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Trade Finance Mechanisms in the Kyrgyz Republic

МЕХАНИЗМЫ ТОРГОВОГО ФИНАНСИРОВАНИЯ В КЫРГЫЗСКОЙ РЕСПУБЛИКЕ

Кыргыз Республикасында сооданы каржылоо механизмдери

Abstract: *the article explores the term 'Trade Financing', and a range of financial instruments of trade financing by dividing them into three categories. The scale of trade financing in the world is discussed. The article presents the analysis of trade financing by the banks of Kyrgyzstan as well as the need of export credit across regions of the Kyrgyz Republic.*

Аннотация: *в статье исследуется термин «торговое финансирование». Приводится перечень финансовых инструментов торгового финансирования, которые распределены на три категории. Указаны масштабы торгового финансирования в мире. Проведен анализ торгового финансирования банками Кыргызстана, а также потребность в кредитовании экспорта по регионам Кыргызской Республики.*

Аннотация: *макалада «соода каржылоо» термини изилденди. Соода каржылоо куралдарынын тизмеси көрсөтүлдү жана алар үч тонко бөлүштүрүлдү. Дүйнөдөгү соода каржылоо масштабы аныкталды. Кыргызстандагы банктардын соода каржылоосу, ошондой эле Кыргыз Республикасынын аймактарынын экспорттук кредиттерге муктаждыгы изилденди.*

Keywords: *Trade financing; financial instruments; letters of credit; banks; export operations; regions; export credit.*

Ключевые слова: *торговое финансирование; финансовые инструменты; аккредитивы; банки; экспортные операции; регионы; экспортное кредитование.*

Негизги сөздөр: *соода; каржылоо; каржы куралдары; аккредитивдер; банктар; экспорттук операциялар; региондор; экспорттук кредиттер.*

'Trade finance' is a selected term for financial instruments that allow trade transaction of goods and services between sellers and buyers. The term relates to the process of financing of certain activities to commerce and international trade. However, it does not have a single unified definition in Economic literature and in practice.

There are three basic definitions of "trade finance" [2]: 1. Trade Finance is a set of economic relations established to maintain trade and investment relations with industrial economies (organization), as well as access international markets.

2. Trade finance refers to domestic and international trade transactions. When a buyer purchases goods or services from a seller, such financial activities are called 'trade finance'.

3. Trade finance includes a range of different financial services and procedures that facilitate payments and transactions.

The third definition accurately reflects the essence of the term 'trade finance' and in a broad scale, including the financial agreements of commercial and corporate transactions. [1]. This understanding suggests that trade finance is related to the process of financing certain activities covering commerce and international trade, but as well as domestic financing. This definition also reflects main differences in trade which have been reviewed within global trade and export finance

As it is known, trade finance includes the following list of financial instruments:

- Letters of Credit;
- Standby Letter of Credit (SLOC);
- Encashment;
- Guarantees;
- Factoring;
- Forfeiting;
- Leasing;
- Bill of Exchange (BOE);
- Target Loans Direct provided by foreign financial organizations;
- Contract Financing
- Pre-Export Financing and Post-Export Financing;
- Trade Credit;
- Invoice Discounting;
- Asset-Based Lending;
- Supply Chain Finance;
- The Bank Payment Obligation (BPO)
- Tolling.

These financial instruments of trade financing for export operations can be structured into three categories:

1. tools for making payments;
2. tools for risk reduction;
3. tools for mobilizing capital.

This structure is made from the needs of exporting companies.

In one form, it is managing the capital required for international trade to flow. Yet there is a wide range of tools at the financiers' disposal, all of which determine how cash, credit, investments and other assets can be utilized for trade.

While a seller (or exporter) can require the purchaser (an importer) to prepay for goods shipped. Banks may assist by providing various forms of

support. In this regard, the role and importance of financial instruments proves the importance of local capital markets for financing development. Popular types of financial instruments of trade finance include:

- Letters of Credit;
- Encashment; or collection;
- Guarantees;
- Invoice Discounting;
- Trade Credit;
- Bill of Exchange (BOE);
- Target Loans Direct provided by foreign financial organizations;

Most complex types of financial instruments provide for trade finance include:

- Assets Based Lending
- Contract Financing;
- Leasing;
- Pre-Export Financing and Post-Export Financing;
- Supply Chain Finance;
- Tolling;
- Factoring;
- Forfeiting;
- The Bank Payment Obligation (BPO)

The complexity of the use of the above financial instruments related to hedging of risks, the payment of money claims, account receivable, protecting from insolvency of debtors, payment deferral and other factors, therefore they are rarely used in practice.

World Trade Organization (WTO) is in the report of “Trade Finance and SMEs: Bridging the Gaps in Provision” (2016) marks that the scales of the world trade financing in 2014 are estimated from 12 to 18 trillion of dollars of the USA [3]. Thus, near one third of the world trade financing supported by the number of financial instruments.

One of the main financial instruments in the world also letters of credit, which are financed by trade operations worth about \$2.8 trillion. Backlog of the demand of the trade financing in 2014 was more than \$1.4 trillion in the whole world [3]. The report ‘Trade Finance and SMEs: Bridging the Gaps in Provision’ also indicates that:

- 80 percent of world trade financed due to credits or insurance of credits, but a scope is uneven. A lack of the trade financing is a substantial barrier for the development of trade, especially in developing countries.
- small and middle-size enterprises run into the most obstacles in the receipt of access to financing. In some large developed countries to one third of small and middle enterprises have such problems. There

- are 20 percent of export of the USA, and 40 percent of export small and middle enterprises from EC.
- In the whole world, more than 50% requests of small and middle enterprises for trade financing and 7% of multinational corporations get a negative answer.
 - small and middle enterprises in developing countries meet great difficulties in the receipt of access to the trade financing. The evaluation cost of backlog of demand on the trade financing in Africa makes \$120 milliards and \$700 milliards in the developing countries of Asia. Overcoming of these blanks in providing would open trade potentials of many thousand small and middle enterprises all over the world.
 - Defects in the grant of the trade financing are the highest in the borderline zones of countries, where trade possibilities increase.

In connection, with this, since 2016, WTO has accepted the following measures:

- **S** Strengthening the existing programs of development of the trade financing for shortening of the deficit of financing on \$50 milliards of dollars of the USA;
- **S** Reduction of break in knowledge in a local bank sector for expansion of instruments for the trade financing by educating, at least, 5000 specialists during next five years;
- **S** Perfection of monitoring of the trade financing grant for an exposure and reacting on blanks, especially concerning possible future financial crises.

In addition to addressing gaps in the provision of trade finance certain action are used in three areas:

- 1) Promoting global financial institutions and participation in the expansion trade finance
- 2) Increasing the capacity of local financial institutions
- 3) Providing support measures to increase the availability of trade finance via multilateral development banks.

What is the current situation in the use of mechanisms of trade financing for export operations in Kyrgyzstan?

The main services provided by the Kyrgyz Banking System for trade finance are the traditional types of financial instruments, such as:

- Trade Credit,
- Letters of Credit,
- Collection,
- Bank guarantee,
- Bill of exchange and Promissory Note.

Table 1 presents the types of financial instruments of banks on trade financing data obtained from the sites of banks of Kyrgyzstan

Table 1.

Financial instruments of trade finance used by banks of Kyrgyzstan

OJSC Aiyl Bank	OJSC "Commercial bank Kyrgyzstan"	CJSC "Demir Kyrgyz International Bank"	OJSC "RSK Bank"	CJSC "Kyrgyz Investment and Credit Bank" (KICB)	OJSC "Optima Bank"
Trade Credit	Trade Credit	Trade Credit	Trade Credit	Trade Credit	Trade Credit
Export and Import Letter of Credit	Export and Import Letter of Credit	Export and Import Letter of Credit	Export and Import Letter of Credit	Export and Import Letter of Credit	Export and Import Letter of Credit
Bank Guarantee	Bank Guarantee	Bank Guarantee	Bank Guarantee	Bank Guarantee	Bank Guarantee
		Simple and Bills of Exchange	Simple and Bills of Exchange	Simple and Bills of Exchange	Encashment

Below are the reasons for these limited trade financing services:

- Small volume of export operations, therefore, a small number of loans and types of financial instruments that do not require the introduction of new financial tools;
- The small size of bank lending, which is only 22% of GDP (2015), which does not encourage banks to introduce new financial tools;
- Challenging trade finance banks are not applied due to the fact, that as deposit is not taken as contracts, working capital, accounts receivable, and according to the regulations of the National Bank of the Kyrgyz Republic (NBKR) on the formation of a reserve for potential losses from lending activities (for bad debts), banks are required to form the high debts. It is not profitable to banks.

With such a small amount of loans to the economy, entrepreneurs in any case, take the loans with current financial instruments.

Innovation in the provision of financial instruments in the banking system of the Kyrgyz Republic is implemented very slowly.

In 2013 although with great difficulty complex types of financial instruments of the export operations of the «loan contracts» were introduced which were implemented under the contract, the Ministry of Defense to supply goods to Afghanistan. The Ministry of Defense signed a contract with the entrepreneurs of Kyrgyzstan, the Bank of the Ministry of Defense opened a letter of credit, and local banks were under contract and letters of credit, loans in local banks. There were six contracts for CJSC "Demir Kyrgyz International Bank", OJSC "Bakai Bank".

In addition, NBKR brought the provision on the formation of the RPPU and equated the RRPP as a pledge of real estate on a financial instrument "loans secured by contracts".

In order to determine exporters' need for credit resources, calculations were made, according to Asian Development Bank's (ADB) methodology [4], which is used to calculate the demand for credit resources of women entrepreneurs in the Kyrgyz Republic. The need for credit resources estimated as 25% of the average revenue of entrepreneurs.

Meetings with the heads of the companies producing products, both to the domestic market and to the external market, confirm that the need for credit resources to produce goods is on average 25% of the sales amount. In general, credit resources need to purchase raw materials, pay administrative costs, transport, logistics and other expenses. These funds expected to be provided with trade finance instruments.

This amount of financing together with the means of enterprises allows maintaining the achieved volume of exports and increasing the volume of output by 10-30%.

When applying this methodology to determine the necessary need for exporters in credit resources, it is necessary to take the volume of export earnings and 25% of this is the need of exporters with lending.

Table 2 shows the calculation of exporters' need for credit resources, which can be provided with Trade finance instruments.

The exporters need an average of 400-450 million US dollars, in the regional context the greatest need is needed for entrepreneurs in Bishkek, then for entrepreneurs in Chui, Jalal-Abad and Osh regions.

Table 2

Export and requirement in crediting of export operations on the areas of Kyrgyz Republic
Million USD

Region	2012		2013		2014	
	Export need for loans	Need for loans	Export	Need for loans	Export	Need for loans
Batken	34,7	8,7	41,3	10,3	15,9	4,0
Jalal-Abad	137,7	34,4	88,2	22,1	106,2	26,6
Issyk-Kul	12,6	3,2	15,1	3,8	26,9	6,7
Naryn	0,4	0,1	0,4	0,1	0,7	0,2
Osh	41,3	10,3	19,3	4,8	23,9	6,0
Talas	33,2	8,3	56,0	14,0	46,2	11,6
Chui	125,5	31,4	117,8	29,5	159,7	39,9
Bishkek	1 163,1	290,8	1 294,6	323,7	1 161,6	290,4
Oshcity	32,5	8,1	56,0	14,0	43,1	10,8
Total	1 581,0	395,3	1 688,7	422,2	1 584,2	396,1

Requirement in credits and the low share of the credit briefcase of the banking system, sent to the export operations show that in part of access to finances for export operations there are many problems, without solving of that development of export will be problematic. These problems include high requirements for collateral security, interest rates, and limited financial instruments of banks.

To solve these problems one can offer to initiate the introduction of proposed changes and additions:

1) The Regulation of the National Bank of the Kyrgyz Republic "On Classification of Assets and Corresponding Withholdings in Reserve on Coverage of Potential Losses";

2) The decision of the Committee on Monetary Regulation of the NBKR requirements for a pledge on credit auctions of the NBKR for commercial banks.

Introduction of the indicated recommendations allows bringing down the requirements of banks to the mortgage providing, gradually to bring down interest rates on credits, to improve potential of export enterprises and increase their profit yield at implementation of requirements on quality parameters.

The financing of export transactions, banks can carry out at the expense of own funds raised with the credit auction of the National Bank of the Kyrgyz Republic, funds of the Russian-Kyrgyz Development Fund, and funds raised on international markets.

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