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# **A preliminary review of policy responses to enhance SME access to trade financing in the Caribbean**

Sheldon McLean  
Don Charles



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## Abstract

The economies of the Caribbean face several challenges, such as a lack of economies of scale in production of goods and services exacerbated by small populations, narrow internal markets and scarce capital, which limit the economic gains from self-sufficiency. For this reason, more emphasis should be placed on building export capacity and facilitating trade. If we examine the characteristics of firms in the subregion, the majority can be categorized as small and medium-sized enterprises (SMEs). Moreover, only about 13 per cent of these SMEs export. This suggests that on average the subregion is not utilising its potential to generate gains from international trade.

Access to finance is a key factor that hinders the subregion's small businesses from developing their export capacity. Given the importance of business finance, this study explores the factors that limit the subregion's entrepreneurs from accessing finance and makes policy recommendations to address this challenge.

Among the recommendations is the need to institute where absent, and to broaden where already in existence, government guarantee programmes, mutual guarantee schemes, diaspora financing, group financing and lease financing initiatives which are tailor-made to the peculiar characteristics and needs of sub-regional SMEs. It may also be necessary to sensitize SMEs to the issue of de-risking and the need to ensure transparency as well as adherence to know your customer (KYC) requirements of financial institutions. However, in order to ensure success, particularly in respect of spurring sustained economic growth and employment, it is important that these measures incentivise SMEs to engage in the production and export of goods and services for which the subregion has comparative advantage, can increase market share in dynamic markets and for which there is potential for intra-industry commerce.





## Introduction

Caribbean economies face a wide range of challenges including low growth, high debt, and vulnerabilities from natural disasters (McLean et. al 2019). (They also rank poorly in the Global Competitiveness Index (Schwab and Sala-i-Martin, 2015).<sup>1</sup> .These small domestic markets make it difficult for firms to derive economies of scale and scope in production and distribution (Henry and Miller, 2009; Harris, 1997; Wint, 2003). Furthermore, often the domestic business climate is excessively vulnerable to external macroeconomic shocks (e.g. demand and price), and conditioned by weak access to trade finance<sup>2</sup>. In addition to other factors such as the absence of the necessary robust trade facilitation and trade-related economic infrastructure, weak trade finance is a notable obstacle to building export capacity.

International trade can spur competitiveness which encourages reallocation of resources from less productive companies and sectors to more efficient ones. International trade can also fuel economic growth as exporting companies are forced to become innovative in order to remain competitive. International trade can also incentivize investment in activities that encourage technological dissemination and generate spillover effects in knowledge transfer (Garone and Maffioli, 2018).

As firms increasingly integrate into the multilateral trading system, they invariably require finance (credit) to facilitate the requisite increased investment for expanding productive capacity. While large private sector firms may readily access the required financing, this is not always the case for small and medium-sized enterprises (SMEs).

SMEs play a crucial role in the economic development of Caribbean economies. Collectively, they generate about 40 per cent of the Caribbean subregion's Gross Domestic Product (GDP). They

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<sup>1</sup> The Global Competitiveness Index measures a country's competitiveness by assessing its performance on twelve pillars of competitiveness. These pillars include: institutions, infrastructure, macroeconomic framework, health and primary education, higher education and training, efficiency of goods markets, efficiency of labour markets, development of financial markets, ability to harness existing technology, market size, production of goods using the most sophisticated production processes, and innovation.

<sup>2</sup> Trade finance is defined as the finance required to enable an economic agent to engage in international trade.

constitute over 95 per cent of companies in the Caribbean subregion. However, only 13 per cent of these SMEs export (Coke-Hamilton, 2013). This is partially attributable to the fact that many Caribbean economies increasingly lack the necessary fiscal space to fund key policy initiatives necessary to support the development of the export potential of SMEs. Furthermore, SMEs in the Caribbean generally continue to face a number of constraints which limit their ability to acquire the necessary level of trade finance from lending agencies. For example, subregional SMEs tend to have a limited ability to produce bankable business plans supported by economically viable financial projections. Another constraint is the relationship between lending institutions and SMEs which is often characterized by a knowledge gap between the principal(s) of the SME and the lending institution in respect of the growth and earning potential of the particular venture (and/or attendant sector) being undertaken by the SME. A third constraint is the practice of banks to assess credit risk based on the credit history and accumulated wealth of the small business owner, completely ignoring the prospects of the SME (ITC 2010).

The efforts of SMEs to export goods and services are also further constrained by their inability to access the necessary financial resources to overcome (i.e. satisfy the requirements of) non-tariff measures<sup>3</sup> (in the case of goods) and regulations (e.g. economic needs tests in the case of services). In addition, the capacity to effectively conduct the necessary market research and generate key market intelligence has long been a challenge for these businesses. These factors are central to successful market penetration in the current international trade environment where behind-the-border measures are increasingly dominating the trade-related policy landscape.

This scoping study examines the constraints to trade financing for SMEs in the Caribbean subregion and suggests initial policy responses aimed at enhancing SMEs access to trade related finance which is seen as a prerequisite to increasing the number of SMEs engaged in external trade and at encouraging further research.

Following a review of the characteristics of SMEs in the Caribbean, the paper provides an overview of the financial sector and typical financial institutions operating in the Caribbean. An examination of the reasons that SMEs have been unable to access trade finance follows. The paper then explores the financing options present in some Caribbean countries (Trinidad and Tobago, Barbados, Jamaica, and the Eastern Caribbean), and proposes policy recommendations which can assist Caribbean SMEs engage in international trade. Finally, policy recommendations and suggestions for the way forward are offered.

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<sup>3</sup> Government measures other than tariffs that restrict trade flow, which include health, food safety and quality-related measures; sanitary and phytosanitary (SPS) measures; standards and technical regulations such as packaging and labelling requirements among others.

## I. Characteristics of the SMEs in the Caribbean

The definition of small and medium-sized enterprises (SMEs) varies across the Caribbean. Some definitions use classification based on the number of employees and the number of assets held, as in Guyana, Jamaica, and Trinidad and Tobago. Others focus on revenues received by the organization, as in Belize. Regardless of the criteria, the majority of SMEs in the Caribbean are categorized as “*own account*” operations with one owner-operator. Moreover, the SMEs generally share similar characteristics: a high degree of informality, labour intensive, production in the household, small-scale, and targeting mainly the domestic market (Wenner and Chalmers, 2001). A definition by Jin and Zhang (2019, 1330) adequately describes SMEs:

*“SMEs refer to natural person enterprises and legal person enterprises with small production scale, small number of employees and assets, including small enterprises, micro-enterprises, family workshop enterprises as well as individual industrial and commercial households”.*

For the purposes of this scoping study, an SME is defined as a business enterprise owned by an individual, a partnership, or related persons, that produces goods and services. It is not a large-scale limited liability company, which has a board of directors and a formal corporate structure.

Although the employment share differs for each country, on average, SMEs account for 45 per cent of the employment creation in the subregion (Kistow, 2017). The CDB (2016) pointed out that as at December 2015, some 200,000 registered SMEs and at least 550,000 informal ones were operating in its eight borrowing member countries (BMCs), Antigua and Barbuda, Barbados, Belize, Guyana, Jamaica, Trinidad and Tobago, St. Lucia and Suriname. The Association of Caribbean States (ACS) (2011) notes several characteristics of the SMEs in the Caribbean. They include:

- (i) Some SMEs operate in rural areas.
- (ii) A large portion of the final products produced by SMEs are basic goods that are frequently consumed, such as food, clothing, and housing.

- (iii) SME's frequently innovate as they produce differentiated products (in other words, their products are similar, not homogenous).
- (iv) Between 35 and 50 per cent of the SMEs are owned and run by women.

The ACS (2011) also notes that the SMEs tend to pursue business opportunities in the following sectors, listed from the highest to the lowest:

- services;
- distribution;
- food processing;
- hospitality;
- building material, machinery and manufacturing;
- agro-industry and fishing;
- accounting, information technology, and financial services;
- printing, advertising, packaging, and labelling;
- wood and metal fabrication; and
- shipping and storage.

Caribbean SMEs also participate in the art and craft and music industries, and other sub-sectors of the creative industries.

Compared with other developing countries, Caribbean SMEs appear to have a lower export participation rate. For example, approximately 13.4 per cent of the Caribbean subregion's SMEs engage in export activity (Suominen and Martincus 2013). However, the export participation rates for SMEs in Latin American economies are much higher; in Argentina it ranges between 30 per cent and 40 per cent; for El Salvador between 25 per cent and 30 per cent; and in Peru approximately 20 per cent (Duvaland and Utoktham 2014). Export participation rates for SMEs are even higher in Asia; consider South Korea (18.9 per cent), Thailand (47 per cent) and Malaysia (54.7 per cent). Furthermore, Caribbean SME exporters tend to be 'narrow' exporters, that is, they export a relatively small number of products, and to a few destinations (Suominen and Martincus 2013).

This weak propensity to export is not entirely attributable to an absence of predictable, preferential market access opportunities provided through trade agreements. In fact, as part of the subregion's customs union, the Caribbean Community (CARICOM), several Caribbean countries have preferential market access to several countries. Indeed, CARICOM has negotiated and signed bilateral preferential trade agreements (PTAs) with:

- Colombia (July 24, 1994, and which entered into force on June 1, 1995);
- Costa Rica (signed on March 9, 2004);
- Cuba (signed on July 5, 2000);
- the Dominican Republic (signed on August 22, 1998, and provisionally entered into force in December 2001); and
- Venezuela (signed on October 15, 1992, and entered into force on January 1, 2000).

CARICOM has also negotiated a regional economic partnership agreement with the European Union (EU), the CARICOM-EU EPA. Many CARICOM countries have also negotiated bilateral Partial Scope Agreements (PSAs). Within the subregion, the Commonwealth Caribbean countries also have nonreciprocal Preferential Trade Agreements (PTAs) with Canada, under the Caribbean Canada Trade Agreement (CARIBCAN)<sup>4</sup>. The broader group of Caribbean countries also benefit from nonreciprocal preferential trade with the United States (US), under the Caribbean Basin Initiative (CBI)<sup>5</sup>.

These trade agreements in principle provide the Caribbean, and the CARICOM Member States with preferential access to the markets of various countries. In practice, however, many of these export markets are protected by myriad non-tariff measures, which may strengthen over time as trade tensions spurred by emerging protectionist sentiments globally take hold. Furthermore, preferential market access does not automatically result in market penetration, particularly since many of these agreements were negotiated without the active participation of the subregion's private sector and so were not tailored to address the peculiar needs of the majority of SMEs in the Caribbean.

Moreover, these bilateral trade agreements also often have not considered the issue of trade complementarity, i.e. the extent to which the import structure of the bilateral partner matched the export structure of Caribbean economies. Nor has there been a robust consideration of the export interests or emerging areas of comparative advantage of the subregional private sector. The end result has been that in most instances the trade agreements negotiated preferences for industries where the policy makers believed that individual countries of the subregion as a whole should develop, and not necessarily the industries in which SMEs showed interest or have been flourishing in production and trade.

Consider, for example, that the subregion's comparative advantage has increasingly been in the area of services. Yet only the CARIFORUM-EU Economic Partnership Agreement (EPA) has enshrined provisions for the liberalization of services trade. This is extremely relevant since ECLAC research has shown that much of the long-run variation in economic growth, even for goods producing Caribbean economies such as Trinidad and Tobago (53 per cent), can be attributed to services exports. Furthermore, even though the majority of businesses in the subregion are SMEs, trade agreements were not structured in way to assist SMEs in enhancing their export opportunities. As a result, there now exists a myriad of trade agreements, but no real increase in market penetration. This is demonstrated by the low utilization rates of many of the subregion's trade agreements.

If Caribbean SMEs are to increase their exports, they must of necessity become familiar with distribution channels, administrative procedures and regulatory requirements, among other things. This requires market research, an area in which many sub-regional SMEs have neither the expertise to pursue nor the resources to purchase or outsource such research. SMEs seeking to export also need to meet international quality standards, especially for the export of food and agro-processed goods, including labelling requirements. SMEs, like all other exporters must also ensure that they can produce sufficient quantities to meet their clients' demand, while coping with arrangements for shipping,

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<sup>4</sup> CARIBCAN was signed in 1986 between Government of Canada, the CARICOM Member States. As a nonreciprocal PTA, CARIBCAN is not consistent with the World Trade Organization's (WTO's) principles on non-discrimination. Therefore, Canada requires a WTO Most Favoured Nation (MFN) waiver to grant non-reciprocated preferential treatment to the CARICOM Member States (Deonarine et al. 2016). CARIBCAN was scheduled to expire on December 31, 2013. However, Canada successfully requested a waiver from the WTO to extend CARIBCAN for up to 10 years after its expiration date. Therefore, CARIBCAN will expire in 2023 (BCCI, 2018).

<sup>5</sup> The US offered unreciprocated preferential market access to the Caribbean region under the CBI in 1984. The CBI was launched in 1983 through the Caribbean Basin Economic Recovery Act (CBERA). It was later expanded in 2000 through the US-Caribbean Basin Trade Partnership Act (CBTPA) and again by the in the Trade Act of 2002. CBERA took effect from January 1, 1984 and has no set expiration date. The CBTPA is scheduled to expire on September 30, 2020 (Oustr 2018). CBI is also inconsistent with the WTO's principle of non-discrimination and MFN. The US successfully obtained an MFN waiver from the WTO to extend the CBI, however, the waiver is scheduled to end by December 31, 2019 (The Daily Observer, 2019).

storage, logistics and other services. These represent key items of expenditure which every SME may not be able to cover out of pocket.

This contrasts significantly with larger export-oriented businesses and conglomerates which may easily seek pre or post-shipment financing or other lines of credit from commercial banks and other financial intermediaries to cover the costs associated with engaging in international trade. SMEs invariably are unable to access such facilities. Indeed, trade credit, where goods and services are supplied before payment, may also not be readily available to SMEs (World Bank, 2018a).

## II. Overview of the financial sector and financial institutions in the Caribbean

### A. Overview of the Caribbean's financial sector

The financial sector plays an important role in the growth and sustainable development of an economy through financial intermediation. In the Caribbean, domestic credit to the private sector typically accounts for approximately 50 per cent of GDP, while domestic credit to the public sector tends to account for less than 5 per cent of GDP. Table 1 provides an overview of credit to the private and public sectors.

**Table 1**  
Credit to the Caribbean private and public sectors, 2016-2017  
(Per cent of GDP)

	Private Sector Credit		Public Sector Credit		Lending	Deposit	Spread
	2016	2017	2016	2017	2017	2017	2017
Anguilla	73.36	74.56	-13.1	-14.3	9.90	2.21	7.69
Antigua and Barbuda	48.91	45.87	10.4	10.3	9.01	1.62	7.39
Bahamas	52	49.06	24.8	23.4	11.75	0.97	10.78
Barbados	60.35	59.66	41.2	42.7	6.56	0.00	6.56
Belize	55.24	54.28	14.4	16.1	9.34	1.2	8.13
Dominica	50.84	51.69	-25.2	-28	7.96	1.60	6.36
Grenada	54.3	51.59	-10.8	-11.6	7.99	1.32	6.67
Guyana	30.28	30.54	1	3.7	10.47	1.11	9.37
Jamaica	23.92	20.69	6.8	7.2	14.59	0.99	13.59
Montserrat	47.94	49.13	-56.7	-49.6	6.88	1.12	5.76
Saint Kitts and Nevis	59.51	58.12	-23.4	-21.7	8.41	1.77	6.64

	Private Sector Credit		Public Sector Credit		Lending	Deposit	Spread
	2016	2017	2016	2017	2017	2017	2017
Saint Lucia	72.18	68.97	-6.1	-7.8	7.99	1.47	6.52
Saint Vincent and the Grenadines	52.46	51.65	-1.9	-0.5	8.58	1.82	6.76
Suriname	38.93	31.21	13.4	16.8	14.30	9.10	5.20
Trinidad and Tobago	35.85	37.44	-0.7	1.7	8.20	0.62	7.58
Caribbean	50.4	48.96	-1.7	-0.8	9.46	1.79	7.67
Goods Producing	40.08	38.37	7	9.6	10.58	3.01	7.57
Service Producing	54.16	52.82	-4.9	-4.5	9.06	1.35	7.70

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

The financial sector can be evaluated on its efficiency and depth. Financial efficiency can be assessed by the margin between the cost of mobilizing liabilities and returns on assets, or the interest spread (Wenner and Proenza, 2003). As can be seen in Table 1, the Caribbean subregion has large interest rate spreads. On average, the lending rate tends to be around 9 per cent, and the deposit rate below 2 per cent. Therefore, the interest rate spread is often in excess of 7 per cent. The high interest rate spread is indicative of inefficiency of bank intermediation in the Caribbean subregion.

In this respect, Tennant and Folawewo (2006, 2) elucidates that “if the banking sector’s interest rate spread is large it discourages potential savers due to low returns on deposits and thus limits financing for potential borrowers”. Wenner and Proenza (2003) further notes that small financial margins (interest rate spreads) are important because they contribute to economic growth by reducing lending rates and the cost of investment. Moreover, tight interest rate spreads reflect a relatively competitive financial sector which is highly responsive to price changes.

Due to the high costs of intermediation between savers and borrowers, only a fraction of the savings mobilized by banks can be finally channelled into investments (Valverde et al., 2004).

With regard to the notion of financial depth, Wenner and Proenza (2003) note that countries with more developed financial markets and greater financial depth, measured by the ratio of M2 (quasi-money) to GDP, are likely to experience faster growth than financially shallow economies (i.e. countries where the ratio of quasi-money to GDP is relatively low). Greater access to finance facilitates greater investment, which in turn generates economic growth.

In the Caribbean economies the financial depth tends to be around 68 per cent. Moreover, over the past ten years, credit to the private sector (as a percentage of GDP) has been declining in the Caribbean even as the financial depth of Caribbean economies has increased. This can be seen in Table 2 and Figure 1 below.

**Table 2**  
Financial depth indicated by the ratios M1 and M2 to GDP, 2016-2017  
(Per cent of GDP)

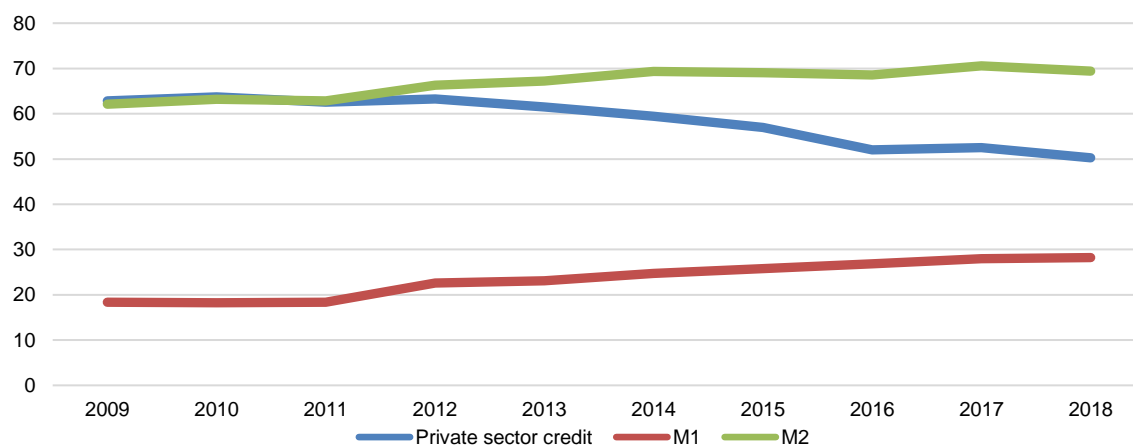
	M1		M2	
	2016	2017	2016	2017
Anguilla	7.26	8.39	33.78	34.83
Antigua and Barbuda	20.06	22.36	73.2	73.8
Bahamas	20.33	22.58	84.37	82.05
Barbados	51.92	50.95	32.57	31.13
Belize	40.43	42.13	81.04	79.05



	M1		M2	
	2016	2017	2016	2017
Dominica	19.26	28.85	85.64	105.6
Grenada	20.26	20.69	69.96	68.09
Guyana	20.02	21.43	48.51	50.02
Jamaica	11.87	10.9	21.38	24.23
Montserrat	37.12	35.69	141.41	137.37
Saint Kitts and Nevis	23.1	22.11	84.78	81.54
Saint Lucia	19.1	19.68	62.35	60.82
Saint Vincent and the Grenadines	23.22	22.32	69.64	68.57
Suriname	34.14	30.95	80.81	70.25
Trinidad and Tobago	30.51	29.4	59.59	57.96
Caribbean	25.24	25.9	68.6	68.35
Goods Producing	31.27	30.98	57.76	64.82
Service Producing	23.05	24.05	69.01	69.82

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

**Figure 1**  
Credit to the private sector, M1 and M2  
(Per cent of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

The largest asset holders of the subregion, commercial banks, generally exhibit a propensity to supply mainly short-term credit. Their longest-term credit offered to individuals is typically in the form of mortgages, and this tends to be restricted to workers with permanent jobs or secured forms of income. While these financial institutions do offer myriad purpose driven short to medium-term credit for example, car loans, consumer credit and personal loans for Carnival or Christmas, financing in the Caribbean is especially deficient in two areas: term financing for all businesses, and all types of financing for small businesses (Brewster, 2006; Holden and Howell, 2009; Tennant, 2009). The domestic institutions tend to use correspondent banks to facilitate cross-border transactions, while the foreign banks mainly use one of their subsidiaries. There is little movement of financial capital from one Caribbean country to another (Holden and Howell 2009), which has a dampening effect on cross-border

investment that could otherwise provide an important source of trade finance for Caribbean SMEs thereby facilitating, among other things, intra-industry intra-regional trade between Caribbean firms.

## B. Financial institutions in the Caribbean

There are many financial institutions operating within the Caribbean. In this regard, **commercial banks** act as the main source of credit for the private sector, domestic business and consumers in the Caribbean. They are typically driven by the motive of maximizing returns to shareholders and therefore with respect to trade-related lending tend to focus on large entities, which have been established for a long (over 10 year) period of time. Sole traders, and small businesses therefore typically experience difficulty accessing business-related lines of credit in general, and trade financing in particular, from commercial banks.

Moreover, credit to the private sector in the Caribbean has been declining, despite excess liquidity in the sub-regional commercial banking system, which hampers investment and industrial restructuring. In keeping with their tendency towards risk aversion, commercial banks in the Caribbean are increasingly paying considerable attention to expanding consumer credit and reducing the level of non-performing loans. As at June 2019, the credit to the private sector stood at 47.6 per cent of GDP contracting from 50.4 per cent of GDP at the end of 2016.

In contrast, **credit unions in the subregion** are focused principally on the mobilization of finance for their members. Each credit union is governed by its members. Although like banks, credit unions accept deposits, and offer some of the financial services associated with commercial banks<sup>6</sup>, their structure is decidedly different. The membership elects its directors, whom in turn develop policies that determine how the institution operates. Voting within the credit union is performed on a one-member, one-vote basis, ensuring that every member has an equal voice regardless of the size of their savings.

One of the biggest differences between a credit union and a commercial bank, lies in the non-requirement of credit unions to satisfy shareholders' profit expectations. This difference results in credit unions being more accommodative in providing loan finance<sup>7</sup>, particularly for small business ventures, in contrast to a commercial bank seeking to maximize profits. Credit unions exist to help their members achieve their economic and social goals. Any profit made by the credit union is distributed to the members as dividends for their shares (McKillop and Wilson, 2011).

More importantly, **microfinance institutions in the subregion** are commonly established to provide small loans, often no more than a few thousand dollars, to sole proprietorships, and SMEs. Microfinance institutions invariably rely only on soft (non-quantifiable) information about the borrower to grant loans. This type of financing is suitable for SMEs in the Caribbean, as they are informationally opaque and lack significant amounts of assets that can be pledged as collateral (Senior, 2012).

Several credit unions in the Caribbean also provide microfinance to their members. These small loans can be used for start-ups, and the development of business opportunities for sole traders and small business owners.

Apart from commercial banks, **development banks** operate widely in the Caribbean. Development banks typically focus on financing development projects and programmes in countries. While there are several well-known international development banks which serve many countries and

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<sup>6</sup> These services include savings accounts, credit cards, and online banking (Griffith et al. 2009).

<sup>7</sup> The loans offered by credit unions tend to have lower interest rates than commercial banks. Additionally, credit unions are more flexible than banks with respect to the repayment of loans, and loan refinancing (Griffith et al. 2009).

jurisdictions, there are a few international or regional development banks that target only the Caribbean subregion.

**Financial and securities exchanges** have existed in the Caribbean since the 1969 creation of the Jamaican Stock Exchange. The securities exchange offers a very narrow range of products for trade. They do not offer derivatives, such as futures, options, and swaps. They offer no opportunity to trade commodities, despite the fact that the subregion produces oil, gold, and primary agricultural products. They also do not allow traders to undertake short-selling<sup>8</sup>.

Further, several authors (Sargeant, 1995; Craigwell et al., 1996; and Thomas and Watson, 2006) have described the stock markets in the Caribbean subregion as inefficient, performing disappointingly, and still in an underdeveloped state. Despite the growth in the number of securities exchanges in the Caribbean subregion over the past 5 decades, overall, they are underdeveloped and remain quite passive compared to those of the developed countries. They are small and characterized by a few market players. Some exchanges, for example, the TTSE, do not facilitate online trading, therefore potential traders must go to the offices of brokers to place orders. This notwithstanding, there is still potential for owners of businesses to raise financial capital through the existing securities exchanges.

In view of the foregoing, it may be useful at this juncture to examine more closely issues relating to the inherent rigidity of the financial sector of the Caribbean, which may act as an obstacle to SMEs access to trade and other related forms of finance.

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<sup>8</sup> Short selling is a practice where a trader can sell the asset before buying it back to cover and close the order.



### III. Rigidity in finance for the Caribbean SMEs

Research suggests that SMEs in the Caribbean subregion face three major difficulties in and/or threats to obtaining finance which include the effect of de-risking, restrictive lending regulations and asymmetric information. The most pertinent of these will be discussed in this chapter.

#### 1. Spillover effect of de-risking

In the mid-2015, many financial institutions in the Caribbean began to experience de-risking. In the aftermath of the 2008 global financial and the 2010-2011 Eurozone crises, several regulatory jurisdictions have strengthened their financial sector regulation, supervision, and risk management to increase the resiliency of financial institutions. More specifically, regulators are seeking to curb money laundering and the financing of terrorism with stricter anti-money laundering (AML), countering the financing of terrorism (CFT) and know-your-customer (KYC) regulations.

The compliance with AML and the CFT regulations is expensive, particularly due to the regulations differing across jurisdictions. Furthermore, the high penalties that banks face for the financial infractions decrease their profitability. Several global banks have responded to this new compliance risk challenge by de-risking. Although the term “de-risking” refers to the strategies adopted by a bank to reduce its risk exposure to the assets in its portfolio, in the context of this new challenge, the de-risking refers to the intentional termination of correspondent banking services (CBS) for clients or groups of clients which may be categorized as “high risk”.

The CBS offer small Caribbean banks access to international finance and their customers access to the wider global economy. The complete loss of CBS would make it impossible to conduct any international transactions, which would impact on trade, remittances and investment. An ECLAC study revealed that the withdrawal of CBS has eroded the access to financial services of businesses and households, heightening economic uncertainty across the subregion. De-risking has led to supply shocks through the channel of higher costs for financial services (Metzgen, McLean et al., 2018). The withdrawal of CBS has also led to higher costs for the main sector in the subregion—tourism, at a time when these tourism sectors are under considerable stress. Moreover, de-risking has potentially

threatened the existence of the offshore financial sectors (OFCs), money transfer service providers (MTSP) and in Belize, the Export Free Zones.

Credit unions, the traditional provider of financial services to MSMEs and small entrepreneurs are also stressed by the withdrawal of CBS. Collectively, the effects of de-risking, which had begun to spill over into the real sector in the Caribbean, raised not only borrowing but also operational costs to many SMEs (as individuals and businesses alike sought to follow KYC requirements), leading to the de-banking of some small businesses operating in what were considered to be high risk sectors. While the situation has stabilized somewhat in recent times with the entry of the Crown Agents Bank of the United Kingdom into the subregional market, offering correspondent banking services, the situation still remains somewhat fragile.

## **2. Restrictive lending regulations**

In many Caribbean countries, secured lending is usually governed by their respective Companies Act, and generally requires business owners to pledge their entire asset base to one lender. For example, if land is used as collateral for trade or other credit, the landowner would be required to pledge the land to one creditor rather than using that land as collateral for multiple creditors. This is also a rigidity in the Caribbean's credit system as it restricts the ease with which borrowers may switch lenders.

The rigidity in lending is also partially due to legal restrictions imposed on banks to regulate their lending without capital. A report notes the following restriction in Jamaica:

"The Banking Act states that a bank shall not lend to an individual in excess of 20 per cent of its capital base but not more than 5 per cent of its capital base on an unsecured basis. If a bank is lending to a group, it cannot lend in excess of 40 per cent of its capital base or more than 10 per cent on an unsecured basis. Connected persons are also restricted from borrowing on an unsecured basis. The capital base of a bank is therefore important in determining how much secured and unsecured lending it can do. Lenders also cite inadequate legal and regulatory framework as a hindrance to the process of lending money to small businesses" (Senior, 2012, 24).

## **3. Asymmetric information**

Asymmetric information describes a situation where one party to a transaction possesses greater material knowledge than the other party. In the case of a small business venture, the business owner is likely to know the business operations, and the potential risks as well as returns in greater detail than the appraising officer.

To compensate for the uncertainty fuelled by the asymmetry of information, it is standard practice for the banks to look at a borrower's credit history as well as financial statements. Unfortunately, however, many SMEs don't possess financial statements to verify present income. Moreover, where a business is not presently generating income, the future income of the business would be an appropriate metric to financial viability. However, many SMEs are unable to prepare business plans, perform net present value evaluations, or derive other financial performance metrics. Furthermore, they may be unable to retain a professional to conduct these assessments. Consequently, commercial banks often deny trade-related and other credit to SMEs that are unable to demonstrate their financial viability using the banks' pre-established metrics.

Asymmetric information also results in the mispricing of risk, given that the lenders often do not adequately understand the risks involved in some SME ventures. Lenders then often try to compensate by charging a premium which they anticipate could offset the perceived risk associated with the loan. This results in the lenders charging interest rates that are high relative to the true credit risk.

This in turn deters SMEs that are unwilling to pay high interest rates. In fact, these high interest rates may lead to adverse selection.

Consideration will now be given to the financing options available to SMEs in select Caribbean economies. This is intended to afford an appreciation of the extent to which trade-financing is a dominant feature in the financing landscape available to SMEs.





## IV. Financing options for SMEs in Trinidad and Tobago, Barbados, Jamaica, and the Eastern Caribbean

Several governments in the Caribbean subregion have recognized the importance of finance in facilitating not only productive but also export activity, being undertaken by their local entrepreneurs. Governments have taken steps to improve the ease of access to finance for SMEs, having recognized that small-scale entrepreneurs can capture more commerce, while earning valuable foreign exchange through exports.

This notwithstanding, discussions with the public and private sector reveal that several SMEs are unaware of various microfinance options available in their country. These weaknesses in access to information and information sharing has been found to negatively impact SME's access to finance. As a result, too often they fail to engage the optimal institution from which to raise financing (CDB 2016). It is with this in mind that the myriad SMEs-centred policy measures and funding initiatives geared towards SMEs instituted in select Caribbean economies will be examined hereunder.

### A. Financing options for SMEs in Trinidad and Tobago

In the case of Trinidad and Tobago there are a number of alternative sources of finance for SMEs, although the extent to which they are organically linked is not clear. This includes:

- (i) The government, through the Ministry of the Social Development and Family Services (MSDFS)<sup>9</sup>, implements the Micro-Enterprise and Training Grant (METG) program which provides a grant up to a maximum of \$5,000.00 paid directly to suppliers of the goods or services, to help individuals start a small business.
- (ii) The government, through the Ministry of Labour and Small and Micro Enterprise Development (MLSMED), implements the National Integrated Business Incubation System

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<sup>9</sup> This ministry was formerly called the Ministry of the People and Social Development.

- (IBIS) which provide loans from TT\$5,000 to TT\$50,000 to SME. The IBIS also provides mentoring, infrastructural support, and financial management training for SMEs to help them succeed in their business ventures.
- (iii) The National Entrepreneurship Development Company Limited (NEDCO) provides business loans up to TT\$250,000 for first-time borrowers, and up to TT\$500,000 for second-time borrowers. NEDCO also has an Entrepreneurial Training Institute and Incubation Centre (ETIIC), which provides business training to SMEs seeking and in receipt of loans.
  - (iv) The Development Finance Limited (DFL) provides loan financing which can enhance, expand or increase the business opportunity for any business owner. DFL has no loan ceiling and can assess a project or loan application on its own merit. Moreover, DFL can provide financing for plant and equipment needs, raw materials, refurbishment, information technology upgrades, vehicle acquisition, agro-processing, construction and infrastructure works, manufacturing, contracts, and international trade.
  - (v) The Business Development Unit (BDU) of the Division of Finance and Enterprise Development in Tobago provides loans to start-ups and existing businesses in Tobago. Similar to other state-funded loan programs, the BDU provides training to the SMEs in both financial and business management.
  - (vi) The Youth Business Trinidad and Tobago (YBTT) provides loans to young people in Trinidad and Tobago, up to a maximum of TT\$30,000. While the YBTT will fund many business enterprises, certain business ventures, such as bars, gambling enterprises, internet cafés, and motor vehicles lie outside of its mandate.
  - (vii) The Agriculture Development Bank provides financing for stakeholders involved in agriculture, and fishing in Trinidad and Tobago. The institution distributes loans for business start-ups, the purchase of tools and equipment, material, and other inputs for farming and fishing.
  - (viii) Several credit unions in Trinidad and Tobago provide loans to individuals. As previously mentioned, credit unions tend to provide loans with lower interest rates, and are more lenient about loan repayment than banks.
  - (ix) The Venture Capital Incentive Program (VCIP) was introduced with the objective of increasing the accessibility of financial capital for small business owners in T&T. The programme facilitates venture capital, and enables large firms to provide finance to SMEs which they believe have high growth potential in exchange for equity.
  - (x) The Ministry of Trade and Industry offers the Grant Fund Facility which provides grant financing to SMEs to purchase capital equipment and inputs geared towards export. The grant covers 8 sectors: financial services; maritime; aviation; fish and fish processing; software design and applications; creative industries; agriculture and agro-processing; and manufacturing.
  - (xi) exporTT administers the Research and Development Facility (RDF), which provides grant financing to SMEs to 1) develop innovative/exportable products, processes, systems and services in manufacturing and service firms; 2) help SMEs obtain intellectual property rights; 3) foster easier modification of products for the purpose of satisfying export markets; and 4) mobilize resources to assist in commercialization of their product.
  - (xii) The Export-Import Bank of Trinidad and Tobago (EXIMBANK) is the only financial institution in T&T whose mandate is to provide credit to business to facilitate and encourage their exports. Although the EXIMBANK is owned by the Government of the Republic of

Trinidad and Tobago (GORTT), it raises funds on the financial market, which it uses to generate loans to businesses already engaging in the export of goods. It is noteworthy that the EXIMBANK's stakeholders are not small enterprises since a business must develop to a point where it can produce a large output, and meet the demands of at least one importer in an international market, in order to effectively participate in international trade.

## **B. Financing options for SMEs in Barbados**

In Barbados, commercial banks are the main institutions which provide debt/ loan financing. Credit unions are also a popular financing institution, especially among SMEs, as they are more willing to provide loans with low interest rates, and lenient repayment terms than the commercial banks. Apart from these institutions, there are several additional options for the country's SMEs to access finance (Antilles Economics Inc. 2017). For example:

- (i) The Government of Barbados partially funds the Enterprise Growth Fund Ltd. (EGFL), which in turn provides debt and equity financing, advisory services and technical assistance to SMEs in Barbados.
- (ii) The Central Bank of Barbados offers financing to the Industrial Credit Fund (ICF), the Tourism Loan Guarantee (TLG), and the Enhanced Credit Guarantee Fund (ECGF). These financing programs provide loan finance to SMEs in Barbados. The ECGF is highly attractive as it allows SMEs to access between BD\$20,000 and BD\$2 million in loan finance.
- (iii) The Central Bank of Barbados uses several programs, for example, the ICF, the Agricultural Development Fund (ADF), and the Energy Smart Fund (ESF) as instruments to provide grants to SMEs.
- (iv) The Barbados Agency for Micro Enterprise Development provides microfinance to SMEs in Barbados. Since the agency has developmental objectives, it also administers training, technical assistance to existing SMEs and potential entrepreneurs within the retail, tourism, agricultural, manufacturing and service sectors.
- (v) Under the Barbados Youth Business Trust (BYBT), young people between the ages of 18 and 35 can access business development loans (Hossain et al. 2009). The size of the loan ranges between US\$500 and US\$15,000 (Knight and Hossain 2008).
- (vi) The Barbados Business Enterprise Corp (BBEC) operates two venture capital funds, the Barbados Entrepreneurs' Venture Capital Fund and the Barbados Quick Response Revolving Seed Capital Fund. The BBEC purchases up to BD\$500,000 in equity to help capitalize local businesses operating in Barbados.
- (vii) The Barbados Investment Fund (BIF) is another venture capital fund operating in Barbados. The BIF purchases equity between BD\$100,000 and BD\$1 million. The venture capital fund targets SMEs operating in the tourism, agro-industry, manufacturing, and other sub-sectors.

## **C. Financing options for SMEs in Jamaica**

In Jamaica, commercial banks act as the main source of lending. Accordingly, several commercial banks provide microfinance loans. For example, Scotia Bank in Jamaica provides microfinance loans ranging between J\$60,000 and J\$850,000. Despite this, SMEs are unable to access credit from the banking sector. Instead, many entrepreneurs that managed to start their own business, used either their own savings or relied upon savings from their friends and family (Senior, 2012).

The SMEs limited success in obtaining credit from the traditional commercial banking sector is due to the latter's preference for traditional collateral-based lending, as well as the requirement to provide business plans, and audited financial statements. The banks rely on these tools to assess the businesses, as they seek to minimize their exposure to credit risk.

Jamaica has several non-traditional avenues which may be used by SMEs for financing. They include:

- (i) The Self-Start Fund (SSF), a microfinance institution developed by the Government of Jamaica, which provides up to J\$1 million in financing to SMEs operating in the manufacturing, services, agro-industry, ICT and creative industries. The loans have a maximum duration of 18 months, while the interest rate charged is 23 per cent per annum on the reducing balance basis (Hall, 2015).
- (ii) Jamaica National Small Business Limited (JNSBL), a state-owned agency, provides loans to entrepreneurs that have been in operation for at least six months. The loans range between J\$60,000 to \$400,000<sup>10</sup>.
- (iii) Micro Credit Limited (MCL), an independent microfinance institution, provides small loans to entrepreneurs in Jamaica. Although MCL provides finance, it is not a bank. In fact, it is not regulated by the country's banking laws as it does not accept deposits. Instead, it raises capital from the private sector, which is used to generate loans.
- (iv) The Government of Jamaica also developed a secure transactions framework, which allows borrowers to pledge moveable property as collateral.

## D. Financing options for SMEs in the Eastern Caribbean

There are also financing initiatives in the Eastern Caribbean outside of the commercial banking sector. For example:

- (i) In the Eastern Caribbean countries, the Eastern Caribbean Partial Guarantee Corporation (ECPGC) has a loan guarantee program. The program offers up to 75 per cent guarantee on loans to SMEs up to a value not exceeding EC\$270,000. Loans with a maturity of 10 years are also offered to the SMEs (DAIC, 2016).
- (ii) In Dominica, the National Development Foundation of Dominica (NDFD) provides microfinance to the country's SMEs. The NDFD offers mentoring, technical and business support services to the SMEs seeking and in receipt of loans.
- (iii) In Saint Lucia, Caribbean Microfinance Ltd (MICROFIN) provides small loans (below EC\$30,000) to SMEs. Although MICROFIN is a for-profit company, it partners with the Government of Saint Lucia to help link the country's local farmers to the tourism industry by providing access to credit to support increased production of agricultural and agro-processed goods
- (iv) In 2018, the World Bank entered an agreement with several governments of Caribbean countries, Antigua, Barbuda, Dominica, Grenada, Saint Lucia, and Saint Vincent and the Grenadines to implement the Micro, Small and Medium-Sized Enterprise (MSME) Guarantee Facility Project. This project which seeks to provide micro finance to SMEs in the Eastern Caribbean countries has two components. The first component involves the

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<sup>10</sup> The institution accepts assets such as appliances, household furniture, motor vehicles up to seven years old, and third-party guarantees as collateral.

capitalizing of the Partial Credit Guarantee Fund which is intended to mobilize finance for participating lenders (PLs). The second component, referred to as "Project Management, Operating Costs, and Lender Training", is designed to build capacity of the domestic lending agencies (World Bank, 2018b).

- (v) AXCEL Finance was launched in Grenada in 2014. The organization is a micro finance institution which targets SMEs. AXCEL Finance also provides financing for the residents of rural communities, thus making the organization a significant stakeholder in entrepreneurship and employment creation in Grenada.
- (vi) Caribbean Microfinance Capacity-building (CARIB-CAP), a US\$2.7 million technical cooperation program between the Inter-American Development Bank (IDB) and governments in the Caribbean subregion, enabled the provision of micro finance to several institutions in the Caribbean subregion. Institutions from the Bahamas, Belize, Guyana, Jamaica, Suriname, St. Lucia, and Trinidad and Tobago were all beneficiaries of the Carib-Cap programme.

## **E. Issues for further consideration**

The compendium of financing initiatives and options geared towards building the productive and export capacity of SMEs in the Caribbean countries, examined above, is by no means exhaustive, with only a few offering trade financing facilities. These financing initiatives while necessary, have not been sufficient to allow the subregion to optimize the contribution that SMEs can make to economic development and export growth. Not surprisingly therefore, SMEs in the Caribbean continue to lag behind and underperform relative to their Latin American counterparts with respect to participation in international trade. It therefore may be necessary to dedicate a body of research towards assessing the efficacy of these financing options available to Caribbean SMEs.

It is against this background that possible policy options that lend themselves to increasing the participation of SMEs in productive and export activity are proposed in the next section.



## V. A consideration of policy prescriptions to enhance SME access to trade finance

SMEs face several obstacles which constrain their access to finance, particularly trade financing facilities, which could assist them in engaging in international trade. As previously mentioned, the notable challenges include their lack of physical immovable collateral, uncertainty with regard to return on investment and their inability to produce financial statements, restrictive lending regulations, unsatisfactory lending terms, and macroeconomic weakness in their domestic economies, such as limited access to or availability of foreign exchange, existence of export taxes or heavy taxation of exporting firms, relatively high inflation or high labour costs tied to the minimum wage. In addition, given the crucial role that SMEs play in driving the economic growth and sustainable development of Caribbean economies, trade financing geared towards promoting the development and export potential of SMEs has increasingly been seen as a public good. For these reasons, policy makers are justified in intervening in the market to correct apparent market failures, thereby improving SMEs access to trade credit.

There are several policy options available to subregional decision makers, some of which are already in place but require tweaking or modernization, to mitigate financing constraints for SMEs, which in turn can help them further integrate into the multilateral trading system. In this regard, the specific policy prescriptions advanced by this paper include the implementation of government guarantee programmes, mutual guarantee schemes, the provision of government loans, the reform of the collateral lending system, endorsing the use of the securities market, and encouraging the use of lease financing, microfinancing, and reverse factoring as well as engaging in pre-emptive action to reduce the possibility of loss of correspondent banking services.

However, in order to ensure success, particularly in respect of spurring sustained economic growth, it is important that these measures be crafted to encourage SMEs to engage in the production and export of goods and services for which the subregion is demonstrating increasing comparative advantage. Annex I of this paper explores these notions, and advances subsectors across goods and services where Caribbean governments could encourage increased entry of SMEs through targeted

trade (and development) financing programmes. Key policy approaches and measures alluded to above and which can be utilized to optimize the export potential of SME will be explored hereunder.

### **1. Enhancing government guarantee programme**

It is proposed that Caribbean policy-makers seek to institutionalize the use of credit guarantee programmes geared specifically towards SMEs which have a propensity towards exporting. A guarantee programme essentially offers a government guarantee on a percentage of losses incurred by lenders. The government extends the guarantees in specific categories. The objective of such programmes is to reduce potential market failure from two scenarios: 1) where SMEs do not have sufficient collateral; and 2) where SMEs operate in sectors which the banks do not understand, and consequently experience information asymmetries.

Since the objective of the government guarantee programme is primarily to reduce barriers to SMEs engaging in export of goods and services, the Ministry responsible for international trade can also provide trade support for the SMEs. Applicable trade support measures include training the SMEs on possible export markets for their goods and services, informing the SMEs about Advanced Rulings and the requirements for the export into various markets, helping to arrange distributors and other contact persons to help the SMEs distribute their goods, and train the SMEs on product quality standards.

### **2. Government funded trade-financing programmes**

In order to substantively enhance SMEs access to trade-related credit Caribbean governments, subject to budgetary constraints, should increasingly (and somewhat directly) provide export finance to SMEs through quasi-state agencies or financial institutions. In order to be eligible, the SME would have to engage in export activity, particularly beyond a crucial threshold. This would typically require that the SME reaches either a particular size or tipping point of export value.

Such programmes can be successful and sustainable, yielding significant export gains if managed properly, and once beneficiaries adhere to repayment schedules. However, if there are inconsistencies in the awarding of credit, and a relaxed system for collections, the programmes can become dominated by "rent-seeking", in which various economic agents (not necessarily limited to SMEs), may try to extract soft loans from the government without repaying them.

### **3. Reform of collateral lending**

Achieving substantial improvement in the availability of trade credit to SMEs may require reformation of the collateral lending system in the Caribbean. In some instances, this reform would necessitate enacting, where not already in place, legislation which would allow banks, and other financial institutions to recognize some forms of movable assets (such as inventory and accounts receivables) as collateral for credit, particularly trade finance to SMEs, where such systems are not already in place. Concomitantly, at the national level there should be a quickening of the movement towards the creation of complementary registries of moveable assets.

The reform of the collateral lending system can be complemented by the modernization (e.g. through the use of ITC) and/or enhancement of secured transactions frameworks<sup>11</sup> already in place across the subregion. This would go a long way in removing ambiguity with regard to whom property has been pledged, while at the same time safeguarding the lender's right to repossess the movable assets in an expedited manner if the borrower is in default of payment.

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<sup>11</sup> The applicable law should establish be flexible enough to, for example, allow newly purchased inventory to become the collateral during the life of the loan without having to draft new contracts; clearly state when the lenders can seize the collateral; establish a registry of moveable assets, which allows the publicizing of information regarding how and to whom the moveable assets have been pledged; and include a framework for its enforcement.



#### **4. Modernizing access to lease financing**

In order to provide SMEs with the necessary tools to increase efficiency and productivity and thereby compete on the international market, avenues for accessing lease financing must be modernized in order to cater to the peculiar needs of SMEs. Lease financing is beneficial to both parties, as the lessee is allowed to use the equipment, simultaneous to the lessor earning lease payments and retaining ownership. However, several medium-sized and small businesses are unable to obtain leases to use the equipment, particularly those operating in the tourism, creative, agro-processing, and light manufacturing industries.

#### **5. Improving access to microfinance**

It is imperative that Caribbean governments and the financial sector acknowledge the key role that micro-finance can play in optimizing the economic benefits and welfare gains that can accrue if SMEs are afforded increased access to development-centred microfinance through dedicated windows. As such, it may be useful for individual Caribbean economies to explore avenues for replicating (while nuancing to accommodate the provision of trade financing) the model of the Grameen Bank, which is a microfinance organization and community development bank founded in Bangladesh, which offers micro-credit without requiring collateral, with a focus on mobilizing finance for fledgling community based SMEs, particularly in rural areas.

#### **6. Creating purpose-built mutual guarantee schemes**

Caribbean governments which have a policy interest in mobilizing finance for SMEs can seek to foster the operationalization of purpose-built mutual guarantee scheme (MGS). MGMs are a private sector version of the previously mentioned credit guarantee program. The only difference is the government acts as the guarantor for a proportion of the risk in the credit guarantee program, while under the MGM, an altruistic private sector agency may act as the guarantor. In Caribbean economies with an active mineral extractive industry, a multinational may consider acting as a guarantor to an MGM as part of its corporate social responsibility program (CSR). However, in Caribbean economies which are natural resource scarce, there is typically an absence of large multinational organizations (except in the hotels, aviation, and finance industries) and therefore the likelihood of an MGM program being implemented is very small<sup>12</sup>.

#### **7. Fostering the use of reverse factoring**

It is also recommended that Caribbean governments, private sector and financial institutions work collectively to foster the use of alternative financing mechanisms such as reverse factoring<sup>13</sup> (or supply chain financing) and ensure that this facility becomes a prominent feature of the trade financing landscape for SMEs<sup>14</sup>. This would go a long way to improving SMEs access to much needed working capital.

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<sup>12</sup> It is noteworthy that while loan guarantees are a good policy mechanism in principle, in practice they carry high risk. Banks tend to lend to clients which they deem low risk, and they can properly assess the client's risk to determine the appropriate interest rate to charge. In the cases where a loan guarantee is provided by a government or a private sector organization, the bank is likely to allocate the clients which it deems as a high risk to the guarantee programme. This can invariably lead to the loan guarantee programme having a pool with a higher risk than the bank would usually take on. As such, the delinquency rate for the loan guarantee programme is likely to be higher than the bank's average delinquency rate.

<sup>13</sup> A financing solution initiated by the ordering party (the customer) in order to help its suppliers to finance its receivables more easily and at a lower interest rate than what would normally be offered.

<sup>14</sup> Under a variant of reverse factoring, the SMEs signs a contract where it agrees to give up its accounts receivable to a financial institution or lender, in exchange for a line of credit. Alternatively, the business owner could sell its accounts receivables to a financial institution at a discount, in return, the financial institution collects the money from the accounts receivable from the various debtors.

## 8. Facilitating co-financing

The research conducted for this paper suggests that co-financing agreements can also be a useful tool to provide trade financing for SMEs. This may be applicable to groups of SMEs that face similar non-tariff barriers, such as a product registration, product testing, labelling requirements, sanitary and phytosanitary (SPS) measures, etc. Co-financing can be used to cover the cost of overcoming (satisfying) these non-tariff measures (or market entry requirements). For example, if an SME needs to test its product in a lab before it can be certified for export to a specific market, it should be able to access group or other co-financing facilities to mobilize the required finance.

It is noteworthy that co-financing can be even more attractive to SMEs if it is administered by an organization (e.g. quasi-government) that also conducts market research and has institutional knowledge about the trade-related barriers to accessing specific markets.

## 9. Promoting diaspora financing

It is also important to explore mechanisms for tapping into the Caribbean diaspora to secure trade financing for SMEs to fill the financing gap not satisfied by commercial banks. There are several avenues available for mobilizing investment capital from the Caribbean diaspora that can be explored e.g. the issuing of diaspora bonds, offering stock exchange facilities for SMEs open to the diaspora, and joint ventures between diaspora investors and SMEs.

One limitation of using diaspora bonds as a mechanism for raising SME funding is the high minimum investment threshold which has the potential to limit the investor pool. However, although diaspora bonds tend to have a coupon that is below the market rate, and long maturities, members of the diaspora may be predisposed to buying these bonds, particularly if they have positive sentiments towards the country.

Since these bonds rely on foreign investment, in the case of natural resource rich Caribbean economies, such as Trinidad and Tobago, Suriname and Guyana, a variant of the diaspora bond could be crafted to target multinational companies, which could be offered in conjunction with a local content policy, such as, for example, in the oil industry. A local content policy could encourage the multinational energy companies to use local inputs, while the diaspora bond can help raise capital which can be used to provide loans to SMEs, to produce goods and services for the energy sector. As the SMEs upgrade their ability to produce, the resources that accrue through the bond issue can be used to provide trade-financing facilities to facilitate the export of their goods and services.

## 10. Facilitating the use of group lending

Group lending<sup>15</sup> can also be an important mechanism for assisting SMEs in securing much needed trade-related financing while at the same time satisfying collateral requirements and lowering default risks. This, however, may require government intervention to institute the requisite legislation and regulatory framework to foster the use of this resource mobilization tool.

## 11. Engaging in pre-emptive actions to avoid de-risking

The detrimental “knock on effects” of de-risking such as economic uncertainty on economic growth—through delayed investments and hiring by businesses (including SMEs) as well as reduced spending by households on a precautionary basis—will take time to manifest (Metzgen, McLean et al., 2018). Therein rests the “paradox of de-risking”: the spillover effects as well as macroeconomic consequences of de-

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<sup>15</sup> Group lending is a lending framework where a group of individuals, often referred to as a solidarity group, provides collateral or loan guarantee through a group repayment pledge, to help its members attain loan financing. Although some members of the group bear greater risks since they pledge collateral which can be used by others, the group lending programme tends to be sustainable since the members of the group place peer pressure on each other to prevent loan defaults (Boachie 2016).

risking are incipient; yet there is a need to take the following pre-emptive actions to avoid the manifestation of the potentially debilitating impacts before they are observable:

- Financial institutions should maintain close relationships with correspondent banks and respond effectively to requests for information;
- **SMEs should be encouraged to follow KYC requirements and keep their financial records;**
- **Undertaking analyses to estimate the actual contribution of SMEs to Caribbean economies;**
- Financial institutions should join the SWIFT KYC Registry and other information sharing mechanisms;
- They should enhance transparency via easy access to current and accurate information on regulatory frameworks, tax transparency and compliance with international standards; and
- They should take pre-emptive action against possible de-risking including response plans and the ramping up of high-level advocacy efforts. Response plans should include scenarios which examine the implications for profits of increase interest rates.



## VI. The way forward

This scoping study identifies a range of challenges faced by small and micro enterprises in the Caribbean, in accessing finance in general and trade-financing in particular. In addition, common macroeconomic challenges in the subregion, which invariably impact SMEs include their vulnerability to external shocks, high unemployment, weak fiscal institutions, crime and violence, a sluggish private sector, weak productive development policies, skill-biased emigration, and limited access to trade finance. Among these challenges, access to financing remains one of the main factors that restricts the growth of these entrepreneurs' activity. Moreover, the weak access to finance limits the ability of these SMEs to increase their productive capacity to a scale that allows them to effectively participate in international trade.

Access to finance, particularly trade financing, has impeded small businesses in upgrading and integrating into the multilateral trading system. The constraints that prevent the SMEs from accessing finance need to be removed in order for the SMEs to increase their productive as well as expand the export capacity.

The research has revealed that a key issue that should be immediately addressed is the reform of the collateral lending system. This can be complemented by a registry of moveable assets and a modified secured transactions framework. It is noteworthy, that the reform of the collateral lending system is highly recommended since a large proportion of the assets of small businesses is in the form of moveable assets (inventory, accounts receivable and equipment).

There is also an urgent need for subregional economies to institute where absent, and broaden where already in existence, government guarantee programmes, mutual guarantee schemes and lease financing initiatives which are tailor-made to cater to the peculiar characteristics and needs of sub-regional SMEs. In this regard, microfinance can be offered to start-ups, while larger loans can be offered to more mature organizations. Additional initiatives which can be used by small business owners to address their financial constraints are the use of leasing, reverse factoring, diaspora as well as group financing.

The research also suggests that lack of knowledge about alternative financing options available to SMEs is another challenge in the Caribbean. Hence, it is important for the subregion's entrepreneurs to become more proactive in seeking out information from finance, trade and development related government agencies in order to seize the available gains from trade. On the supply side, agencies which offer trade and general financing to SMEs should undertake period public awareness campaigns.

SMEs often find it difficult to either start exporting or expand exports (when they do) due to several obstacles such as regulatory requirements, technical standards, phytosanitary measures and logistic requirements. As such, while the foregoing financing options and policy measures are important for the development of SMEs in the subregion, what is crucial to making SMEs a vehicle for broad-based export growth, is the provision of purpose-built trade financing, which offers not only the traditional pre and post shipment financing but also lines of credit for meeting technical and quality standards, labelling and overcoming other non-tariff measures in export markets as well as logistics. Accessing market intelligence is also important if SMEs are to take advantage of the opportunity provided by several trade agreements. It should be considered a public good or having public good characteristics, which warrant the state's intervention to address the apparent market failure. Consideration therefore should be given to making this market intelligence available free of charge (or at a minimal cost) to SMEs.

Given that many of the foregoing measures and initiatives may require varying degrees of government intervention, in order to foster the export capacity of SMEs as well as to ensure compliance with WTO law on export subsidies, it is imperative that participation in these programmes not be contingent (*de facto or de jure*) on exporting.

In addition, de-risking has had a material impact on the banking sector. The withdrawal of CBS has eroded the access to financial services of businesses and households, heightening economic uncertainty. De-risking has led to supply shocks through the channel of higher costs for financial services. The withdrawal of CBS has also led to higher costs for tourism, a sector of increasing interest to Caribbean SMEs. Moreover, de-risking has potentially threatened the existence of money transfer service providers (MTSP), the facilities of which are commonly utilized by Caribbean SMEs in the conduct of business. Furthermore, credit unions, the traditional provider of financial services to MSMEs and small entrepreneurs are also stressed by the withdrawal of CBS.

Importantly, the detrimental "knock on effects" of economic uncertainty on economic growth—through delayed investments and hiring by businesses as well as reduced spending by households on a precautionary basis—will take time to manifest. Therein rests the "paradox of de-risking": the spillover effects as well as macroeconomic consequences of de-risking are incipient; yet there is a need to take pre-emptive actions to avoid the manifestation of the potentially debilitating impacts before they are observable. In light of the paradox of de-risking, SMEs should be encouraged to follow KYC requirements and keep their financial records. Financial institutions should maintain close relationships with correspondent banks and respond effectively to requests for information.

For commercial banks in the Caribbean, there are risk aversion issues that hinder their ability to reach out to SMEs and collect data necessary to make lending decisions. The high opportunity cost of SME lending is another constraint, because commercial banks can easily invest in less risky investment opportunities such as T-bills, bonds, car loans or mortgages. Hence it may be useful to consider expanding the coverage of credit rating to SMEs, so that commercial banks can get proper indicators of the investment risk of SME lending. In order to reduce moral hazard in a government guarantee scheme, efforts made to ensure that mechanisms are instituted, where they do not currently exist to ensure credit history should be shared between banks, financial institutions and retailers that offer credit.

Interestingly, credit unions are increasingly playing an important role in providing financial intermediation to businesses, since in the Caribbean it is much easier for SMEs to access loans from

credit unions. Hence, subregional governments which have a policy interest in growing SMEs' contribution to employment as well as exports should consider fiscal and other policy measures to foster the growth of credit unions and encourage their deeper entry into the SMEs market.

Certainly, there is considerable scope for countries to harness SMEs in their efforts to generate export led growth. Embracing SMEs in any trade and economic diversification strategies, and making trade-related and other forms of credit easily accessible to them, will go a long way in moving the subregion towards increased production and exports in industries with increasing comparative advantage, increased market share in dynamic markets and potential for intra-industry commerce.

Given the weak propensity of Caribbean SMEs to export, it may be prudent for the subregional governments and financial sector as well as International Development Partners (IDPs) to design, and implement, export-centred financing programmes and facilities tailor-made for SMEs. In order to increase the possibility of success and maximize the contribution that SMEs can make to domestic economic restructuring efforts, these programmes should seek to encourage entrepreneurship in value-added and high-value niches and industries where Caribbean economies possess increasing or emerging comparative advantage; in dynamic sectors for which market share is trending upwards; and in those areas where the Caribbean has potential for engaging in intra-industry trade either intra-regionally or with extra-regional partners. (See Appendix I).

In this regard, it is recommended that food and beverage, cosmetics, cleaners and light manufactures be targeted as key goods industries for further development by facilitating SMEs. Services sectors which can be targeted for SME development include: cultural industries, entertainment services, ITC, maritime services and intellectual services. However, in some instances other policy interventions geared toward attracting foreign investment for the development of human capital and physical infrastructure may also be necessary to make business services more competitive and attractive.

It is important to bear in mind that these recommendations are being made on the basis of a preliminary examination of the rigidities of trade financing for SMEs in the Caribbean subregion. There is scope to expand exploration of the characteristics of the financial sector, such as the size of assets, deposits, and liabilities and the effectiveness of the available financing instruments and lending programmes. It would also be useful to examine in greater detail the subregional banking sector's view on SME financing and the likely interventions needed to facilitate increased readiness to offer financial products that are customized for SMEs.

It may also be useful to investigate the extent to which non-tariff measures erected in key markets of interest to subregional SMEs have stymied export growth, and to determine what sophisticated trade financing instruments (e.g. bundling financing with technical support) may be necessary to assist entrepreneurs in overcoming these challenges. This information would be crucial in providing a deeper understanding of key characteristics Caribbean SMEs and the trade financing challenge they face. This would go a long way towards revealing more nuanced recommendations and policy prescriptions for strengthening domestic policy-setting geared at making SMEs a vehicle for delivering broad-based export expansion at the domestic and subregional levels.





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## **Annex**

## Annex 1

### Consideration of sectors of export interest for Caribbean economies

For the small, open economies of the Caribbean, trade and investment are key drivers of economic growth and development. However, thus far, Caribbean economies have largely been unable to maximize the welfare gains that can accrue from trade liberalization and deeper integration into the multilateral trading system. Moreover, while subregional economies have an average trade openness index<sup>16</sup> of 111.8 per cent, they only account for 0.09 per cent of global trade (2018). Moreover, the subregion's exports are, on average, far too specialized in a few products when compared to the world average or even with that of other Small Island Developing States (SIDS). The average trade concentration index for the Caribbean was 0.38 in 2018.

Furthermore, efforts to diversify Caribbean economies over the past two decades have been mildly successful, with some economies such as Trinidad and Tobago showing an increasing share of mid-tech products in their export profile. These attempts at diversification, however, have proven to be largely horizontal in nature and insufficient to either adequately improve the country's economic resilience or boost economic growth.

With protectionist sentiments emerging globally, which threaten to disrupt the multilateral system and the global economy, building economic resilience and reducing the effects of external shocks<sup>17</sup> has increasingly become a priority for subregional governments. A leading policy across member state, therefore, has been the transformation of exports to ensure that the country increasingly produces higher-value goods and services, with growing global demand. Subregional governments also recognize the need to derive new growth engines to drive the economic diversification and transformation required to ensure the quickening of economic growth in the Caribbean, given that average growth within the subregion was merely 1.9 per cent in 2018. Consequently, subregional governments have increasingly sought to harness the potential of SMEs.

#### 1. Goods sector

The empirical analysis revealed that the Caribbean economies have been shown to have a comparative advantage in energy/petrochemical products and in some agricultural products. In particular, the subregion as a whole has a higher comparative advantage in agricultural products such as sugar, beverages fish, cereals, fruit and vegetables and wood than Trinidad and Tobago alone, and the degree of the advantage increased in the long run. (See Table A1).

However, most of these agricultural products are classified as "Missed Opportunities"<sup>18</sup> because global exports (6.8 per cent annually from 2000-2002 to 2015-2017) of these products grew faster than Caribbean exports (1.0 per cent), even though the subregion has a comparative advantage in them. Only Gas natural/manufactured and Manufactured fertilizers are the products with a comparative advantage which are classified as "Rising Stars"<sup>19</sup>.

As such, the food and beverage as well as cosmetics and cleaners and light manufacturing subsectors are key goods industries that can be targeted for development through facilitating SMEs.

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<sup>16</sup> The sum of imports and exports as a share of GDP.

<sup>17</sup> Particularly external shocks relating to commodity prices, global demand, climate change and geo-politics.

<sup>18</sup> "Missed Opportunities" are products of decreasing market share in a dynamic sector.

<sup>19</sup> "Rising Stars" are products of increasing market share in a dynamic sector.

**Table A1**  
**Revealed comparative advantage index of various export products for the Caribbean<sup>a</sup>, 1980, 2010 and 2015**

	1980	2010	2015
Gas, natural and manufactured	0.15	6.11	12.63
Chemical elements and compounds	2.79	5.80	8.88
Fertilizers, manufactured	0.30	4.08	9.61
Sugar, sugar preparations and honey	2.56	4.56	5.28
Petroleum and petroleum products	4.55	2.97	1.54
Beverages	0.86	3.49	3.85
Animals, n.e.s., incl. Zoo animals,	0.10	2.29	3.07
Crude fertilizers and crude mineral	0.29	1.47	3.52
Metalliferous ores and metal scrap	1.63	1.01	2.57
Fish and fish preparations	0.30	1.66	2.41
Cereals and cereal preparations	0.09	1.99	2.10
Miscellaneous food preparations	0.61	1.27	1.79
Fruit and vegetables	0.62	1.30	1.25
Iron and steel	0.04	1.29	1.55
Crude chemicals from coal, petroleum	2.54	0.00	0.01
Tobacco and tobacco manufactures	0.34	0.65	1.45
Wood, lumber and cork	0.02	0.87	1.31

Source: Comtrade through WITS.

<sup>a</sup> Antigua and Barbuda, The Bahamas, Belize, Barbados, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago. The numbers of available countries are 9, 12 and 11 for 1980, 2010 and 2015, respectively.

This notwithstanding, there is considerable potential for increased intra-industry, intra-regional trade, which could provide a basis for a regional integration process which is predicated on production integration as originally envisaged in the CARICOM Single Market and Economy (CSME). Using the Grubel-Lloyd (1975) Index to investigate intra-Caribbean commerce (for the period 2000-2015), it was observed that while the indicators are generally low (typically below 0.25) there has been a general rising trend over time. This suggests that the subregion is not presently involved in significant intra-regional intra-industry trade but there is untapped and increasing potential for same.

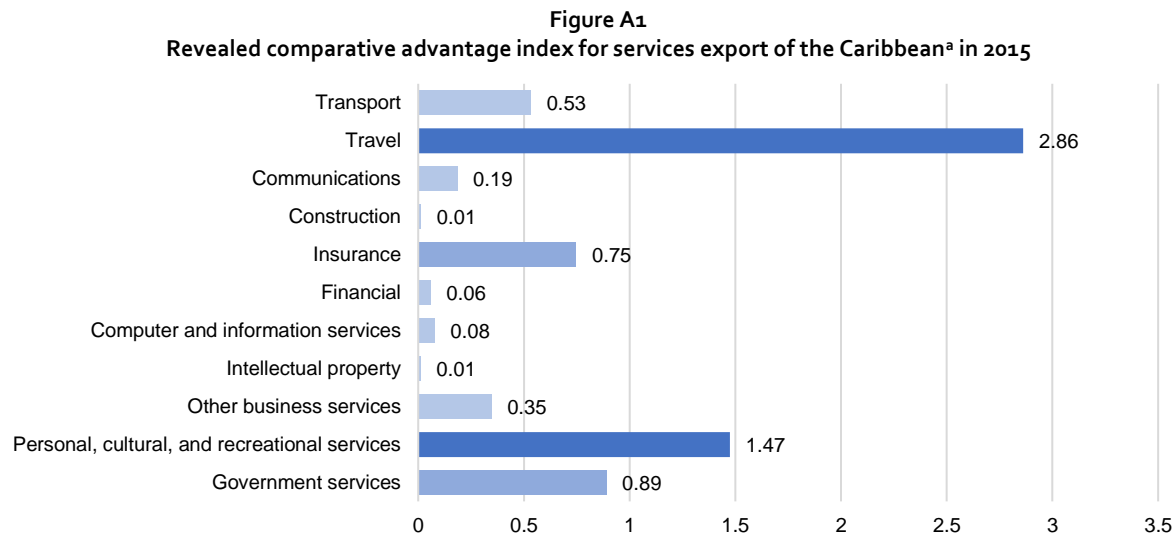
## 2. Services sector

The services sector continues to be one of the main engines of growth in the Caribbean; even among goods producers like Trinidad and Tobago, where 53 per cent of the long-run variation in economic growth will be attributable to this sector (ECLAC, 2019).

More specifically, the subregion has a strong comparative advantage in travel services and some degree of advantage in “personal, cultural and recreational services”. However, the subregion’s travel services is classified as “retreats”<sup>20</sup> because 1) global travel services exports (5.5 per cent annually from 2005-2007 to 2015-2017) grew slower than total services exports (5.5 per cent), as exports of telecommunications services (21.6 per cent) grew faster; and 2) Caribbean’s travel services (2.8 per cent) grew slower than the global travel services (5.5 per cent) as the Caribbean didn’t profit much from the

<sup>20</sup> “Retreats” are products of decreasing market share in a stagnant sector.

expanding Chinese demand<sup>21</sup>. The latter suggests that Caribbean economies have not fully exploited its comparative advantage in this area. (See Figure A1)



Source: Comtrade.

<sup>a</sup> Antigua and Barbuda, The Bahamas, Belize, Dominica, Grenada, Guyana, Jamaica, Suriname and Trinidad and Tobago. The number of available countries varies depending on the sector.

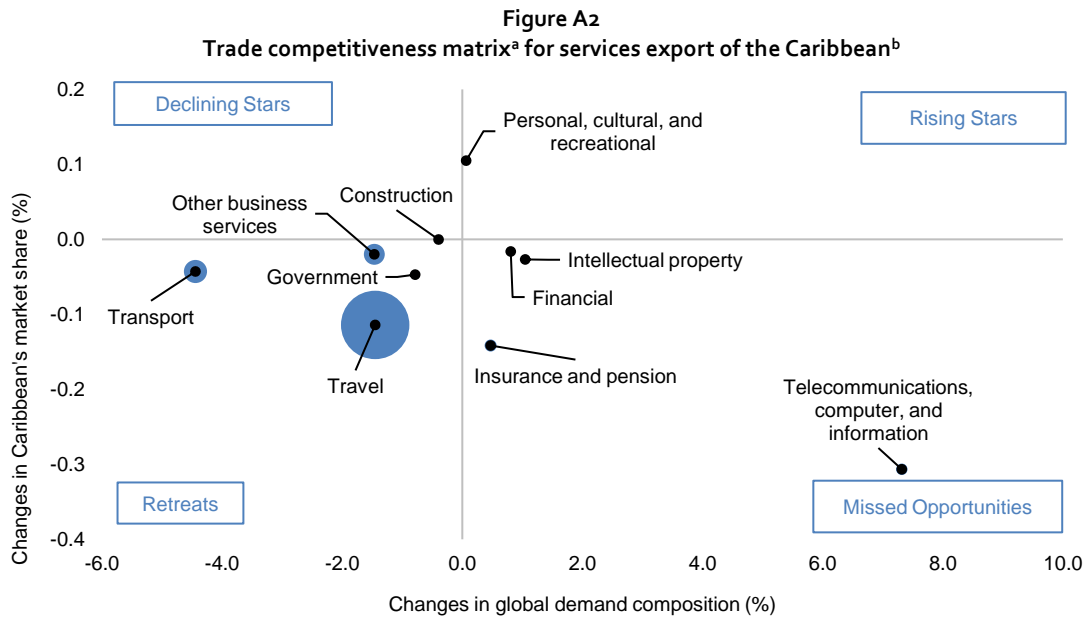
The subregion's "personal, cultural and recreational services" is classified as "Rising stars". However, the volume of this sector's export is too small (1.3 per cent of total export in 2015-2017) to be a driving force of the Caribbean's total export growth at this stage. Another challenge is that telecommunications services is classified as "Missed opportunities". This is the fastest growing sector in the global services trade, but the Caribbean is lagging behind this trend. Caribbean telecommunications services export decreased by 2.6 per cent annually while global exports increased by 21.6 per cent. (See Figure A2).

On the other hand, sectors where the subregion does not have a comparative advantage, or its export volumes are very small (e.g. financial services and intellectual property), have been shown to be missed opportunities. This suggests that the sectors are in the early stage of development, and thus technical and financial policy support, particularly for SMEs, may be needed.

Hence services sectors which can be targeted for SMEs development include: cultural industries, entertainment services, ITC, maritime services and intellectual services. However, in some instances other policy interventions geared at attracting foreign investment into the development of human capital and physical infrastructure will also make business services more competitive and attractive as a services export may be necessary.

<sup>21</sup> China's population is around 1.4 billion, so its economic growth has tremendous effect on neighbouring countries' travel services export. For example, Japan's travel services export grew by 11.5% annually (faster than Caribbean's 2.8%) because of increasing Chinese demand.





Source: ITC, UNCTAD, WTO trade in services database.

<sup>a</sup> Based on changes from 2005-2007 average to 2015-2017 average.

<sup>b</sup> The Bahamas, Belize, Guyana, Jamaica, Suriname and Trinidad and Tobago.



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