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GFTN
GLOBAL FINANCE & TECHNOLOGY NETWORK

Connecting The World with Financial Trust and Digital Assets

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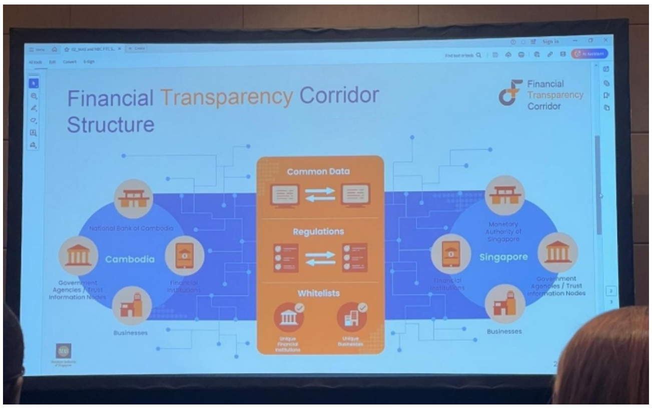
Executive Summary

As global trade moves towards digital transformation, small and medium-sized enterprises (SMEs) need to overcome systemic barriers to cross-border interaction. These include issues of currency volatility, high borrowing costs, and trust gaps in the existing global financial ecosystem. FTCs and innovations such as blockchain, tokenization, and new foreign exchange (FX) mechanisms provide viable solutions for creating scalable, trusted ecosystems for SMEs to expand internationally. This report outlines the key challenges SMEs face and presents actionable recommendations for creating more inclusive and effective digital trade infrastructures as well as how the public can best prepare and utilise them.

Introduction

In today's rapidly developing and globalised world, access and connectivity has never been higher. People can communicate and transact across borders. Beyond major corporations, small and medium-sized enterprises (SMEs) can ride the wave and seize these opportunities to operate beyond their domestic borders or risk falling behind, leaving profits and potential unturned.

However, many SMEs struggle to do so due to a wide range of reasons, such as being unable to access financial resources and global trade networks due to high transaction costs, lack of interoperability, and limited financial inclusion. A roundtable held at the 2024 edition of the Insights Forum, which convened players from central banks, multilateral agencies, and financial institutions, explored how these players can leverage emerging technologies and digital finance systems to connect SMEs with global markets.



Source: Insights Forum Presentation

One of the most promising solutions for connecting SMEs with global markets are integrated Financial Trust Corridors (FTCs). FTCs function as the digital version of physical trade corridors, which facilitate trade across major centres of economic activity by providing favourable transport and logistics infrastructure.

Likewise, FTCs are digital frameworks that build trust, transparency, and connectivity between financial institutions and businesses across borders, by allowing for the exchange of common data, the utilisation of smart digital assets and the democratised access to foreign exchange. By addressing challenges such as currency risk, data gaps, and regulatory misalignment, FTCs can make cross-border trade smoother and more accessible for SMEs, thus driving economic growth on a global scale. A recent study by McKinsey on digital trust which surveyed 1,300 businesses and 3,000 consumers globally noted that organisations that are best positioned to build digital trust will see annual growth rates of at least 10% on their top and bottom lines.[1]

Key Insights and Recommendations

1. Leveraging Blockchain for Transparency and Efficiency

If technology has reshaped the expectation people have in their daily lives in terms of convenience in communication, so too has it reshaped expectations for financial transactions, with higher demand for instantaneous and efficient communication. However, high costs and long waiting times still plague cross-border transactions. For SMEs operating beyond domestic borders, any delay in payments or additional barriers to validate trade documents are steps too many and too costly to traverse. Blockchain technology has the potential to rectify this problem and change the game of cross-border trade, by enabling real-time transaction tracking, simplifying compliance requirements, and reducing costs.

The advantage of blockchain is its immutable, transparent ledger of transactions. This increases traceability which reduces the risk of fraud by facilitating the tracking of the flow of funds and ensuring that all parties have access to the same information. This also has the added benefit of streamlining cross-border payments by enabling the verification of trade data and credentials before the funds are even released, allowing things to run with less barriers and ensuring that the transaction is legitimate and compliant with all regulations beforehand.

Actionable recommendations

The development of international standards around blockchain use in trade finance can ensure interoperability across borders and systems. This can be done through a commonly agreed list of data to be made public as well as increasing sufficiency and scope of data to allow for better scaling.

To further increase efficiency, the creation of green lanes can be carried out with the support of banks.

2. Enhancing Trust Through Financial Trust Corridors (FTCs)

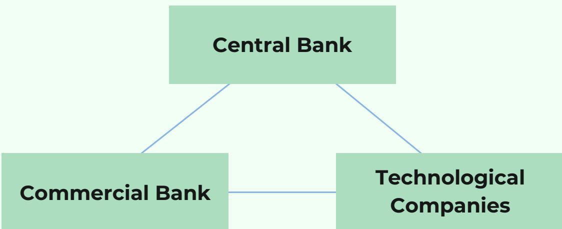
One barrier to cross border trade is the lack of trust between financial institutions and businesses, one which is usually mediated by third parties, such as commercial banks and credit-scoring institutions. SMEs in developing economies struggle to attain financing or investments as traditional financial institutions typically are unable to assess their creditworthiness, due to a lack of data.

FTCs address these challenges by enabling secure data sharing, creating scalable digital ecosystems that support cross-border financial services and improving data accessibility. To build a network of trust, FTCs bring together central banks, multilateral agencies, payment solutions providers, and financial institutions, as a means of ensuring that transaction data is verifiable and trustworthy.

The SME FTC between the Monetary Authority of Singapore and Bank of Ghana, for instance, has a governance framework and digital infrastructure which banks and fintech firms in both countries can refer to and use to share information necessary for credit assessments. This helps to promote trust for SMEs by financial institutions, and enables them to engage in cross-border trade more easily.

By sharing a standardised pool of datasets, banks can gain insights into the financial health of SMEs, reducing the perceived risks of lending. Such collaborations can make cross border payments more affordable, improve the efficiency of transactions, and increase the availability of supply chain financing and other financial services for the previously underserved.

Actionable recommendations:



- Triangle of trust: Central banks, commercial banks, and technological companies must all play a part in the trifecta to create the ecosystem needed for the corridor. They act as points of trust by creating a safe domain, breaking down initial barriers.

- Adopting a “once-only” principle ensures that SMEs only need to provide data once based on trust, ensuring secure and accurate data exchange now where it is required and increasing the interoperability of state databases allowing for seamlessness.

3. Currency Risks for SMEs in Emerging Markets

Currency volatility is a substantial risk for SMEs in emerging markets, due to the significant impact of minute fluctuations in exchange rates. SMEs frequently obtain loans in foreign currencies with 70 to 85 percent of their long-term borrowing being in hard currency, typically US dollars. This is because of the restricted availability of financing options in local currency. When an external crisis hits financial markets, such as the Covid-19 pandemic, the standard reaction of investors is to flee into the dollar, regardless of where the problem lies, causing the currency of emerging markets to tank. As emerging market currencies go down, the value of the dollar goes up, putting SMEs in a tough spot due to the decreased real value of their currency.

Foreign exchange (FX) concerns can be alleviated through multi-currency financing alternatives, FX hedging systems, and stable digital currencies. For example, should hedging tools or multi-currency accounts integrate and gain access to FX, SMEs can lock in exchange rates at favourable conditions, securing more profits and avoiding the unpredictable fluctuations that could negatively affect their bottom lines. This is a form of mitigation for currency risk exposure, allowing them to make more informed and viable decisions for cross border trade.

Actionable recommendations:

- Develop accessible FX hedging tools to allow SMEs to protect against currency fluctuations and reduce risk in cross-border transactions. Nostro accounts and multi-currency financing options can also be implemented to provide stability for SMEs in emerging markets.

4. Building Scalable and Inclusive Digital Ecosystems

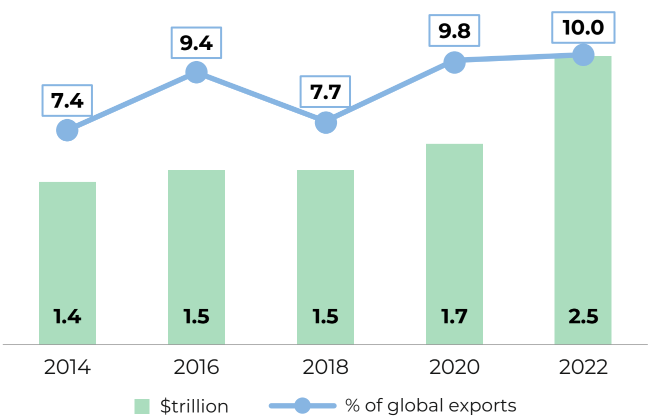
Whilst scalability for larger corporations is important, inclusivity is crucial for the success of FTCs, allowing for systems that are accessible to smaller SMEs and those underserved in the markets. Such digital finance ecosystems should be designed to specifically address the unique needs of SMEs in developing economies, where access to financing, digital tools, and training are often limited.

One example is the Financial Transparency Corridor (FTC) initiative between MAS and the National Bank of Cambodia (NBC) which aimed to increase SME trade across both countries.[2] The initiative aims to tackle the issue of digital trust by enabling the bilateral sharing of data. Through a consent-based digital infrastructure, the corridor aims to support financial institutions in making better credit risk assessments and hence support SMEs in accessing financing opportunities in Singapore and Cambodia.

International standards are also critical for supporting the development of scalable and inclusive digital ecosystems. These include Europe's eIDAS, a standardised digital identity framework that facilitates secure cross-border transactions, reducing fraud and helping businesses and consumers access a wide range of digital services. These standards serve to encourage the development of interoperable solutions across countries, improving the trustworthiness and legitimacy of cross-border transactions.

5. Overcoming the Global Trade Finance Gap with Innovative Solutions

Figure 1: Global Trade Finance Gap



Sources: ADB. 2023 Trade Finance Gaps, Growth, and Jobs Survey—Banks; and World Trade Organization. WTO Data. https://data.wto.org/ (accessed 19 July 2023).

During the discussion, roundtable participants noted the global trade finance gap of $2.5 trillion, which represents the global unmet financing demand to support imports and exports.[3] This financing gap disproportionately affects SMEs which remain underserved in international trade. The exclusion prevents them from participating in international trade, which limits their growth potential.

New solutions that ride on technology such as blockchain-backed tokenization and smart contracts can offer more accessible, efficient, and transparent alternatives to traditional collateral-based financing models. Tokenization allows for the conversion of conventional trade assets into digital tokens, which can increase liquidity without the need to rely on physical assets, thus enabling them to expand internationally.

Actionable recommendations:

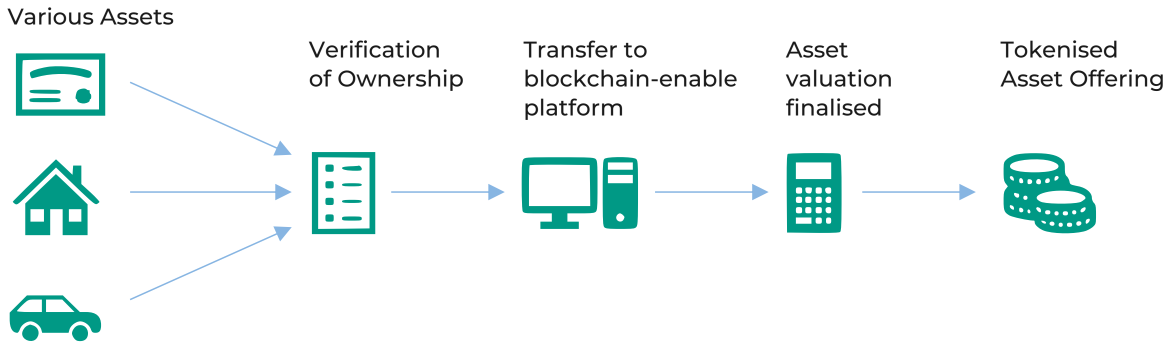
- The tokenization of trade assets such as invoices, receivables, and trade contracts can unlock new financing sources for SMEs, enabling them to engage more easily in international trade.
- Develop smart contract solutions that automatically execute trade financing transactions based on predefined terms, reducing delays and ensuring trust between all parties involved.

6. Fostering Digital Financial Literacy to Empower SMEs

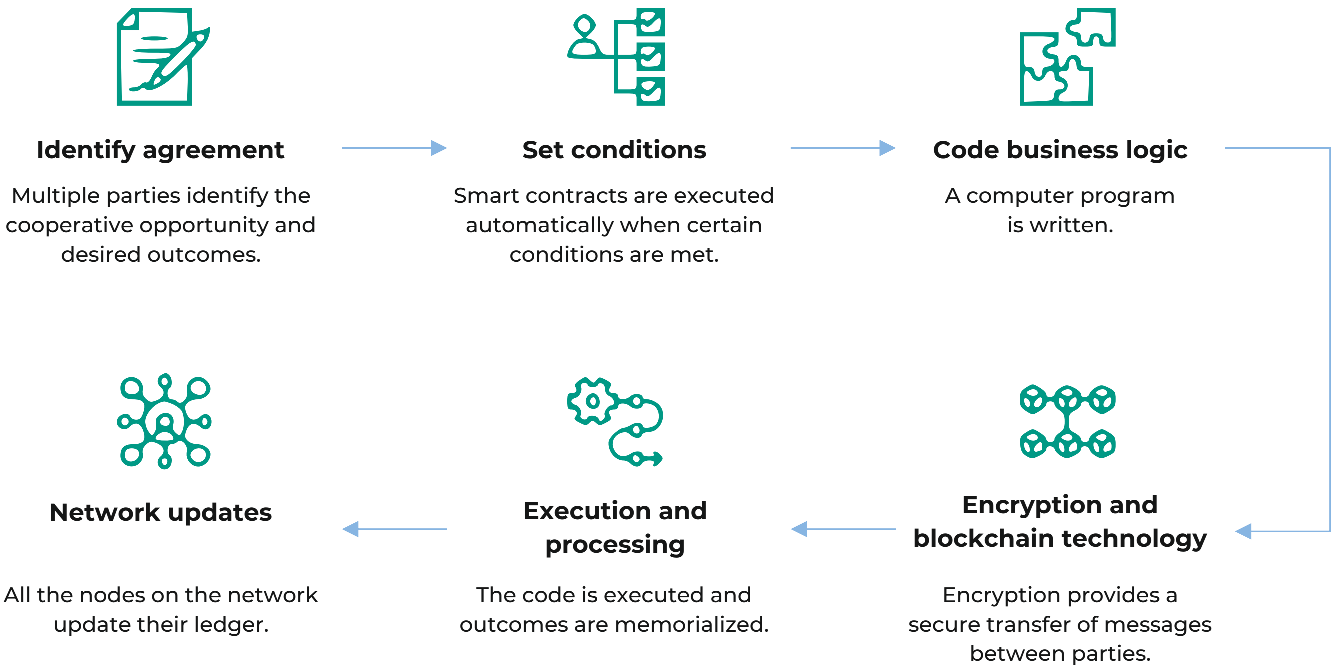
A key issue when it comes to the adoption of new solutions among SMEs is the lack of digital financial literacy. Poor digital financial literacy can prevent SMEs from exploring new solutions and opportunities that could support their long-term growth, as they may lack the ability, skills, or understanding to navigate these new platforms.

Actionable recommendations:

- Develop digital literacy and financial education programmes suited to the perspective of SMEs which can equip them with the skills to properly leverage on these technologies.
- Adopt explainable and easy to use UI/UX principle to reduce the barrier to entry needed to engage with these platforms.



How Does A Smart Contract Work?



Conclusion

Cross-border trade is essential for global economic growth, yet SMEs face significant barriers that hinder their ability to access international markets. FTCs provide a framework to overcome these barriers by enabling secure data sharing, reducing currency risks, and fostering trust between financial institutions and businesses.

The integration of blockchain and FX solutions further enhances transparency and efficiency, making cross-border transactions smoother and more accessible. However, to maximise the potential of FTCs, it is necessary to build scalable and inclusive ecosystems, invest in infrastructure, and foster collaboration among stakeholders. With these efforts, SMEs can fully participate in the global economy, unlocking new opportunities for growth and development.

Authors

Yogesh Hirdaramani
Content Manager, GFTN

Nicholas Pramono
Student, St Joseph Instuition

Production

Sachin Kharchane
Graphic Designer

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Global Finance &
Technology Network (GFTN)

6 Battery Road, #28-01, Singapore 049909
gftn.co | hello@gftn.com

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