

Accelerating SME and Inclusive Economic Growth through Trade Digitalization

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Small and medium enterprises (SMEs) are often the cornerstones of an economy. In Hong Kong, for example, while the vast majority of SMEs are micro-enterprises engaging less than 10 persons, they account for 98% of all local enterprises and 46% of total employment. In the Mainland, close to 80% of the labour force work for SMEs. Although they pale in comparison with big companies in terms of earnings ratio and contribution to gross domestic product, they are essential to economic stability, job creation, and innovation. Take the fifth wave of the coronavirus pandemic in Hong Kong in 2020 for instance. The massive SME closures not just caused vacancy rates of commercial premises in core business districts to remain high but also led to a significant surge in the total unemployment rate to 10%.

However, providing adequate support for the development of SMEs is a tall order. In the process of business expansion, these enterprises find themselves constantly facing various challenges, with poor earnings ratios and low resistance to risks, especially when the economy is heading south. With limited bargaining chips, capital, and human resources, because of their small size, SMEs are hard-pressed to establish links with the participants in many segments of the global supply chains.

To make matters worse, the additional restrictions on SMEs imposed by financial institutions have raised the financial thresholds for such enterprises. Increasingly stringent compliance stipulations, including the commonly used Know-Your-Client and Anti-Money Laundering requirements in recent years, are hard for SMEs to meet. Data of the Asian Development Bank shows that the traditional financial institutions' rejection rate of trade financing applications is around 45% for SMEs but only 17% for big companies. With their development hampered by insufficient capital, most

SMEs resort to staying in the domestic market rather than entering the global market.

Digitalization key to SME growth

There has long been general consensus that digitalization is part and parcel of business development, especially in the case of SMEs. Comprehensive and timely data analysis can help companies to adjust production model. For SMEs plagued with constraints on capital and human resources, digitalization should be the perfect way to sharply raise productivity. Unfortunately, with the ever complicated and sophisticated technological advances, many SMEs have found it hard to keep pace, hence are lagging farther behind sizeable companies.

As a result, governments around the world have commenced deliberations about ways to promote digitalization. In a highly digitalized trade environment, data for each and every segment and action is transmitted in real time and automatically without any paper transmissions. The data collected in the process can be used for tracking, analysing, and investigating supply chains to further enhance productivity. As a potentially crucial benchmark for evaluating corporate health, such transaction data, if sufficient, can enable financial institutions to gauge the credibility and security of enterprises. This not only lessens the burden of self-investigation falling on enterprises but also greatly lowers financing costs.

Should the above-mentioned data be transparent and accessible, lenders in addition to traditional financial institutions can benefit from it for risk assessment. A survey by the International Chamber of Commerce shows that digitalization is conducive to reducing trade financing cost by 35%. Low financing cost will make financing more readily available for SMEs, thus expanding their borrowing opportunities and capital sources.

Proactive response necessary from the government and public sector

Trade digitalization is set to herald a landmark change in global trade. The well-established requisite technology has long been used by many large corporations. For instance, the Just-In-Time (JIT) production strategy adopted by large companies such

as Apple has markedly brought down costs while focusing on the real-time capability and accuracy of data. JIT is made possible with the development and wide use of Internet of Things (IoT). By the end of 2021, over 10 billion devices worldwide were already connected to IoT. Recent years have seen the provision by companies (e.g. Amazon) of IoT building services suitable for SMEs. Blockchain technology, which has come under the spotlight because of cryptocurrency, is another example. The transparency and security of blockchain technology have made supply-chain tracking easier, greatly facilitating the traceability of carbon emissions products or information of suppliers.

Yet technology is not a problem. What SMEs need the most is a targeted industrial policy so that the connectivity and interoperability of global supply chains can be enhanced. Such developments will not only open up more room for SMEs to become global trade players but also bring handsome economic gains to the community as a whole.

One of the many hurdles to progress in digitalization is the relative conservative stance of the government and the public sector in this respect. Various international organizations and national governments have put much emphasis on how to proactively promote digital transformation in the public sector and to gear up for trade digitalization. G7, G20, and APEC, etc. are also attempting to advance digital transformation among their respective member states. Notable examples include the Model Law on Electronic Transferable Records (MLETR) and the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific, both being initiated by the United Nations. As of September 2022, the number of countries having adopted MLETR reached seven while a range of countries have kick-started trials and have pledged to speed up the approval process.

Enhancing standardization with a digital ID system

Another major hurdle to digitalization lies in the lack of common standards and requirements within the trade financing domain. While generic documentation and standards are in place across different segments of supply chains, different requirements are set by different countries or different industries in the same

country. There is no mutual recognition of standards among different countries. This poses a huge financial burden on multinational businesses. SMEs which cannot afford the costs have no choice but to remain in the local market or to conduct business with the limited number of markets that have the same requirements of standards. Hence, despite the fact that the requisite technology for digitalization is already mature and data transmission is not a problem, only 1% of international trade transactions are currently carried out via highly digitalized processes.

In comparison, the pace of digitalization is faster in the financial domain. Survey results illustrate that over 60% of multinational banks and 30% of local banks said that they have digitalized at least part of their supply chains. The sudden outbreak of the coronavirus epidemic in 2020 further prompted more banks to greatly speed up digitalization. With increasing digitalization among financial institutions, the different standards of different systems are creating more and more hurdles. Data Silos, i.e. collections of data not accessible by other groups in the same organization, are beginning to pop up as companies are faced with all kinds of issues caused by the simultaneous operation of multiple systems.

To resolve standardization and certification problems, building a standardized digital ID system has become one of the widely-accepted options. Back in June 2021, the European Commission already came up with a proposal for devising digital ID frameworks for individuals and companies. The establishment of digital ID is aimed at strengthening linkages among different trade entities. Each SME will have its own digital ID, featuring its accreditation, financial credit ratings, and other related information. By checking a company's digital ID, lenders or investors can quickly obtain vital information about the company. Transparent data can greatly lessen the time and investigation cost involved in the borrowing process, so that SMEs will stand a better chance for securing loans.

Wide application of digital ID will facilitate borrowing. Through digital ID, capital sources from different industries, regions, or foreign countries can evaluate risks before making decisions on the loan business. Diversified capital sources and a lower borrowing threshold would be the crux for SMEs to overcome their size limitations. The first step to achieve this purpose is for government departments and regulators

to re-examine the existing regulatory requirements so as to provide different participants with safe and easy access.

Addressing future challenges by promoting digitalization

In the digital era, much like a new currency in circulation, data circulation and application are prerequisites for economic development. It is estimated that in G7 alone, trade digitalization between 2019 and 2026 will manage to generate US\$9 trillion worth of additional income by bringing down trade costs. Digitalization can also help to resolve such pain points as lack of certification records, incomplete data, etc. that are common in emerging countries, narrowing the current financing gap worth a whopping US\$1.7 trillion. In the next few decades, digitalization will be the major solution to a string of challenges facing the global community. In tackling such issues as poverty, income inequality, climate change, etc., digitalization is a force to be reckoned with. Given the technologies and the common international standards already in place, a high degree of trade digitalization is not much of a tall order and most countries can complete the transformation process in a few or a dozen years.

In the meantime, Hong Kong should seize the opportunity to expedite digitalization among the Government and the public and private sectors, securing a head start in response to the new situation. Hong Kong can reference guidelines in the above international standards such as MLETR and, by promoting paperless trade for a start, so that electronic records and paper documentation will have the force of law to save cost and time of administrative procedures for SMEs. As a world-class trading hub, Hong Kong is set to benefit companies in Asia and even worldwide if the city becomes a pioneer in paperless trade.

While big companies manage data circulation through their own trade networks, SMEs are hampered by restrictions in terms of size, regulation, entry conditions, etc. Given the key role SMEs play in advancing equality and raising income, support for digitalization among these enterprises should be a priority in economic policy.