SOCIO-ECONOMIC VOICES

"India needs to Bridge the Credit Gap towards Boosting SME Growth, Green Exports and Energy Security amid Evolving Trade Landscape"

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From Factoring to Green Bonds - Strategic Insights into India's Trade Finance and Export Ecosystem

Intro: India's trade finance is witnessing a transformation driven by digitisation, fintech innovations and evolving global dynamics. Trade economist **Dr Rahul Nath Choudhary** highlights the challenges of credit gaps, rising global risks and underutilised trade mechanisms. While speaking to **Mahima Sharma** on **Socio-economic Voices** he shares solutions like green bonds, energy diversification and infrastructure diplomacy. An exclusive discussion only at **Indiastat** that digs deeper into the future of Indian trade, unlocking opportunities for SMEs and exporters alike. Take a read...

MS: With the rise of digital trade finance solutions and fintech in the last few months, how is India leveraging these innovations to modernize its trade finance ecosystem? What challenges and opportunities do this bring for small and medium enterprises (SMEs)?

Dr Choudhary: India being in the forefront of digitization has tremendously leveraged innovation specially in trade finance space. Many of the Indian banks including the PSU banks have already adopted Machine Learning and Artificial Intelligent solutions in their regular business practice. Several fintech companies in India are also providing services of digitizing trade documents. Digital platforms like TReDS provide a marketplace for SMEs to sell their receivables/invoices to financial institutions. Establishment of the GIFT city in Gujarat is another commendable step taken in India.

Adoption of Account Aggregator (AA) framework as a financial data-sharing system by the Reserve Bank of India (RBI) is also facilitating the credit ecosystem in India by encouraging cash-flow based lending. Launch of Unified Lending Interface (ULI) by the RBI where it proposes to integrate financial & non-financial data sources into a unified system is also a remarkable step in streamlining the lending ecosystem in India.

With these benefits digital trade finance solutions also bring **some challenges for various firms, especially for the SMEs.** Switching from paper-based trade documentation to digital format increases the compliance cost of the firms. As digital trade finance solutions proliferate, the risk of cyberattacks and fraud increases. SMEs may be more vulnerable to such threats, particularly if they lack robust cybersecurity measures. There is also a risk of fraudulent activities, such as fake invoices or document manipulation, which could undermine the trust in digital trade finance systems. As technology changes frequently, firms are also required to spend on the employees' training and capacity building.

MS: In light of the rising interest rates and global inflationary pressures, how have trade finance mechanisms such as letters of credit and short-term financing evolved for Indian exporters? What impact has this had on liquidity for Indian businesses?

Dr Choudhary: The letter of credit facilities has been a traditional instrument of financing for the traders across the globe including India and it has been a powerful financial instrument in boosting cross-border trade. As per an estimate made by International Chambers of Commerce, among the traditional trade finance instruments, around 50% are conducted in L/C. Apart from L/C, there are other important short term financial instruments available with the exporters. Packing credit, factoring etc. are some of the prominent options available with the exporters to finance their consignments. Exporters can also opt for credit from various schemes launched by many banks from time to time which are mostly short term in nature. With the growth of fintech in India, many fintech firms have also come out with various attractive short term loan options for the exporters.

These short-term credits immensely help exporters to maintain their liquidity by allowing them to access finance that would otherwise be inaccessible for up to 120 days. Settlement of any bill in a shorter period also limits various risks involved in trade finance. They can also use the working capital to invest in other areas of business and its expansion.

MS: There exists a huge trade credit gap in India especially for the MSMEs who have only around 11% access to formal credit. In addition, the outstanding credit in March 2024 dropped by 5% over the same month in 2022. In your opinion, what are the major obstacles in extending trade credit in India?

Dr Choudhary: Despite making remarkable progress in its export performance in the recent past, India's export credit disbursements remained very low. **In FY 2022-23, the RBI sanctioned USD 50.71 Bn in packing credit to 61,000 accounts, with USD 19 Bn outstanding,** suggesting a preference for large corporate borrowers due to their perceived lower credit risk compared to MSMEs. The government's own estimation suggests credit gap of Indian Rupee (INR) 20 - 25 trillion for MSMEs while less than 11% of MSMEs have access to formal credit in India.

There are several reasons for limited disbursement of credit in India. One of the primary reasons for this is lack of credit worthiness among the exporters. A large number of our exporters do not have sufficient credit worthiness due to their poor documentation, small volume of export, and limited amount of inventories among others. Also, it is difficult to assess credit worthiness for companies that cannot provide collateral. MSMEs face higher rejection in their trade finance application compared to their large competitors and exporters are not aware of the availability of various trade finance options.

MS: India's total factoring volume in 2023 was only EUR 17 Bn accounting less than a percent of the global factoring market. What are the major impediments to the growth of factoring in India and how to eradicate them?

Dr Choudhary: Despite adopting the idea of factoring in India more than 3 decades ago, the factoring market has remained very limited. India tried to facilitate the growth of factoring with various steps like enacting factoring act in 2011, amending insurance guidelines, establishing TReDS and making special provision for factoring in the GIFT city, but all these generated limited results.

Although domestic factoring in India has picked up with establishment of TReDs, Indian cross-border factoring remained stagnant over the years. India holds less than 1 percent share in the global factoring market.

The low growth of factoring business in India are due to a number of reasons:

- lack of awareness among the exporters about the benefits of factoring
- higher expenses for factoring in India compared to other trade finance options like EPC due to government support.
- Indian regulation does not allow insurance in reverse factoring among others.
- Moreover, there are a limited number of factoring companies in India. e.g. India has only 11 companies compared to 2000 in China, 180 in Germany, and 250 in the USA, providing factoring services to their

respective countries.

MS: With rising global risks like pandemics, geopolitical tensions, and crisis such as the Red Sea situation, insurance premiums have surged by about 25%. In India, the Trade Credit Insurance (TCI) sector remains heavily dependent on a single agency. What are the primary challenges facing the TCI sector, and how can these be effectively addressed or mitigated?

Dr Choudhary: Trade Credit Insurance (TCI) serves as a protection against the risk of non-payment which are inherent in cross-border trade. The Indian TCI landscape is highly skewed and only 70% of the market shares is held by ECGC India.

IRDAI data suggests that in 2022-23, the gross direct premium (GDP) earned collectively by all the trade credit insurance companies was USD 198 Mn where public sector companies contributed USD 154 Mn ECGC alone has earned USD 139 Mn with its 70% market share.

The monopoly of one organisation happened as the RBI permits capital relief to banks and FIs for policies only from the ECGC, depriving other private insurance providers from similar treatment. **This discrimination forced many banks to use TCI on a limited basis. Only a few firms in India offer bespoke trade insurance policies serving the diverse needs of the exporters in an era of global economic uncertainties.**

Moreover, insurance companies cover only 80-90% of the risk which is followed by long claim settlement periods and complex procedures. **Modifying insurance policies as per the need of the exporters, considering the changing risk involved in international trade, digitising the entire procedure from application to claim settlement and encouraging global insurance companies** to invest in India on limited scale in association with Indian firms would greatly help to boost the TCI ecosystem in India.

MS: Given India's heavy reliance on crude oil imports, which stood at $170 billion in 2024, how do you assess the impact of global supply chain disruptions on India's energy imports? What measures should India take to safeguard its energy security while ensuring that trade remains stable during such volatile periods?

Dr Choudhary: The global economy has witnessed multiple supply chain disruptions in the past few years. The incidence of COVID19, Ukraine crisis, red sea crisis, etc. has primarily contributed to this crisis. Any disruption in oil supply can lead to multiple problems. India imports almost 85% of the world's oil requirements. However, the impact of this crisis in the recent past on India was very limited. **To safeguard the economy from such a crisis in the future, there are some steps that India should take.**

- First, diversify import sources. Currently India's oil import is concentrated to a few countries like Russia (40%), Iraq (20%) and Saudi Arabia (15%). Heavy reliance on a small number of suppliers may lead to sudden supply disruptions if any crisis situation arises in those sources.
- India may develop and strengthen strategic relationships with major oil supplying countries and make efforts to secure supply even during a potential crisis situation.
- Maintaining a buffer in large volume would also help avoiding crisis.
- Further, shifting focus from traditional energy sources to renewables, solar, etc. would also help India to reduce dependence on foreign suppliers and become self-reliant.

MS: With India's green energy exports growing by 18% in 2024 and the EU's carbon border tax being implemented, how should India adapt its trade finance policies to ensure that Indian green exports remain competitive? What role do you think green bonds or trade finance instruments should play in financing India's green exports in the coming years?

Dr Choudhary: Green bonds are debt instruments that raise capital to finance environmental or climate-related projects. India being in the forefront of green initiatives has taken multiple steps in facilitating green finance. Export-Import Bank of India launched a 5-year Reg S Green Bond in 2015. In India, SEBI, the nodal agency to regulate the bond market, issued guidelines for issuing green bonds in 2017 and 2023. India drafted its Framework for Sovereign Green Bonds following the ICMA international guidelines. Recently, India allowed foreign investors operating within the International Financial Services Centre (IFSC) Gift city to invest in Sovereign Green Bonds (SGrBs).

These steps have encouraged many banks and financial institutes to **expand their business operations and investor base and support many lucrative markets** with more socially responsible investment options.

However, the total green bond issuance remained very limited. India issued green bonds of USD 21 Bn in 2023 which had a minuscule share of only 2.2% in global issuances. To increase the use of green bonds, India should facilitate the growth of the sector that uses these bonds. **Encouraging the green energy sector, electric vehicle market, production of solar panels and incentivising export from India** would help in promoting green finance activity.

MS: How could the ongoing political crisis in Bangladesh impact India's $13 billion bilateral trade and the progress of key infrastructure projects like the Akhaura-Agartala rail link? What measures should India take to safeguard its economic and strategic interests in the region?

Dr Choudhary: Political crisis in Bangladesh had very limited impact on India's trade interest as Bangladesh accounts for only 2.5% of India's total merchandise exports. India's trade basket to Bangladesh remains very diverse which ranges from perishable agricultural products to auto parts, pharmaceutical products to electric power to RMG. Initially for a few weeks, there were some disruptions in transportation networks causing widespread delay. Many consignments were stranded in the ports. However, soon enough, the situation got normalised and usual trade resumed.

Despite the quick normalcy after the brief disruption in trade, there remained several other challenges. Since 2016, India extended $8 billion in credit for several infrastructure projects to develop roads, rail networks, shipping, and ports - key fields for improving regional connectivity and economic growth. These projects include the ambitious Akhaura-Agartala rail link. It is a major connectivity development project as it is expected to boost bilateral trade in items like tea, sugar, construction items, iron and steel, and consumer products. With change in the power, there has been a complete halt in the infra projects funded by India. If the construction is not resumed soon, it may jeopardise the future of seamless trade transportation between India and Bangladesh.

India should engage diplomatically with the current interim government in Bangladesh and discuss the possibility of resuming the construction work. A stable bilateral tie between India and Bangladesh is not only important for these two neighbours but also for the people in the region.

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About the Interviewer

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