the financing of terrorism.

TABLE 2.6

All-in prices for confirmed letters of credit, 2022 (in per cent)

	Cambodia	Viet Nam
Minimum	2.25%	1.20%
Average	3.25%	3.25%
Maximum	4.00%	5.00%

Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3. All fees are annualized, reported as a percentage of the transaction value charged per annum.

TABLE 2.7

Average prices for selected trade finance instruments, 2022 (in per cent per annum)

	Cambodia	Viet Nam
Cost of funds	3.50%	4.25%
Letter of credit post-financing	8.00%	6.25%
Export financing	8.00%	7.00%
Import financing	8.00%	7.00%

Source: IFC–WTO calculations based on the 2023 IFC survey of trade finance in the Mekong-3.

Endnotes

1. The estimates of local trade finance are expressed as a range and in the case of Cambodia and Viet Nam were produced using the methodology developed for the purpose of this publication based on the observation of a sufficiency large share of bank trade finance and total assets in the country (see Annex II for a description of the methodology). For the Lao PDR, the available data were insufficient to complete a regression-based estimation of the local trade finance market. A rough estimate based on reporting by banks accounting for 50 per cent of assets, assuming a proportional relationship between total assets and trade finance assets, would suggest that the country's trade finance market would be rather small, at around US\$ 0.5 billion.
2. Calculated as sum of exports and imports divided by GDP.
3. See <https://vir.com.vn/supply-chain-finance-a-solution-to-support-msmes-and-promote-the-economy-86403.html>.
4. Data on banking concentration are available from the World Bank Development DataBank (<https://databank.worldbank.org/home>).
5. This estimate is consistent with data previously collected by the SWIFT banking network prior to the COVID-19 pandemic. The International Chamber of Commerce (ICC, 2020a: 41) reports that SWIFT data show that Asia and the Pacific received 3.1 million letters of credit in 2019, more than any other region. Of this, Viet Nam received 106,114, a slight increase from 105,668 in 2018. According to ICC (2020a), the average value of import letters of credit in the region was US\$ 430,000. If this average is used for the number of Viet Nam's letters of credit, the total amount would be over US\$ 45.6 billion. A 2021 working paper by the International Monetary Fund finds that Viet Nam had one of the world's highest correlations between its import flows and the flows of letters of credit and documentary collections (Ghazaryan *et al.*, 2021).
6. See <https://vir.com.vn/supply-chain-finance-a-solution-to-support-msmes-and-promote-the-economy-86403.html>.
7. See General Statistics Office (2022: 388 and 394). While structured around the presence of large foreign corporations, the electronics sector in Viet Nam has a large eco-system of small companies and vendors operating local factories of parts (semi-conductor circuits, chips, camera modules, phone batteries) produced for local assembly and export of the final goods. Around 68 per cent of the 4,476 companies operating in the electronics sector employ fewer than 50 people; 84 per cent of companies employ fewer than 200 people.
8. Construction is generally a sector that imports a high volume of materials and therefore depends on trade finance.
9. While COVID-related constraints are in principle temporary, there can be delayed and persisting impacts to which the banks may be referring.
10. Based on global survey of over 100 IFC clients participating in the GTFP, which extends and complements the capacity of banks to deliver trade financing by providing risk mitigation in new or challenging markets.