Policy brief

Diagnostics &

trade

finance
Trade finance is a term that describes the financial instruments and products used by companies to facilitate international trade and commerce. Access to trade finance makes it easier for suppliers and buyers of goods and services to do business by protecting against the inherent risks of trading, such as issues of non-payment and creditworthiness. For example, it may be used to bridge the financing gap in the supply chain between dispatch and receipt, providing reassurance for the seller (e.g., manufacturers and exporters) that payment will be received on delivery, and mitigating risk for the buyer (e.g., importers and distributors) by shifting the timing of payment. Trade finance is usually provided by a third-party intermediary, such as a bank or financial institution.

Timely delivery of diagnostics is key to achieving public health objectives. Delays in diagnosis lead to poor patient outcomes, inappropriate use of medications, and deficiencies in outbreak preparedness and management. Trade finance is essential to ensuring that diagnostics are available and accessible, particularly in low- and middle-income countries (LMICs), which have limited in-country manufacturing capacity and must therefore import the majority of their diagnostic needs.

In LMICs, governments frequently rely on small- and medium-sized enterprises (SMEs) to import and distribute diagnostic tests and devices. Governments procure the diagnostics they need through a tender process to which these SMEs respond. SMEs provide essential expertise, experience, customer service, product knowledge, last-mile delivery, and oversight. Many SMEs are also responsible for installation of devices, warehousing, maintenance, and training services.

SMEs are often required to bid on contracts that are large in relation to the size of their balance sheets and financial resources. The SME must pay the overseas seller prior to receipt of payment for the diagnostics from the government, as well as paying logistics providers, insurance, and customs fees. The SME must 'float' this difference, paying for goods and services upfront and then waiting for reimbursement. Maintaining sufficient liquidity throughout these procurement transactions, which can extend to 90 days or beyond, is exceedingly difficult. If they are not able to find appropriate alternative financing, SMEs may abandon the transaction, or the seller may offer in-demand goods to another buyer who can afford the upfront costs. Further, many overseas manufacturers require payment not only upfront, but in US Dollars or Euros. This makes the financing even more difficult, as the SME must source another currency to make the required upfront payment. These challenges often leave contracts unfulfilled and healthcare systems in LMICs without essential diagnostic tools.

Trade finance can address this issue by providing working capital during the transaction period. However, SMEs in LMICs often struggle to obtain trade finance as banks associate them with high solvency risks and therefore require extensive collateral and higher-than-market interest rates, which can put loans out of reach. According to a survey conducted by the Asian Development Bank, more than 40% of trade finance applications that are rejected by banks come from SMEs. When trade finance is received, the SME must pass the high cost of debt on to customers, decreasing the affordability and availability of products to the end consumer.

Over US$220 million worth of COVID-19 Ag RDTs were ordered by Ministries of Health in low- and middle-income countries, through tenders to be paid using domestic funding. However, these products never got to market because of overseas manufacturers’ upfront pricing models and lack of access to trade financing capital by local SMEs.

Source: FIND & Kountable Trade Governance and Finance Analysis, 2021
Addressing barriers to trade finance for SMEs

A funding mechanism is urgently needed to encourage traditional investors and to de-risk investment in SMEs in LMICs. SMEs need a revolving fund that can be accessed quickly, for small amounts. This could unlock numerous trades that are outstanding, potentially representing millions of diagnostic tests in flux, as well as supporting future transactions.

There is also a need for strategies to reduce the high cost and inefficiency of obtaining working capital for SMEs. Local banks in LMICs require significant collateral, often in excess of 125% of the contract value, and their application processes are slow, paper-based, and cumbersome, which often derails potential trades.

Long-term affordable pricing agreements for healthcare tools are often made at the global level on behalf of LMICs. These agreements often leave the buyer, usually an SME, responsible for bearing the risk and costs of goods from the point of despatch from the seller’s warehouse, known as an ‘ex-works agreement’. Payment terms in which the seller bears the most risk and cost, such as Delivered Duty Paid terms whereby the seller takes responsibility for the goods until import and customs duties are passed, should be considered when negotiating pricing agreements to limit trade finance requirements for the SME.

The pathway from initial purchase through shipping and delivery to receipt by the ultimate buyer is complex, involving numerous different parties and process. Without an overview of this process, trades can become lengthy and inefficient, sometimes leading to failure. Digital platforms that can coordinate and organize the process, providing quick and easy access to relevant information, could improve governance of the overall transaction and prevent the delays and bottlenecks that can impede delivery.

SUMMARY

Trade finance is an essential mechanism to provide timely access to diagnostics in LMICs. Barriers to access to trade finance for SMEs who import and distribute diagnostics in LMICs must be addressed in order to ensure that critical tests and devices are accessible and affordable to those who need them, supporting universal health coverage and public health security goals.

References