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Conclusions *and* Recommendations

Photo: Cargo containers being offloaded at the port in Ensenada, Mexico © by Wayne via AdobeStock



Bank-intermediated trade finance is in short supply in the three countries studied: Guatemala, Honduras, and Mexico (CAM-3). Possible causes of this include high shares of related-party trade in the case of Mexico, the structure of trade and a less mature financial sector in the case of Honduras and Guatemala, and a history of conducting trade on open account across the region. As trade-related risks remain, export growth and deeper integration into global value chains in the CAM-3 are likely to increase demand for bank-intermediated trade finance. The same holds for supply chain finance (SCF) solutions to bridge payment gaps that may be riskier and costlier with new suppliers. Greater diversification of trade partners and routes, the entry of new traders, and increased export penetration especially within Latin America could drive demand for volume and innovation in the local trade finance market in the future.

Even though most large traders in the CAM-3, especially in Mexico, rely more on open account transactions and less on local bank-intermediated finance, local banks are essential for facilitating cross-border trade. Access to affordable working capital loans and the development of bank-intermediated SCF in particular can reduce financial risks for smaller trading firms and deepen the CAM-3's integration into value chains. Yet lending and related solutions remain expensive and often out of reach, as documented in Chapters 1 and 2.

Mexico's SCF market has benefited from regulatory and digital innovations, global value chain integration, and the presence of subsidiaries of large foreign banks with experience in SCF. In

contrast, Guatemala and Honduras rely more on traditional instruments, reflecting their relatively smaller and less mature banking and trade finance sectors. Sectoral and spatial coverage of bank-intermediated trade finance in the CAM-3 aligns with their international trade pattern. The trade loan interest rate spread over the monetary policy rate is lower in Mexico than in Honduras and Guatemala, reflecting cross-country differences in the structure and functioning of the banking sector. Macroeconomic instability, liquidity issues, and correspondent banking constraints are among the challenges facing CAM-3 banks, with Honduran banks reporting more severe constraints (see Chapter 2).

Complementary action by the corporate sector, financial institutions, national policymakers, and regional and multilateral development banks could help increase the uptake of trade and supply chain finance (TSCF) in the region, and address the constraints identified. Key recommendations for Mexico include regulatory harmonization with key trading partners to further grow SCF markets, as well as expanding the use of e-invoice and improving their registration procedures, available typically at the largest banks only. In Guatemala and Honduras building market awareness of financial product availability, promoting common sector-level operating infrastructure (e.g. dedicated electronic platforms), strengthening the capacity of banks, and the use of warehouse receipts would be more critical. Banks in these two countries voice greater need of liquidity support, advice on regulatory compliance, as well as the expansion of correspondent banking relationships for second-

tier banks. In all three countries, trade finance costs can be reduced by better assessing risks i.e. incorporating separate assessments of risk into banks' pricing of related lending.

Broader financial sector interventions that are not directly related to trade finance stand to benefit trade finance markets in many ways as well. Prime among them is better access and terms of financing for smaller firms, greater competition in the banking sector, and incentives to expand digitalization of bank operations.

Below are some key recommendations to help strengthen the TSCF sector in the countries studied.

4.1 Expand Supply Chain Finance Markets

SCF comprises a variety of financial products and solutions that can help smaller producers and service providers manage their cash flow and improve their financial stability, ultimately expanding opportunities for deep tier financing. Especially in Mexico, regulatory harmonization with key trading partners, and digital innovations such as e-invoice adoption by companies, are critical to upscale SCF provision. Combined with broader regulatory reforms at the level of government discussed below, various SCF products can be implemented, including receivables discounting, factoring, and pre-shipment finance.

At an earlier stage of development, SCF markets in Guatemala and Honduras would require pioneering action to address the needs of smaller enterprises and develop their linkages. Besides promoting

common sector-level operating infrastructure (e.g. dedicated electronic platforms) and services, examples of specific actions include building market awareness of financial product availability, modalities of use, and risks; and strengthening the capacity of banks and other supply chain participants to offer SCF products, and of trading firms to take advantage of them.

4.2 Harmonize and Modernize Regulations

Because outdated conditions and frameworks inadvertently generate barriers and risks for financial institutions, regulatory advances can facilitate SCF expansion and product development. Harmonization of the three countries' regulatory framework with key trading partners, combined with steps to fully digitalize invoices, can provide greater predictability to market participants and foster growth in trade finance. Improving the efficiency of the invoice registration process and facilitating real time invoice authentication through certification providers are further examples of action at the level of government. While Mexico and Guatemala are improving their registration procedures for factoring and e-invoices, these are available typically at the largest banks only. Honduras has undertaken such changes to a lesser extent: hard copies of documents are still required for legal actions despite e-invoice adoption.

The regulatory framework for warehouse receipts is another powerful tool to expand the range of options for commodity traders lacking collateral. The United Nations Commission on International Trade Law has adopted a model law governing

warehouse receipts for developing countries, which is particularly relevant to those rich in agricultural commodities like Honduras and Guatemala.

Warehouse receipt financing offers credit access: strong regulations protect depositors and lenders, ensuring enforceability and making these receipts valuable collateral. However, electronic warehouse receipts are not yet legally recognized, presenting opportunities for further digitalization. More advanced in this area, Mexico recently enacted regulation on digitalization of warehouse receipts.

At the frontier in this field, Brazil provides digital solutions for warehouse and inventory financing using blockchain, big data, and the Internet of Things. The Brazilian Financial Regulatory Warehouse Platform employs these technologies to constantly monitor cargo activity online.

4.3 Reduce Costs by Better Assessing Risks

In all three countries, the cost of trade finance is well above that country's monetary policy rate (see Chapter 1B and 2). Revisiting the pricing methodologies of trade finance-related products by incorporating separate assessments of risk into the pricing of related lending may be an effective way to reduce costs. Furthermore, insufficient foreign currency exchange is one of the major concerns voiced by banks, especially in Honduras.

Facilitating competition in the banking sector stands to reduce the costs of trade finance provision across the CAM-3. The provision of banking services to small businesses in Latin America remains generally expensive by

international comparison (World Bank 2020). While many factors contribute to high costs of financial intermediation in the region, restricted or distorted competition may be an important supply-side driver. Collaboration between competition and financial sector authorities aimed at fostering more evidence on the efficiency of financial services markets would be essential in a rapidly evolving landscape marked by technological advances.

4.4 Enhance Banks' Capacity

In Guatemala and Honduras, trade finance products have limited availability among smaller banks that may benefit from interventions that enhance their capacity to offer trade finance. This may involve actions such as liquidity support, advice on regulatory compliance, setting up mechanisms for collecting market intelligence and assessing risks, as well as the expansion of correspondent banking relationships for second-tier banks. International institutions, including regional and multilateral development banks, could help smaller banks in areas such as compliance. The involvement of international institutions could help reassure correspondent banks on counterparty risk, but more importantly, help alleviate the high cost that local lenders face to open new relationships and build bigger networks.

Greater adoption of environmental, social, and governance standards can also be incorporated in the design of trade finance instruments, with the help of international institutions. That kind of capacity building is most effective when provided to both banks and end users of trade finance.

Strengthening digital capabilities is an overarching objective of capacity building for banks and trade finance users as evidenced in Mexico where digital innovations, including artificial intelligence, have enabled automation of trade finance document examination. The region has significant potential to leverage digital infrastructure to make risks more predictable both for both banks and cross-border traders, irrespective of the economic activity concerned or trading partner.

4.5 Improve Firms' Access to Financial Services

Enhancing access to financial services more generally, particularly for smaller and women-owned firms, is critical to broaden the range of users of trade finance in the CAM-3 and to offer opportunities for further expanding TSCF markets. This is particularly important for smaller firms that may not have access to traditional financing options, especially in Honduras due to insufficient financial literacy. Despite adopting international standards, the documentation burden prevents smaller traders from benefiting from lower banking costs. Small and medium-sized enterprises struggle due to informality as well as difficulty in adopting necessary standards, which makes them rely more on alternative financing with higher interest rates. This is particularly the case for SCF products such as factoring, offered by Guatemala and Honduras' largest banks.

All stakeholders have an important role to play to improve firms' access to trade finance. Banks can benefit from tailored training; governments can facilitate risk-sharing facilities among traders and financial institutions e.g. by proposing first-loss guarantees; and smaller traders can benefit through greater participation in industry associations offering technical assistance and relevant knowledge sharing. Improving the perceived risk profile of smaller and women-owned businesses through better data collection on performance, business transactions, and credit as well as the systematic use of these data by financial providers is crucial. Digitalization offers vast opportunities to that end. The incorporation of improved assessments of their risk profiles into pricing and access of TSCF instruments can ultimately benefit both providers and users of trade finance.



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