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Outline

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The Trade Finance Market in Africa

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1 | Introduction

Trade contributes to economic growth and development through different channels. Exports allow firms to access larger markets and to innovate through greater competition, leading to higher productivity and growth. Imports expand the range of goods and services that consumers can access. In addition, imports allow firms to access machinery and intermediate goods for production purposes. In the past decade, trade has been a major contributor to Africa's economic growth, and expanded at an average annual rate of about 8% (Figure 1). Yet, importers and exporters are faced with the key challenge of financing cross-border trade where there is a significant lag between payments and the delivery of goods and services. In the absence of trade finance, international trade would be daunting since distance and institutional differences between trading partners in different countries make contract enforcement difficult. By providing financing for trade transactions, trade finance helps firms to better manage risks, improve their liquidity and enables them to optimally invest to enhance their growth.

Despite the importance of this intermediation activity, there is a great deal we do not know about the trade finance market in Africa. This includes the approximate size of trade that is intermediated by banks, its variation across sub-regions, the share going to intra-African trade, the importance of this sector for banks' earnings, and how the characteristics of trade finance evolves with other macroeconomic variables. Without an accurate picture of the current trade finance landscape on the continent, it is challenging for policy makers and development finance institutions to implement targeted programs to address the trade finance gap.

This brief summarizes some of the findings of the African Development Bank's survey of trade finance activities performed by commercial banks in Africa over 2011 – 2012 (AfDB 2014). The survey questionnaire was sent to approximately 900 banks in Africa, out of which 277 banks responded. The respondents come from 45 African countries spread over all the sub-regions.

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2 | Participation in Trade Finance by African Banks

The vast majority of banks in Africa engage in trade finance (Figure 2). Specifically, about 93% of surveyed banks have provided trade finance activities. This proportion is roughly the same in 2011 and 2012. This high participation rate also holds across all sub-regions but at different levels. The participation rates of commercial banks in Central, East, North, Southern and Western Africa are 100%, 91%, 95%, 89% and 94% respectively (Figure 3). Interestingly, there is no significant difference between fragile and non-fragile states in terms of the proportion of banks engaged in trade finance.

Figure 1 Trade and GDP in Africa over 2000-2012

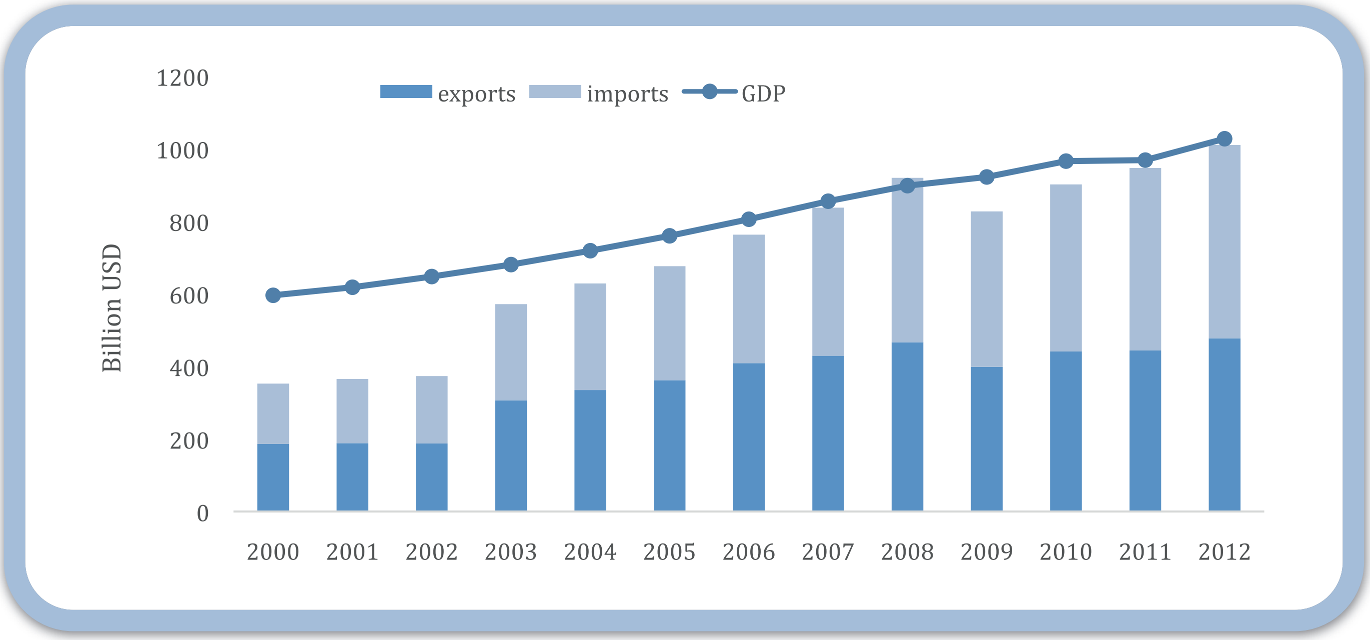


Figure 2 Proportion of Commercial Banks Providing Trade Finance in 2011 and 2012 in Africa

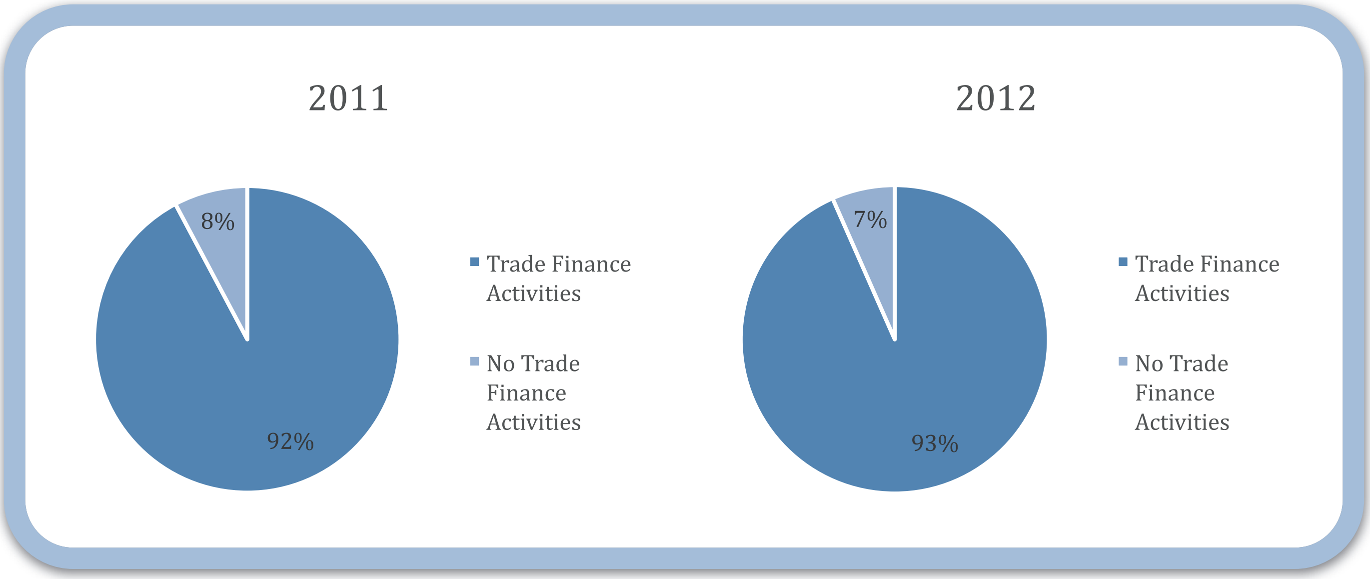
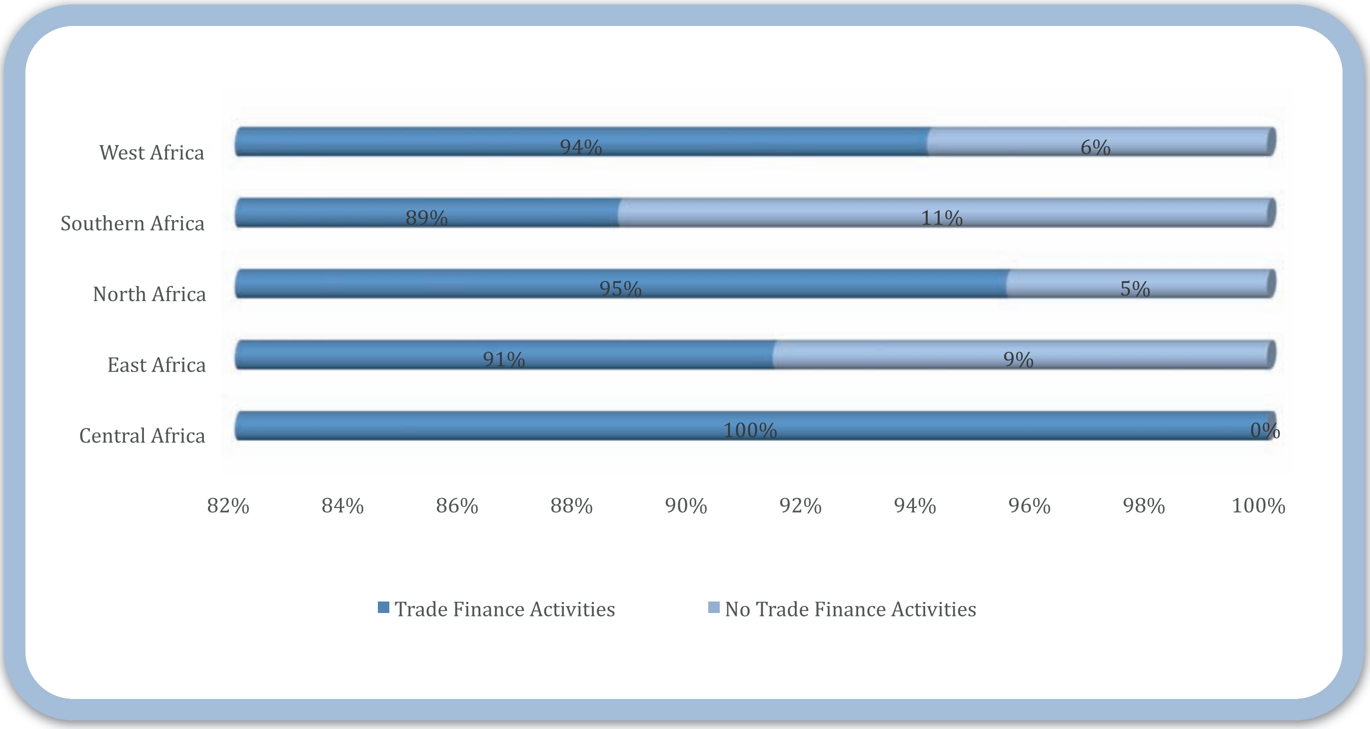


Figure 3 Proportion of Commercial Banks Engaged in Trade Finance in 2011 and 2012 by sub-Region



3 | Importance of Trade Finance as a Source of Income for Banks

Trade finance is a significant source of income for banks. On average, about 17% of banks' income in Africa comes from trade finance operations. This share has been stable between 2011 and 2012 (Figure 4). The share is relatively lower for banks that are majority publicly (government) owned at 14%. This is followed by majority foreign-owned banks at 17%, while 18% of the income for majority privately (local) owned banks comes from trade finance. Banks with other forms of ownership report the highest share of income from trade finance at 21%. Hence, there seem to be little variation in the scale of trade finance operations related to the ownership structure of our sample banks.

There is however important variation in the share of income from bank's trade finance activities across geographical sub-regions. The share is lowest in Southern Africa (12%) and highest in Western Africa (21%). There is negative correlation between the level of financial development and the share of banks' income from trade finance activities. For instance, banks in fragile and low-income countries derive a greater share of their income from trade finance (25% and 19% respectively) relative to non-fragile states and middle-income countries (15% and 16% respectively). This could reflect greater depth and complexity of financial market which enables banks to offer a wider array of instruments or financial products, and hence becoming less reliant on trade finance. Another possible reason, which is related to the previous point, is that firms in less developed markets are less likely to access inter-firm credit (trade credit) which makes their demand for trade finance more important, all things being equal. This situation leaves this set of firms with the options of only cash-in-advance and trade finance, the latter being less costly. We also find that banks in oil-importing countries have a greater share of their income from trade finance (21%) than those in oil exporting countries (17%) (Figure5). This difference is likely due to the fact that in some African countries, governments help facilitate imports in sectors considered strategic such as the energy sector. For instance in Ghana, the Central Bank has trade facilitation programs to support trade finance for strategic sectors of which oil importation is the most important component. Another explanation is that African oil exporters are less likely to request trade finance from their foreign buyers than foreign firms from African buyers because of differences in risk perception.

[1] Some of these banks included other mixed ownerships and joint ventures or equal foreign and domestic ownership shares.

Figure 4 Average Share of banks' income from trade finance activities by year and ownership

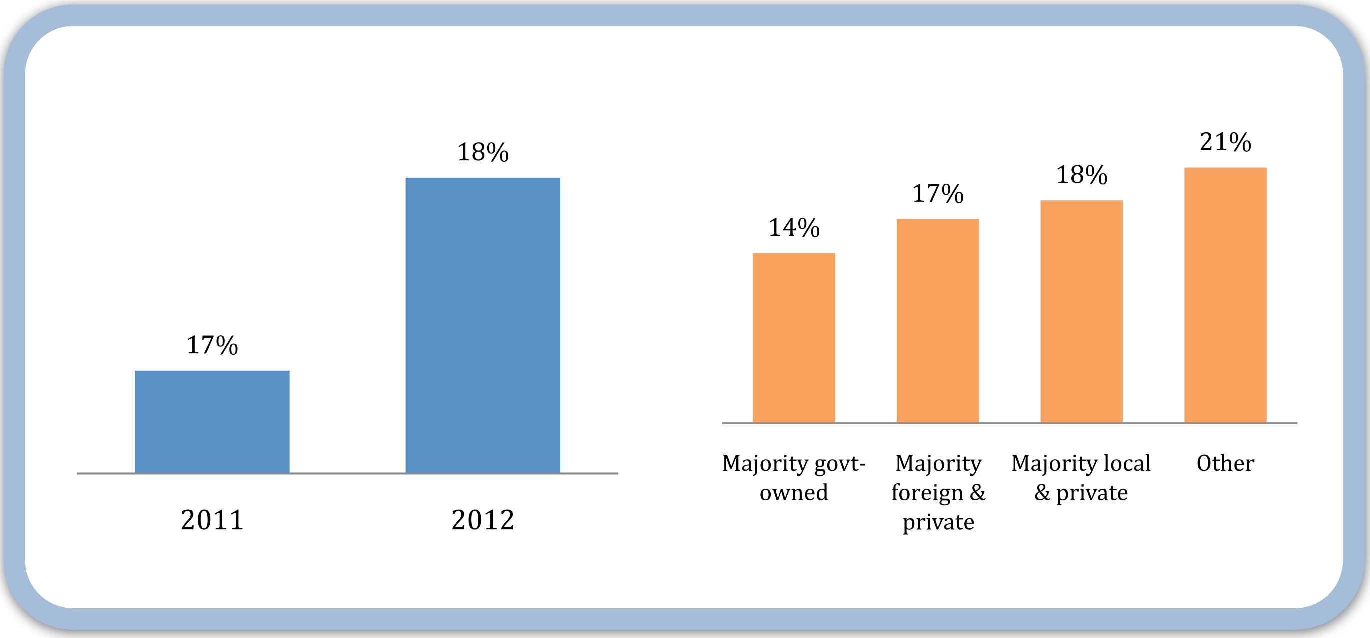
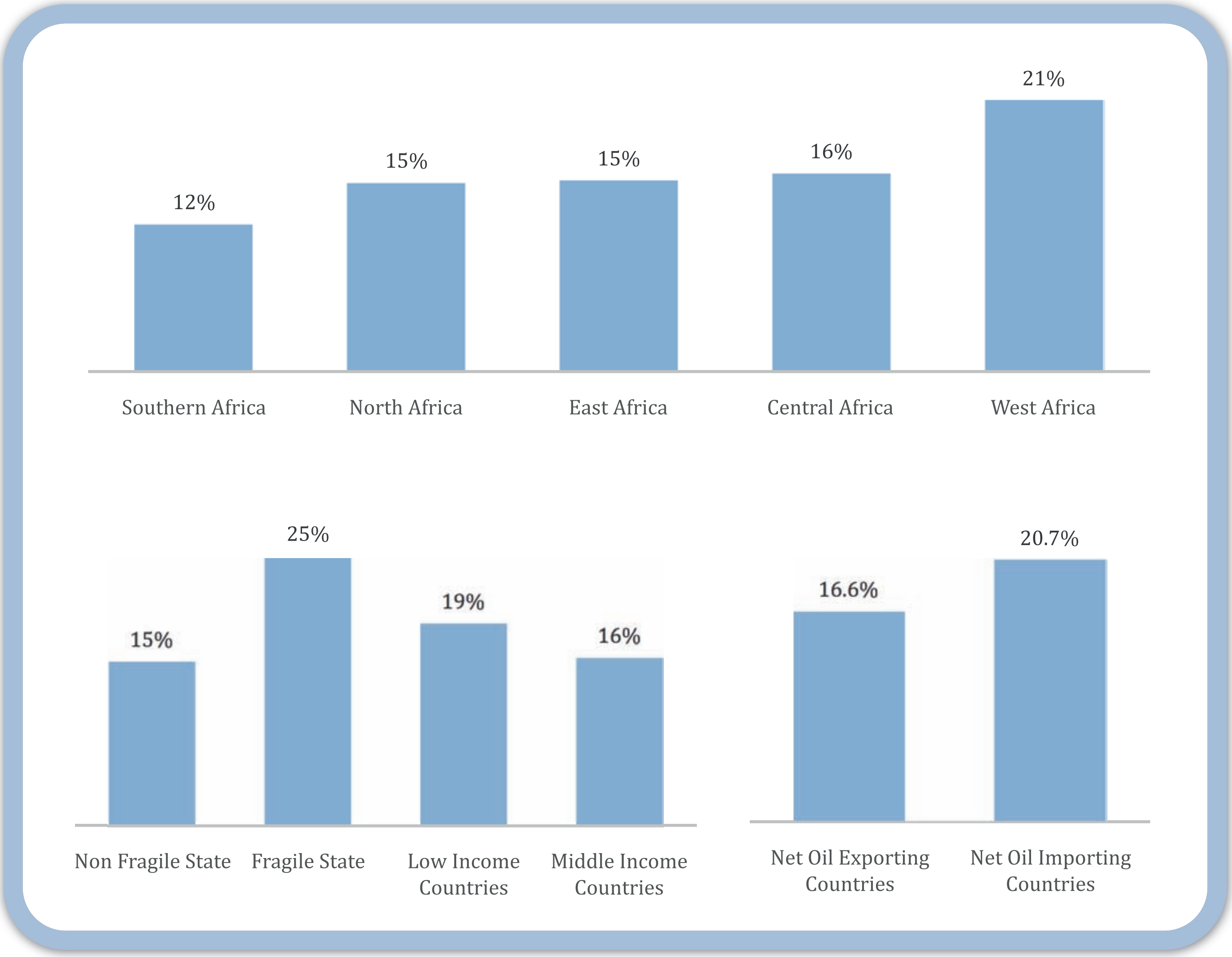


Figure 5 Average Share of Bank's Income from Trade Finance by Country Type and sub-region (2011-2012)



4 | Trade Finance Assets: On and off-Balance Sheet operations

Banks offer trade finance both through on-balance sheet and off-balance sheet operations. The main on-balance sheet trade finance instruments are short-term loans such as pre-export loans, post-import loans and trade-related revolving credit, while the key off-balance sheet activity is the issuing of letters of credit. The average annual value of off-balance sheet trade finance assets of banks stood at USD 297 million in 2011 and USD 270 million in 2012. The average value of on-balance sheet trade finance assets was USD 136 million in 2011 and USD 127 million in 2012. This decline in the value of trade finance assets is consistent with the findings of the 2013 International Chamber of Commerce (ICC) survey of mostly advanced economies which revealed a decline in certain trade finance activities over this period. A majority of banks in that survey reported either a decline or no change in both import and export letters of credit over the same period (ICC 2013).

There are major differences across sub-regions in the average value of trade finance assets. Specifically, the mean values for off-balance (USD 13930 million) and on-balance sheet (USD 319 million) trade finance assets of North African banks dwarf those of other sub-regions (Figure 6). This partly reflects the fact that the trade volumes in Northern Africa are significantly higher than most of the other sub-regions. The average trade finance asset values in Western and Eastern Africa are closer to the median of the distribution in Africa. The Central African sub-region has the lowest average values for on-balance sheet (USD 6 million) and off-balance sheet (USD 136 million) trade finance assets.

Figure 6 **The Values of on and off-Balance Sheet Trade Finance Assets by Year, Bank Ownership Structure, sub-Region and State Type from 2011 to 2012. Values are in USD millions**

5 | Size of Bank-Intermediated Trade Finance in Africa

From average values of the trade finance assets and the proportion of commercial banks engaged in trade finance activities, we can provide a rough estimate of the size of bank-intermediated trade finance market on the continent. This value amounts to about USD 350 billion in 2011 and USD 330 billion in 2012. The value of trade (sum of imports and exports) in Africa was approximately USD 950 billion in 2011 and USD 1 trillion in 2012. In other words, the estimated value of trade finance undertaken by our sample commercial banks ranged from 33% to 38% of the African trade over this 2-year period. Furthermore, the majority of the bank-intermediate trade finance (about 68%) is off-balance sheet trade finance (e.g. letters of credit), while the rest was financed with on-balance sheet instruments (e.g. short-term loans).

The above estimate is within the range found in other recent studies. BIS (2014) estimated globally bank-intermediated trade finance to range between USD 6.5 trillion to USD 8 trillion in 2011, covering about one-fifth to a third of global trade. Within this amount, it estimated African bank intermediated trade finance to represent about 5%. The IMF and BAFTA-IFSA (2011) estimated that bank-intermediated trade finance covers about 40% of total trade. Dornel (2014) estimated the share of bank-intermediated trade finance in Africa to be about 30%, which is very close to our estimate.

6 | Conclusion

Trade finance is vital in facilitating international trade, and therefore critical for economic growth. It is particularly important when trading partners are separated by distance, when trading firms are small with no international reputation, contract enforcement is difficult or information asymmetry and high risk perception is prevalent between trading countries. Trade facilitation and greater economic integration is important for Africa, given its small markets, a relatively high share of its trade with other regions and a high degree of limited access to finance for firms. The estimated size of bank-intermediated trade finance was over USD 300 billion in both 2011 and 2012, covering about a third of the total value of the region's trade. This estimated size of the market is consistent with the values suggested by other reports.

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