

The Impact of Exchange Rate Fluctuations on the International Trade Financing Costs of Small and Medium-Sized Enterprises and Legal Countermeasures

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Abstract. In the globalized economy, small and micro enterprises (SMEs) increasingly engage in international trade, facing significant challenges from exchange-rate volatility. These fluctuations can escalate trade-financing costs, posing substantial risks to SMEs' financial stability and competitiveness. Combining theoretical analysis with case studies, this study investigates how exchange-rate movements impact the international-trade financing costs of SMEs and explores effective legal-policy strategies to mitigate these effects. The research reveals that exchange-rate fluctuations significantly increase trade-financing costs through currency-swap losses, higher credit costs, and elevated financial risks. By analyzing domestic and international financial theories and risk-management systems, the study proposes comprehensive legal regulatory measures, including domestic institutional reforms, financial-supervision regime changes, and international law cooperation mechanisms. By surveying theories of domestic and international financial markets and risk-management systems, empirical evidence shows that a robust legal framework and strong policy instruments can effectively reduce SMEs' exposure to exchange-rate risks, lower their financing costs, and enhance their global competitiveness.

Keywords: Exchange-rate volatility, Small and medium-sized enterprises, Cross-border trade finance, Cost of capital, Legal and regulatory framework

1. Introduction

With the rapid advancement of global economic integration, international trade has become a key driver of economic growth in various countries, and its importance has become increasingly prominent. As crucial participants in the international trade system, small and medium-sized enterprises (SMEs) occupy a core position in the global value chain. According to the latest statistics from the World Bank, SMEs contribute approximately 40% of global international trade volume and more than 50% of employment opportunities. Nevertheless, SMEs encounter a variety of systemic risks when engaging in international trade, among which the financial risks caused by exchange rate fluctuations are the most significant.

Exchange rate fluctuation is a basic feature of the international financial market, and its influencing factors are diverse and complex. Shi Xiaoxia's research points out that against the

background of intensified global financial fluctuations, exchange rate fluctuation has become a key factor affecting the international trade financing risks of SMEs [1]. Such fluctuations are not only driven by traditional economic factors such as differences in macroeconomic fundamentals and adjustments in monetary policies but also strongly influenced by non-economic factors such as geopolitical conflicts and fluctuations in market sentiment. Zhao Zhixin further reveals that exchange rate risk has a particularly significant negative impact on SMEs in specific industries such as construction [2].

This paper analyzes the institutional flaws in the present legal and regulatory framework and examines the ways in which exchange rate changes affect SMEs' financing costs through a variety of channels. It uses a thorough approach that blends theoretical analysis and empirical research, building a multi-level analytical framework to methodically investigate the economic effects and transmission mechanisms of exchange rate changes. The findings aim to enrich the theories of SME financing constraints and exchange rate risk management, offering new theoretical perspectives and policy recommendations to enhance the international competitiveness of SMEs.

2. The current situation of international trade financing for small and medium-sized enterprises

Currently, the international trade financing of small and micro enterprises in China presents a development status of differentiation and asymmetry, with their financing channels mainly centered on three core pillars: traditional bank financing, trade credit systems, and emerging fintech platforms. For traditional financing, although products such as letters of credit, packing loans, and import/export bills provided by commercial banks are highly secure and standardized, they often "shut out" some small and micro enterprises due to high entry thresholds [3]. In contrast, models such as accounts receivable financing or advance payment financing based on the business reputation of both buyers and sellers are more flexible, but they cannot meet the medium- and long-term capital needs of small and micro enterprises due to scale limitations. It should be noted that with the rapid evolution of financial technology, new methods such as cross-border e-commerce platform financing or blockchain-based supply chain financial financing are gradually developing into core alternatives to solve the international trade financing problems of small and micro enterprises.

Therefore, for many small and medium-sized enterprises (SMEs), there exists a serious problem of "difficulty in financing". Practical survey data shows that compared with large companies, the interest rate spread for trade financing of SMEs is often two to three hundred basis points higher than that of the latter. These additional costs are caused by various factors such as loss compensation, information asymmetry, and diseconomies of scale [4]. The typical manifestations of these problems are as follows: higher collateral is required to meet banks' requirements, loan terms are shorter (with approximately 65% of loans having a duration of less than 1.5 years), and the approval process is complex and lengthy. These financing inadequacies not only affect the total volume of international trade of small enterprises but also directly impact their international competitiveness.

For SMEs, their ability to cope with exchange rate risks is particularly fragile. Studies have found that few SMEs (19%), even less than one-tenth, can effectively establish systematic exchange rate risk management and proactively avoid exchange rate risks using financial derivatives [3]. The main reasons are a series of structural factors such as the lack of professionals, imperfect institutional settings, and insufficient effective defensive measures. Especially for small enterprises in industries with obvious cyclical characteristics such as construction, their exchange rate risk exposure is much

higher than that in other industries, but their exchange rate risk management capabilities do not have obvious advantages.

With the development of the digital economy, digital finance is changing the cross-border trade of SMEs. Blockchain technology has greatly accelerated the identification of the authenticity of trade backgrounds; big data risk management models have partially alleviated the problem of information asymmetry; and artificial intelligence technology has further promoted the simplification and improvement of loan approval procedures. However, there is a significant imbalance in the digital transformation of SMEs in different regions. According to relevant research, about 40% of SMEs have not truly participated in the digital financing system, and the "digital divide" has objectively increased the uncertainty of the financing environment [5].

The current institutional system still has defects in terms of financing for small and micro enterprises' overseas business transaction funds. Firstly, the legal system for international foreign exchange requires small and micro enterprises to achieve a high level of compliance to use financial instruments. Secondly, the relevant regulations on important steps such as overseas loan business and advance payment mortgages are insufficiently improved. The institutional gray areas and uncertainties not only increase compliance costs for small and micro enterprises but also constitute a "institutional premium". It is worth noting that the regional financial reform pilots in free trade zones have shown that institutional innovation can effectively reduce the financing costs of small and micro enterprises, which has reference value for national institutional reforms.

3. The impact of exchange rate fluctuations on the cost of international trade financing

For small and medium-sized enterprises (SMEs), exchange rate fluctuations affect the cost of international trade financing in an all-round way. Existing studies have shown that exchange rate fluctuations directly increase foreign exchange transaction losses of companies and indirectly raise financing costs by altering banks' risk rating standards and market financing requirements [6]. Such impacts are more pronounced in economies at the developing stage and regions with underdeveloped markets, being one to two orders of magnitude higher than in developed countries.

The indirect effect impacts corporate operations through exchange losses. When enterprises hold foreign currency assets or liabilities, or conduct transactions with exchange rate-linked price terms, exchange rate changes will revalue their balance sheets. It is estimated that for every 1% change in the RMB exchange rate, the exchange losses of small and micro enterprises in foreign trade transactions account for 0.8% - 1.2% of their revenue. Debts denominated in foreign currencies and purchases of raw materials will disrupt enterprises' cash flow forecasts and solvency assessments [7].

Indirect transmission stems from the risk rating systems of financial institutions. During periods of high market volatility, financial institutions revise their risk pricing models to measure credit risks. Wei Lina's research indicates that this may significantly increase the loan interest rates for small and micro enterprises. Each one standard deviation of exchange rate fluctuation may raise financing costs by 35 - 50 basis points, which stems from channels such as increased uncertainty in enterprises' operating funds, higher volatility in financial reports, and reduced predictability of collateral assets [8].

There is asymmetry in the feedback of exchange rate fluctuations on financing costs. Zhou Ruoxin et al. found that when the exchange rate moves in an unfavorable direction, banking financial institutions tighten loans to small and micro enterprises to a greater extent, putting small and micro enterprises in a more disadvantageous position in coping with the exchange rate environment. When the local currency appreciates significantly, export-oriented small and micro

enterprises face the dual blow of declining product competitiveness and deteriorating financing conditions, making the expansion of overseas markets more challenging [6].

SMEs in different industries have varying exchange rate sensitivities due to industry characteristics. Studies have shown that enterprises with high export dependence, high substitutability, and low profit margins have a stronger desire to transfer costs caused by exchange rate changes. There are structural differences in enterprises' ability to convert and prevent exchange rate risks, which is more prominent in the construction industry. The impact of exchange rate fluctuation shocks on financing costs may be superimposed [8].

The impact of exchange rate changes on financing costs is time-varying. It is minimal in stable markets but can escalate non-linearly in turbulent ones. Wu Gongliang's research shows that after the exchange rate volatility reaches the upper limit, its effect on the financing costs of small and micro enterprises will change abruptly. General linear models may fail to accurately estimate the substantial impact of exchange rate risks in extreme market environments, increasing the difficulty of risk management [7].

4. Legal countermeasures

4.1. Improvement of the macro legislative and regulatory framework

Julian and John's research reveals that there is a lack of an institutional framework designed to address the impact of the externalization of global financial policies on small and medium-sized enterprises (SMEs). The current round of aggressive interest rate hikes by the United States has led international banks to reduce the outflow of US dollar funds. Small and micro enterprises in emerging markets, unlike large multinational corporations, struggle to lower hedging costs to cope with shocks and find it difficult to offset the rise in hedging expenses caused by US dollar sell-offs. In response to the impact of exchange rate fluctuations on the international trade financing costs of SMEs, the establishment of a sound legal countermeasure system is of vital importance [9,10].

The legal framework for foreign exchange risk management should be improved. At the national level, special guidelines for SME exchange rate risk management ought to be formulated to clarify the basic requirements for enterprises to establish foreign exchange risk management systems [11]. Meanwhile, foreign exchange management regulations should be revised to provide more convenient conditions for SMEs to use financial derivatives. Taking South Korea as an example, during the sharp fluctuation of the Korean won in 2015, the South Korean government launched a "package plan for SMEs to cope with foreign exchange risks". This comprehensive initiative included measures such as expanding the quota for foreign exchange derivatives transactions, providing subsidies for exchange rate risk consulting, and establishing an emergency financing mechanism. Effective legal countermeasures can significantly enhance SMEs' ability to respond to exchange rate risks.

4.2. Internal governance and contractual arrangements at the enterprise level

Against the backdrop where exchange rate fluctuations have increasingly become a normal exogenous phenomenon, if small and medium-sized enterprises (SMEs) still regard exchange rate risks as occasional events rather than strategic operational variables, they will hardly escape the fate of "profits coming from foreign exchange and losses also coming from foreign exchange". Therefore, the internal governance structure of enterprises and external contract clauses must be reengineered simultaneously. External market fluctuations should be incorporated into contracts as

identifiable, distributable, and remediable legal rights and obligations, and exchange rate risk management should be elevated from a tactical tool of the financial department to a governance issue at the board level [12].

Take a precision mold enterprise in Ningbo that exported 15 million euros to Germany as an example. Internally, the board of directors formulated the Exchange Rate Risk Management System, setting the maximum acceptable exchange loss at $\leq 5\%$ of export gross profit. Externally, it signed an insurance contract and added a dual-trigger clause of "force majeure + extreme exchange rate fluctuations" in the contract. As a result, the enterprise made a profit of 1.8 million yuan from forward contracts and received 1.4 million yuan in insurance compensation, with a total hedging amount of 3.2 million yuan, successfully maintaining its profit margin.

Legislation, oversight, financial institution responsibilities, company governance, and dispute resolution are only a few of the legal countermeasures that might successfully lessen the negative effects of currency rate swings on SMEs' international trade finance expenses.

5. Conclusion

This study conducts a systematic analysis of the mechanism through which exchange rate fluctuations affect the international trade financing costs of small and medium-sized enterprises (SMEs) and proposes targeted legal countermeasures accordingly. It is found that exchange rate fluctuations significantly increase SMEs' financing costs through multiple channels, such as causing exchange losses, lowering credit ratings, and triggering cash flow volatility. This impact is particularly prominent in emerging markets. Effective legal response strategies should cover key areas including improving foreign exchange risk management laws and regulations, optimizing financial regulatory policies, and establishing international legal coordination mechanisms.

While this study makes several contributions, including constructing a systematic and multi-dimensional framework of legal countermeasures, and verifying the effectiveness of these countermeasures through specific case analyses, it also has some limitations. The sample size used in the case analyses is relatively small, which may limit the generalizability of the findings. Additionally, the study primarily focuses on legal countermeasures and could benefit from a more detailed examination of other potential risk management strategies.

Future research should focus on the following directions: exploring the transformative impact of digital technologies on traditional exchange rate risk management models; analyzing the differences in sensitivity to exchange rate fluctuations among SMEs in different industries; and investigating emerging issues such as exchange rate risk management in green trade financing. Against the backdrop of profound changes in the global economic landscape, such research will help SMEs better cope with exchange rate risks and enhance their competitiveness in the international market.

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