Trade Finance in Africa

Overcoming Challenges

AFRICAN DEVELOPMENT BANK GROUP

Cover first photo: Shutterstock photo
Photo 1 by Stephane Bidouze

 Published September 2017
Printed in Côte d'Ivoire.

TABLE OF CONTENTS

Table of Contents

Foreword	4
Acknowledgements	6
Executive Summary	7
Chapter 1: Overview and Main Findings	11
Chapter 2: Trade Finance Landscape	19
Chapter 3: Trade Finance Gap in Africa	35
Chapter 4: Constraints to Trade Finance Growth	47
Chapter 5: Trade Finance for Intra-African Trade	53
Chapter 6: Trade Finance for SMEs and New Market Entrants	59
Chapter 7: The AfDB's Trade Finance Program	69
Chapter 8: Conclusion and Outlook	75
Bibliography	77
Appendix	78
List of Figures	84
List of Tables	86

Abbreviations

Abbreviations

AfDB	African Development Bank Group
CDC	CDC Group UK
DFI	Development Finance Institution
EBRD	European Bank for Reconstruction and Development
ICC	International Chamber of Commerce
IFC	International Finance Corporation
ITFC	International Islamic Trade Finance Corporation
KYC	Know Your Customer
MDB	Multilateral Development Bank
NPL	Non-Performing Loan
RPA	Risk Participation Agreement
SCFF	Soft Commodity Finance Facility
SME	Small and Medium-sized Enterprise
TFI	Trade Finance Initiative
TFLOC	Trade Finance Line of Credit
TFP	Trade Finance Program

FOREWORD

Trade can be an important catalyst for economic growth and poverty reduction. However, Africa as a continent has yet to fully capture the growth-enhancing benefits of trade. Today, the continent's shares of global GDP and trade stand at only 3 percent, yet it accounts for 11 percent of the world's population. A correction of this anomaly is possible if we work to remove the constraints to trade. And there are quite a number. The infrastructure deficit that has for long inhibited regional and international trade is well known.

Another major impediment, and the focus of this report, is the lack of availability of trade finance – the lubricant of trade without which opportunities for growth and development are missed. Trade finance can also contribute to regional integration and macroeconomic resilience through international trade expansion and foreign exchange earnings. The African Development Bank has always recognized the importance of access to trade finance for businesses, especially given its contribution to virtually all of the Bank's High 5s priorities.

Historically, the African Development Bank has relied on special purpose vehicles to serve the trade finance needs of Africa, such as the Afreximbank and the Eastern and Southern African Trade and Development Bank that it helped to create. However, at the height of the global financial crisis, the Bank was requested to intervene directly in the market to address the sudden shortfall in commercial bank financing for trade. Consequently, in 2009, the Bank established its first Trade Finance Initiative (TFI) with a size of USD 1 billion. This initiative proved decisive in cushioning regional member countries against the effects of the crisis. As a result of the successes of the TFI, coupled with the persistent structural market gap, the Bank decided in 2013 to establish a fully-fledged Trade Finance Program (TFP), which has now evolved into a mainstream activity.

While significant efforts have been made in reducing barriers to trade finance in the recent past, not much is known about the dynamics of the trade finance market in Africa. Bridging this knowledge gap has therefore become a critical element of the Bank's trade finance agenda. This encouraged the Bank in 2014 to undertake a continent-wide market survey which was the first of its kind and led to the publication of the report "Trade Finance in Africa". This has become the touchstone for the industry and a valuable reference source for market practitioners and policy makers. The first report highlighted the size of the financing gap and other challenges facing African financial institutions, especially in low income countries.

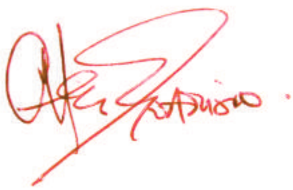
This second report follows the major themes highlighted in the first report and examines some of the unanswered questions from the first survey, such as trade finance challenges faced by SMEs and commercial banks' first time trade finance clients. The survey revealed that although banks support one third of Africa's trade, the trade finance gap is still in excess of USD 90 billion annually. Secondly, despite the long-held view that SMEs are the most significant contributor to African economies, they account for just over a quarter of banks' trade finance assets. First time trade finance clients of these banks account for much less. The survey also revealed that the constraints faced by businesses vary in nature and magnitude across regions, between fragile and non-fragile states, and between net oil-importing countries and net oil-exporting countries.

Given these challenges, the report provides some policy recommendations, including the need to put more effort into reducing the barriers that prevent SMEs and new market entrants from accessing trade finance services, as well as putting in place reforms and policies that reduce information asymmetry and facilitate credit information sharing.

Finally, the report concludes that a win-win partnership and a collaborative approach involving development partners is needed to overcome the challenges of access to trade finance faced by financial institutions and the private sector in Africa. I trust that development partners will find this report helpful in re-calibrating their trade finance programs and in encouraging close collaboration with relevant stakeholders to make trade finance more accessible to African businesses.

For Africa to improve its competitiveness, raise productivity, and achieve robust and inclusive growth, it is essential that African countries become more integrated into the global economy and have a strong and well diversified export base. For this to happen, trade finance must be genuinely accessible and affordable to those who need it.

Akinwumi A. Adesina
President, African Development Bank Group



ACKNOWLEDGEMENTS

The authors of this report are Mouhamadou Sy (former Research Economist, African Development Bank), Eugene Bempong Nyantakyi (former Research Economist, African Development Bank), Lamin Drammeh (Chief Trade Finance Officer, African Development Bank) and Mouna Ben Dhaou (Development Economist, African Development Bank).

The authors would like to thank Alisa DiCaprio (Asian Development Bank), Ousman Gajigo (international consultant), Edward George (Ecobank International), and Qingwei Meng (African Development Bank) for their comments and review. The report was made possible thanks to the active collaboration with commercial and central banks across Africa as well as African Development Bank country economists. We would like to particularly thank staff members of commercial banks who took time to provide detailed responses to our questionnaire. Editorial support was provided by Nicholas Jewitt and graphic design support by Mounir Ben Ammar.

The report was produced under the supervision of Issa Faye (former Division Manager, Microeconomic, Institutional and Development Impact Division), Yaw Kuffour (Manager, Trade Finance Division) and under the overall guidance of Abebe Shimeles (Acting Director, Macroeconomic Policy, Forecasting and Research Department) and Stefan Nalletamby (Director, Financial Sector Development Department)—all from the African Development Bank.

The opinions expressed in this report are those of the authors and do not necessarily reflect the views of the institutions to which they are affiliated.

September 2017
African Development Bank Group, AfDB
Avenue Joseph Anoma
01 BP 1387 Abidjan 01
Côte d'Ivoire
Email: economic-research@afdb.org

EXECUTIVE SUMMARY

The objective of this report is to deepen our understanding of the challenges facing bank-intermediated trade finance in Africa. Since the launch of the first survey in 2013 (covering the period 2011-2012), the trade finance landscape in Africa has evolved in terms of the overall size of bank-intermediated trade finance, unmet demand, and the performance of banks' trade finance portfolios, among others. The second survey launched in 2015 (covering the period 2013-2014) not only builds on the findings of the first one, but goes beyond to gauge other aspects of bank-intermediated trade finance including challenges encountered by SMEs and first time trade finance clients. This report is based on the combined data from the two rounds of surveys mentioned above and outlines the following main findings:

1. **Bank-intermediated trade finance is a non-negligible part of Africa's total trade.** The value of bank-intermediated trade finance in Africa in 2013 and 2014 is estimated at USD 430 billion and USD 362 billion, respectively. Put differently, banks support about one third of total trade in Africa.

2. **The share of bank-intermediated trade finance devoted to intra-African trade is still modest.** In 2014, 20 percent of bank-intermediated trade finance was devoted to intra-African trade. This compares favorably to the estimated 18 percent in 2011. Banks in East and Southern Africa reported the highest share (25 percent) while banks in North and Central Africa reported the lowest, around 5 percent and 4 percent respectively.

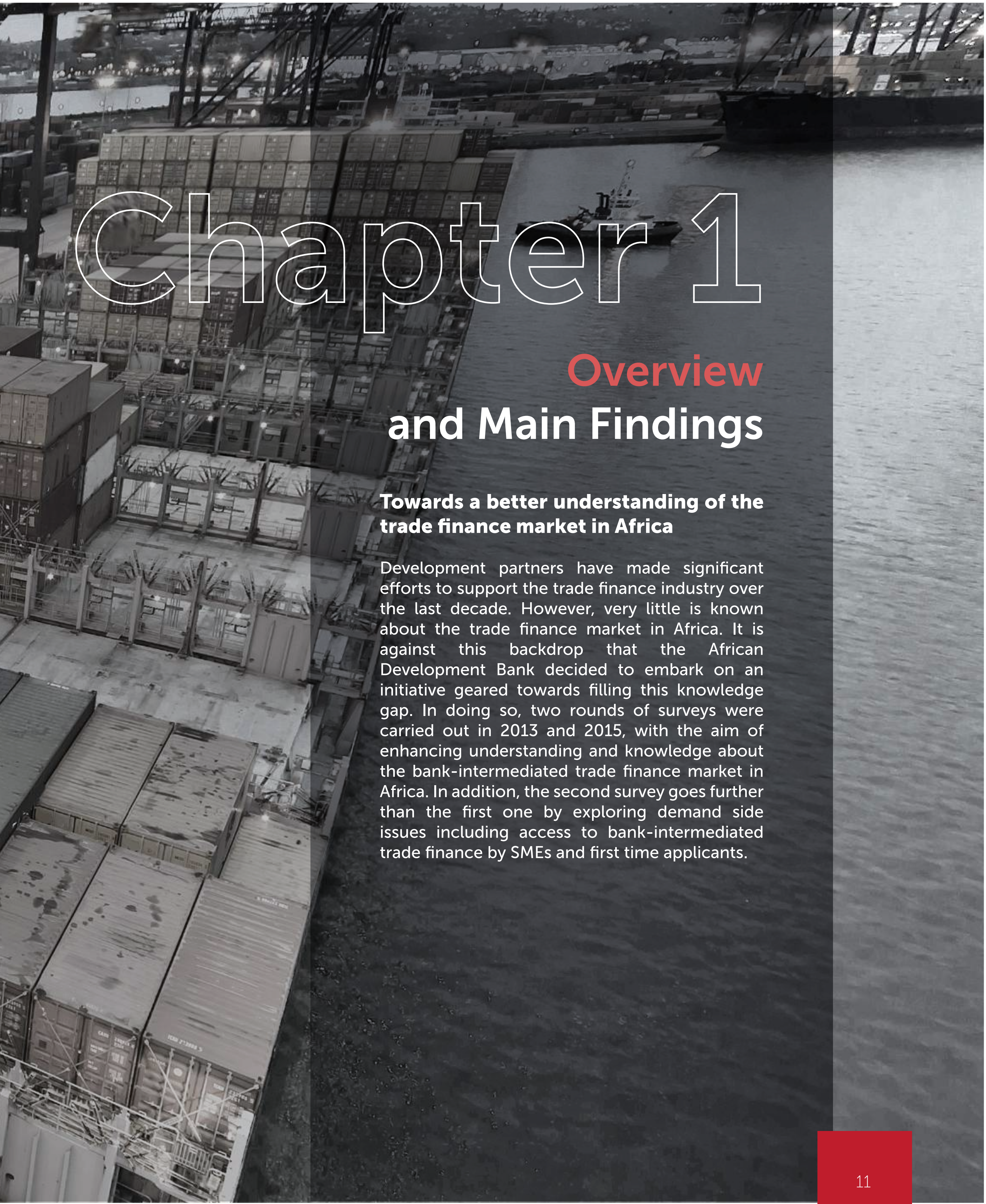
3. **The value of the bank-intermediated trade finance gap in Africa remains significant, although it has nudged down slightly from an estimated USD 94 billion in 2013 to USD 91 billion in 2014.**

4. **Trade finance continues to be a relatively low-risk activity for commercial banks in Africa.** The estimated default rate on trade finance transactions in 2011 and 2014 were 4 and 5 percent respectively compared to 9 and 12 percent Non-Performing Loan (NPL) ratios for all bank asset classes. The trade finance default rates are lower for banks in Southern (2 percent), East (3 percent), and North (4 percent) Africa compared to banks in Central (9 percent) and West (7 percent) Africa.

5. **Only 28 percent of banks' total trade finance portfolio benefits SMEs, while the bulk of trade finance facilities serve large companies.** The relatively low share of SMEs could be attributed to the higher risk perception associated with this client segment. Indeed the average trade finance default rate of SMEs was 14 percent in 2014, far higher than the overall trade finance default rate of 5 percent for the same period.

6. **First time applicants face significant challenges in accessing trade finance facilities from banks.** Only 15 percent of banks' trade finance portfolio is composed of new applicants, although the default rate attributed to these clients was only 3 percent in 2014. This also highlights the need to revisit banks' lending approaches and, as much as possible, to move from relationship lending to transaction-based lending for the benefit of new entrants.

7. **Adequate financial infrastructure, including credit information systems, is required to de-risk transactions and enhance banks' ability to supply trade finance.** The report reveals that the major reasons why banks reject trade finance demands include poor creditworthiness and lack of adequate collateral.



Chapter 1

Overview and Main Findings

Towards a better understanding of the trade finance market in Africa

Development partners have made significant efforts to support the trade finance industry over the last decade. However, very little is known about the trade finance market in Africa. It is against this backdrop that the African Development Bank decided to embark on an initiative geared towards filling this knowledge gap. In doing so, two rounds of surveys were carried out in 2013 and 2015, with the aim of enhancing understanding and knowledge about the bank-intermediated trade finance market in Africa. In addition, the second survey goes further than the first one by exploring demand side issues including access to bank-intermediated trade finance by SMEs and first time applicants.

CHAPTER 1

1.1 About this Report

In December 2014, the African Development Bank produced its first "Trade Finance in Africa" report. The aim was to provide policymakers and financial institutions engaged in trade finance a comprehensive insight into various aspects of trade finance supply in Africa. In particular, the report focused on understanding the size of the bank-intermediated trade finance market, the financing gap (unmet demand), the characteristics of banks active in trade finance intermediation, and key challenges they face.

Since that last survey, however, the world economy has changed and with it the outlook for trade finance. Commodity prices, particularly oil, have fallen precipitously since mid-2014 and continue to strain the availability of foreign currency liquidity in many oil-dependent African countries. Furthermore, the scaling back of unconventional monetary policy[1] in major advanced economies means that excess foreign capital that was previously channeled towards emerging markets in search of higher yields has started to dry up including in Africa. This has reduced the supply of foreign currency which is vital for the growth of trade finance markets.

For policymakers, the ability to steer trade finance resources to where they are needed the most requires taking continuous stock of progress made and tackling emerging new challenges, including demand-side related issues.

The focus of this report is to track the changes that have occurred in the trade finance market in Africa during the period 2013-2014. In addition to updating and expanding our understanding of the key issues discussed in the previous report, this report also introduces new dimensions that have hitherto not been explored. In particular, the second survey explored factors limiting SMEs' access to bank-intermediated trade finance, including high default rates on trade finance facilities extended to the SME business segment. The report also examines the extent to which new trade finance clients—those that have for the first time requested financing from commercial banks to export or import goods—are able to gain access to trade finance facilities offered by banks and the concentration of trade finance assets among commercial banks' top clients.

[1] Unconventional monetary policy refers to monetary policies driven by exceptional circumstances such as recessions and financial instability. It typically entails quantitative easing to lower long-term interest rates, and other asset purchase programs (government bonds, mortgage backed securities, and private sector debt).

1.2 About the survey

The report is based on primary surveys conducted by the African Development Bank. Two questionnaires were distributed to commercial banks in 2013 and 2015 in order to report on their trade finance activities during the periods 2011-2012 and 2013-2014 respectively. In these surveys, trade finance refers to financing activities aimed at supporting external trade only. The questionnaires were distributed to around 900 banks in Africa, of which 272 completed the first survey and 246 completed the second survey. The average response rate for the two surveys was approximately 30 percent.

The overall sample combining data from the first and second surveys covers 49 countries in Africa[2], comprising the following sub-regions: West Africa (36.9 percent), East Africa (21.1 percent), Southern Africa (25.5 percent), North Africa (9.3 percent) and Central Africa (7.2 percent). This composition is representative of the regional distribution of banks on the continent[3]. The data provides good country coverage in terms of levels of development and degree of fragility, with 52 percent of observations in low-income countries and 23 percent in fragile states[4].

The questionnaires included bank-level questions to capture information on bank characteristics such as ownership structure, bank size (total assets, customer deposits and equity), and financial characteristics (after tax profits and non-performing loans ratio). The data show a high prevalence of majority foreign-owned banks (56 percent), followed by majority locally and privately-owned banks (26 percent), and majority government-owned banks (13 percent). Foreign-owned banks are dominant in all sub-regions except in North Africa where an equally important number of responding banks are either majority locally and privately-owned (36 percent) or government-owned (30 percent).

[2] The full list of countries represented in the sample is shown in the Appendix.
[3] We use African commercial banks' distribution as a proxy for trade finance activities distribution across the continent's regions.
[4] The AfDB defines fragility as "a condition of elevated risk of institutional breakdown, social collapse, or violent conflict". Lists of country classification are in the Appendix.

> The trade finance gap in 2013 and 2014 was estimated at USD 94 billion and USD 91 billion respectively.

1.3 Main Findings

The Trade Finance Gap has slightly narrowed but is still fairly large

The trade finance gap in 2013 and 2014 was estimated at USD 94 billion and USD 91 billion respectively, while the comparative estimated gap was USD 120 billion in 2011 and USD 105 billion in 2012. Although, this trend suggests a gradual narrowing of the gap over time, the latter remains quite significant.

The two major reasons for banks' rejection of trade finance facility applications are weak client creditworthiness and insufficient collateral. Banks are also facing several challenges hampering the growth of their trade finance portfolios and cite competition, lack of sufficient risk capital and limits with correspondent banks as the main constraints.

SMEs and New Trade Finance Customers

For the first time, the survey presents some evidence on constraints to access bank-intermediated trade finance for SMEs in Africa. While there is no clear consensus on the share of SMEs operating in the private sector in Africa, it is estimated to account for more than 80 percent of all enterprises in the continent[5].

Given the real and perceived risks attached to them, the majority of SMEs face challenges in accessing bank-intermediated trade finance. The survey results show that, on average, only 28 percent of total trade finance portfolios of responding banks support SMEs with the remainder going to large enterprises.

[5] It is estimated that SMEs account for 90 percent of firms in West Africa (GIIN, 2015). They also account for 80 percent of all private sector employment in Africa, according to the World Economic Forum.

> On average, the ten biggest trade finance customers account for more than half (58 percent) of a bank's total trade finance assets while SMEs account for less than 30 percent.

This suggests that the banks' perception of SMEs being high risk clients also applies to trade finance facilities.

Indeed, our findings show that the rate of default on trade finance facilities extended to SMEs is higher than that on banks' overall trade finance activities. The average default rate on SME trade finance assets in 2014 is 14 percent, far higher than the overall default rate of 5 percent on banks' total trade finance assets. This trend is observed across all sub-regions. In Central Africa, the default rate on SME trade finance customers is as high as 31 percent versus 9 percent for the sub-region's overall trade finance portfolio.

More than half of bank-intermediated trade finance benefit a few large corporates.

On average, the ten biggest trade finance customers account for more than half (58 percent) of a bank's total trade finance assets while SMEs account for less than 30 percent. This indicates that large corporates dominate the bank-intermediated trade finance landscape in Africa.

Banks' new trade finance clients[6] are particularly more constrained. Across the continent, the average share of trade finance portfolio dedicated to new customers is around 15 percent, although the default rate among this group is only 3 percent—lower than the 5 percent default rate on banks' total trade finance assets. This suggests that new entrants are disadvantaged by a relationship lending technique, which puts a premium on longstanding relationships.

[6] Customers that have for the first time, within the past 12 months, received a trade finance facility from commercial banks.

1.4 Policy Implications

The survey reveals that significant challenges lie ahead in meeting the demand for trade finance by African firms, of which the majority is composed of SMEs. Most banks still consider creditworthiness as one of the key elements of their underwriting processes. It is therefore a major reason for rejecting trade finance facility applications by customers.

Policies geared towards facilitating more financing to SMEs and those in need should focus on measures intended to de-risk trade finance transactions and improve credit information systems.

Efforts to tackle trade finance challenges by policymakers and Development Finance Institutions (DFIs) across the continent must include specific initiatives that enhance access to trade finance for SMEs and new trade finance clients. Financial sector reforms should include measures geared towards revisiting banks' underwriting processes, as well as their lending approach, to make them more relevant to customers in need, particularly SMEs to which a high risk perception is attached. Moving to transaction-based or asset-based lending could facilitate access to trade finance by new market entrants.

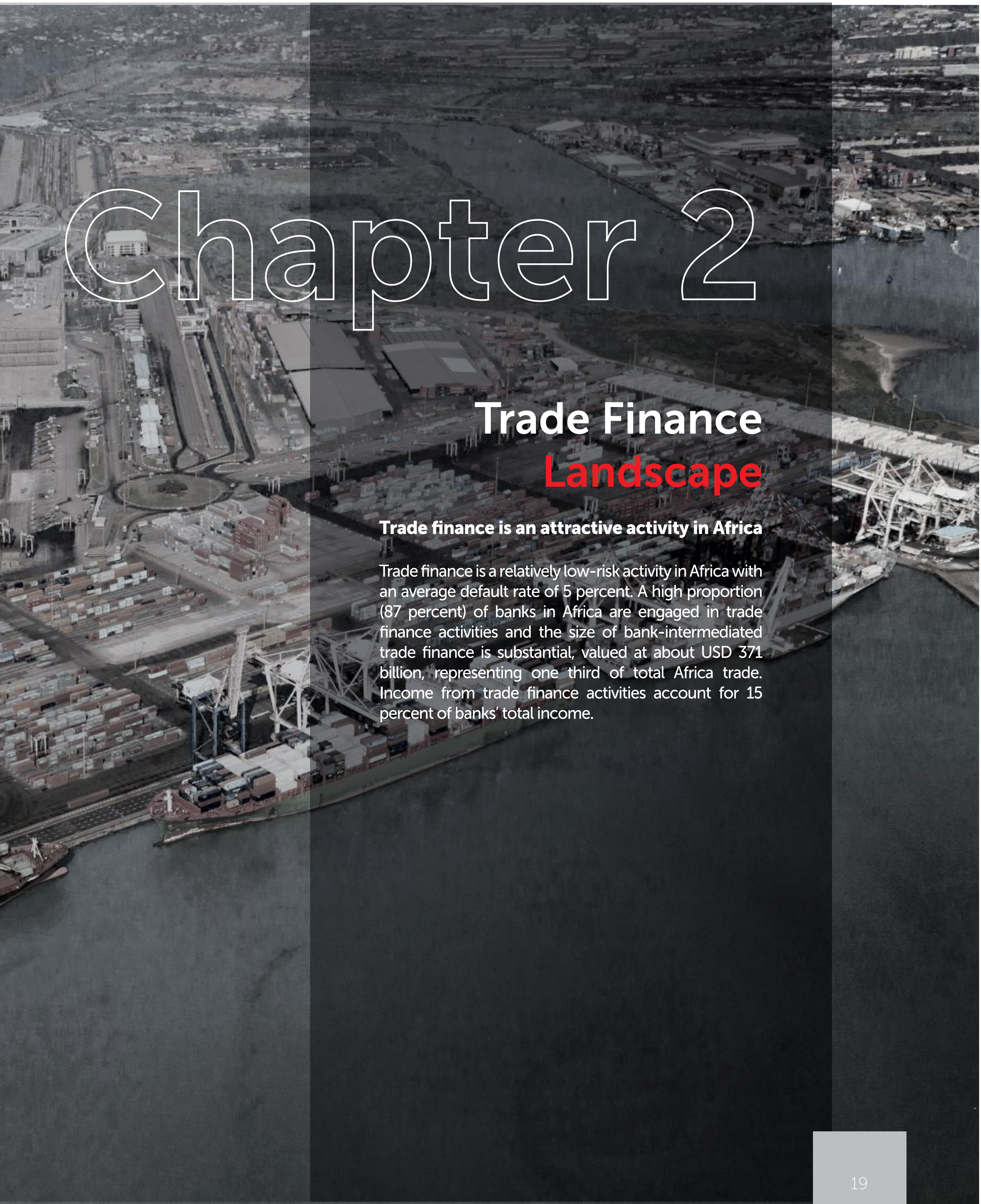
Moreover, reforms and policies that reduce information asymmetry and facilitate credit information sharing should be encouraged. A few countries in the region are already taking positive steps towards addressing information asymmetry related to creditworthiness and risk. For instance, Ghana recently implemented reforms to upgrade its credit infrastructure in order to facilitate the operation of private credit bureaus and the setting up of a national collateral registry. Such reforms, embarked upon by several countries[7], are positive steps that can contribute to addressing some of the main constraints (creditworthiness and lack of collateral) reported by banks in the survey.

[7] See Triki and Gajigo (2012).

Furthermore, regulatory reforms aimed at promoting trade facilitation as well as better designed and implemented regional trade agreements, and other policy measures such as custom unions, are also needed to ensure free trade areas are well functioning and facilitate access to trade finance for the benefit of intra-African trade.

Similarly, know-your-customer (KYC) and regulatory compliance challenges faced by international banks with respect to their African correspondent banks need to be tackled more vigorously to avert any withdrawal of these institutions from Africa or any meltdown of correspondent banking relationships, as was witnessed during the global financial crisis.

> " Efforts to tackle trade finance challenges by policymakers and Development Finance Institutions (DFIs) across the continent must include specific initiatives that enhance access to trade finance for SMEs and new trade finance clients.



Chapter 2

Trade Finance Landscape

Trade finance is an attractive activity in Africa

Trade finance is a relatively low-risk activity in Africa with an average default rate of 5 percent. A high proportion (87 percent) of banks in Africa are engaged in trade finance activities and the size of bank-intermediated trade finance is substantial, valued at about USD 371 billion, representing one third of total Africa trade. Income from trade finance activities account for 15 percent of banks' total income.

CHAPTER 2

2.1. High Engagement of Commercial Banks in Trade Finance in Africa

A majority of commercial banks are still very active in Africa's trade finance market (Figure 2.1), although their number among our responding banks has declined between the 2 survey periods. Indeed, our results indicate that about 87 percent of commercial banks in our sample were engaged in trade finance between 2013 and 2014, down from 92 and 93 percent in 2011 and 2012, respectively.

The large involvement of commercial banks in trade finance activities is observed across all regions. Indeed, between 2011 and 2014 (Figure 2.2), over 90 percent of commercial banks in East, North, and West Africa were engaged in trade finance, while 87 percent of commercial banks in Southern Africa and 82 percent in Central Africa reported on such activities.

Foreign and privately- owned local banks are the most active financiers of trade with 92 percent of those supporting trade finance compared to 80 percent for majority government-owned responding banks (Figure 2.3).

Figure 2.1.
Share of Commercial Banks Engaged in Trade Finance Activities by Year

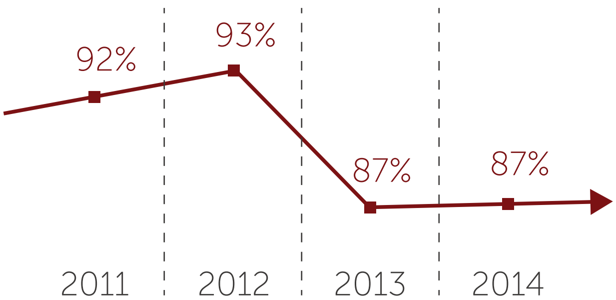


Figure 2.2.

Share of Commercial Banks Engaged in Trade Finance Activities by sub-Region

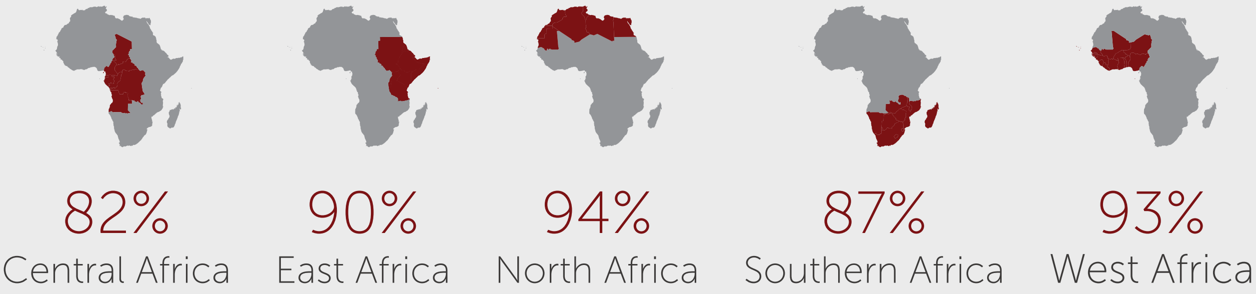


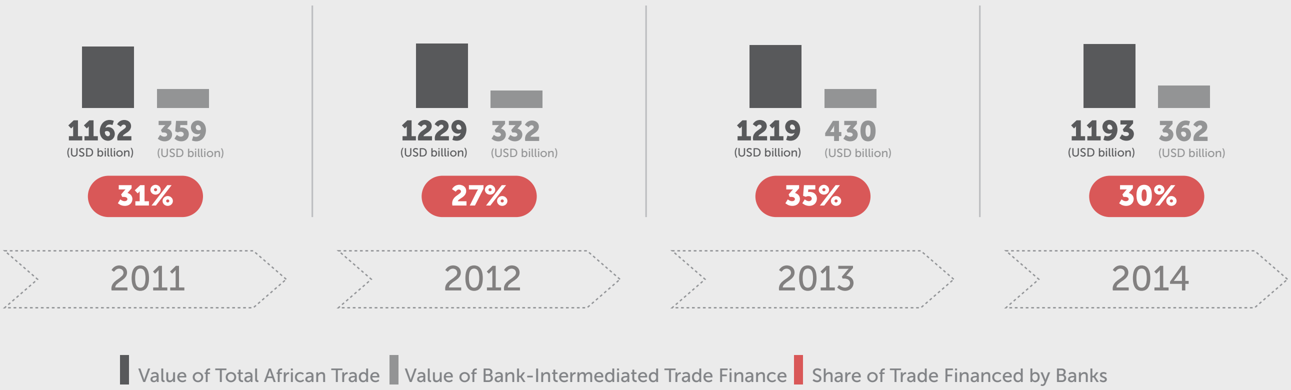
Figure 2.3.

Share of Commercial Banks Engaged in Trade Finance Activities by Bank Ownership Structure

Majority Foreign **92%**
Majority Local & Private **92%**
Majority Public **80%**

Figure 2.4.

Bank-Intermediated Trade Finance and Total African Trade Volume by Year



Source: Authors' calculations based on AfDB data portal and World Trade Organization database.

2.2. A Sizeable Bank-Intermediated Trade Finance Market

The size of bank-intermediated trade finance in Africa averaged about USD 371 billion from 2011 to 2014 (Figure 2.4). The value of bank-intermediated trade finance was highest in 2013 (USD 430 billion), but declined by 16 percent to USD 362 billion in 2014. This decline may be a result of the decrease in Africa's total trade with the rest of the world in 2014 and the difficult economic conditions experienced by Africa's major trade partners from mid-2014 onwards, including the debt crisis in Europe and economic slowdown in China. The fact that African countries are trading more with other regions of the world rather than within the continent makes it plausible that this decline is largely externally induced. Africa's total trade[8] averaged about USD 1.2 trillion between 2011 and 2014, about one third of which corresponds to bank-intermediated trade finance (Figure 2.4).

The average assets of banks in our sample for the period 2011-2014 is around USD 2.7 billion, while the average trade finance portfolio is about USD 410 million over the same sample period. This suggests that, on average, trade finance assets account for about 15 percent of total assets of commercial banks in Africa (Figure 2.5). For comparison, a survey of selected banks by the International Chamber of Commerce (ICC) indicates that, as a proportion of total assets, trade finance assets accounted on average for about 4.3 percent in 2014. More specifically the evolution of the share of trade finance assets in total bank assets has not been stable over the last couple of years. This probably reflects the instability of the global economy during this period.

There are also significant regional differences in the share of total assets devoted to trade finance. As depicted in Figure 2.6, banks in West Africa have a fairly significant exposure to trade finance with a 31 percent share of their total assets devoted to this activity, followed by Central and East Africa at 28 and 25 percent respectively. Banks in North and Southern Africa record lower exposure to trade finance with 15 and 8 percent respectively of total bank assets devoted to trade finance. This could be a reflection of a more developed financial sector where banks in such markets are able to hold a diversified portfolio of assets under a wider range of banking activities. For instance, bank assets in such markets are not necessarily dedicated to short term activities such as trade finance but go beyond that to finance much longer tenures and higher volumes as required for infrastructure and housing projects.

[8] All trade data used in this report are from the AfDB data portal and World Trade Organization database.

Figure 2.5.

Bank-Intermediated Trade Finance Assets and Total Bank Assets by Year

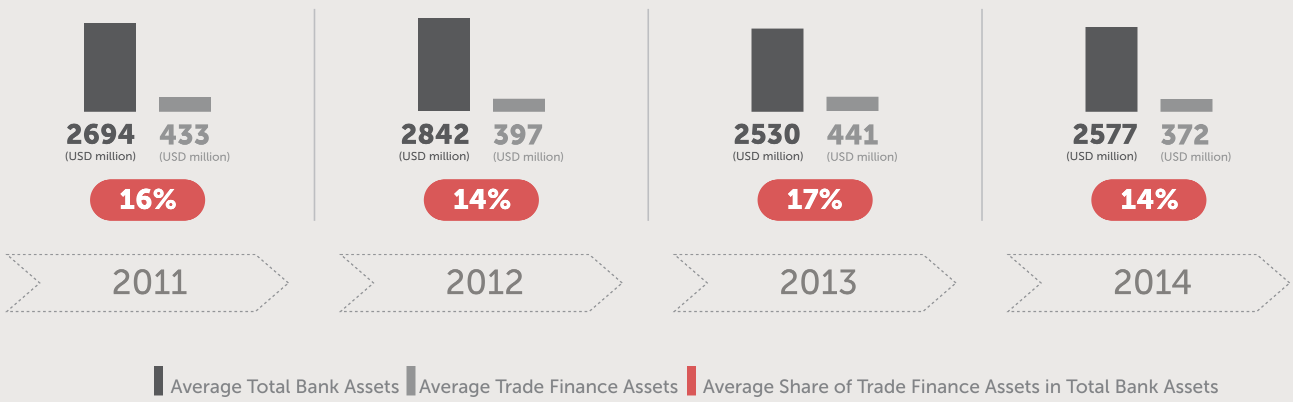
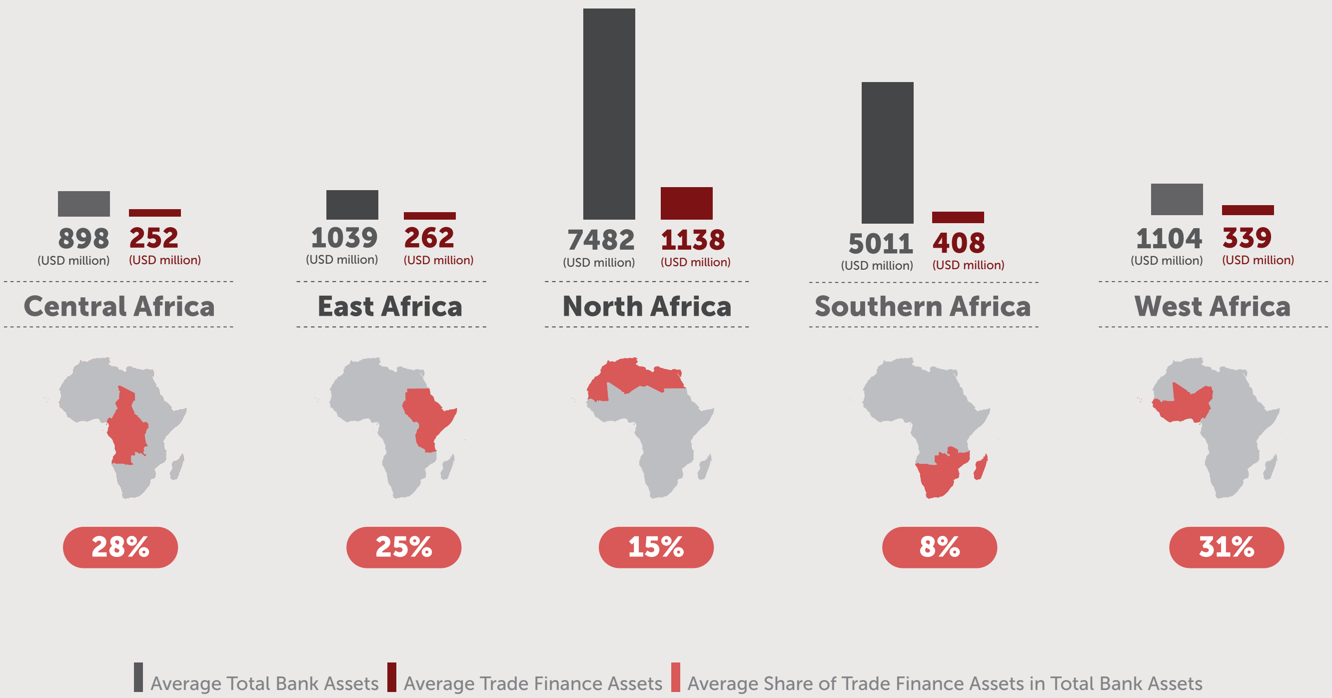


Figure 2.6.

Bank-Intermediated Trade Finance Assets and Total Bank Assets by sub-Region



> " ... funding trade, which is a relatively less risky short-term activity, appears to be one of the core activities of commercial banks in fragile states.

The regional disparity could be explained primarily by the risk profiles of countries in the sub-regions, in addition to their income levels and their economies' reliance on natural resources. Despite their limited capacity, commercial banks in fragile states are highly engaged in trade finance activities with trade assets representing 50 percent of their total assets, compared to banks in non-fragile states where trade finance exposure averages 14 percent (Figure 2.7). Thus, funding trade, which is a relatively less risky short-term activity, appears to be one of the core activities of commercial banks in fragile states. Indeed, banks' assets in these markets are more skewed towards short term activities (such as trade finance) given the relatively higher risk associated with providing longer term finance in such economies.

Furthermore, commercial banks' high exposure to trade finance in fragile states could indicate that bank-intermediated trade finance is a primary source for funding trade in those markets. This relates to the fact that other alternatives for funding trade outside of the bank channels (e.g. inter-firm credit, supply chains finance) may become difficult as fragility is likely to hinder business relationships. As Figure 2.8 shows, the same argument applies to banks in low-income countries, which appear to be more engaged in trade finance (28 percent) than those in middle-income countries (14 percent). Banks operating in net oil exporting countries have a higher exposure to trade finance (21 percent) compared to those operating in net oil importing countries (13 percent), probably since commodity producers and traders require pre-export financing (Figure 2.9).

Majority foreign-owned banks are the most exposed to trade finance activities (26 percent) compared to the majority publicly (15 percent) and privately owned banks (10 percent) (Figure 2.10). This could be explained by the fact that subsidiaries of foreign banks established in Africa take advantage of their ties with their parent banks in terms of confirmation lines allowing them to allocate higher shares of their assets to trade finance activities.

Figure 2.7.
Bank-Intermediated Trade Finance Assets and Total Bank Assets by Fragility Level

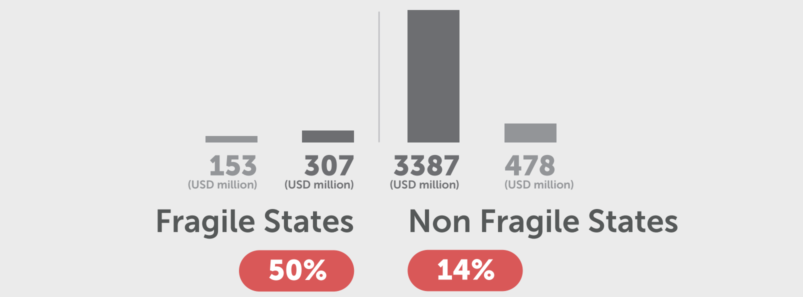


Figure 2.8.
Bank-Intermediated Trade Finance Assets and Total Bank Assets by Income Level

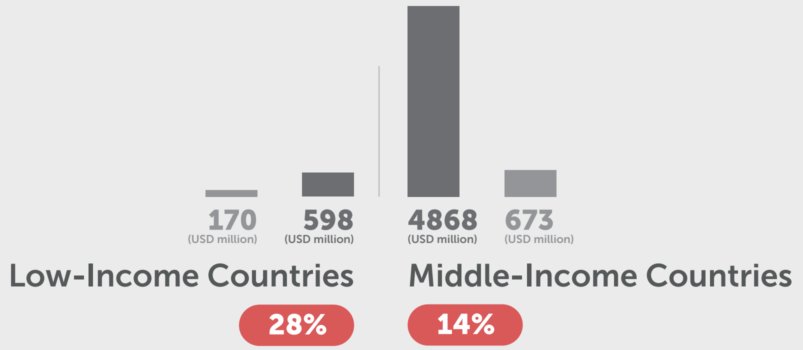


Figure 2.9.
Bank-Intermediated Trade Finance Assets and Total Bank Assets by Oil Trade Balance

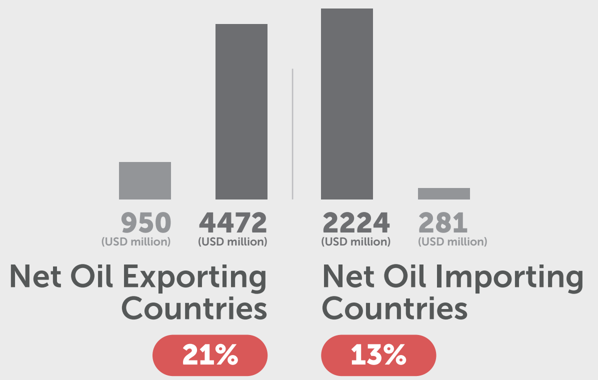


Figure 2.10.
Bank-Intermediated Trade Finance Assets and Total Bank Assets by Bank Ownership Structure

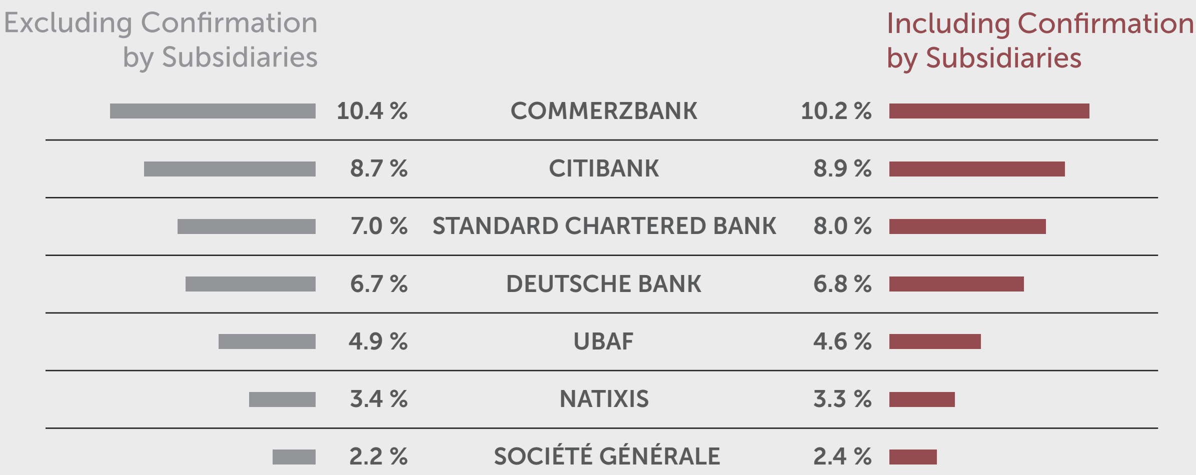
Average Total Bank Assets | Average Trade Finance Assets | Share of Trade Finance Assets in Total Bank Assets

Role, Ranking and Structure of Confirming Banks

Confirming banks play an important role for African trade finance by ensuring that banks and enterprises on the continent are able to do business with their international trading partners. Letters of credit issued by African banks frequently require confirmation by other banks based abroad. The ranking of the top confirming banks for African issuing banks, as reported in the survey[9], is provided in Figure 2.11. In order to test the hypothesis that banks are more likely to confirm trade transactions from their affiliates, Figure 2.11 displays results for cases where affiliates of banks are included in the sample as well as those where they are excluded. In both cases, Commerzbank, Citibank, and Standard Chartered Bank are ranked as the top three confirming banks for African issuing banks in 2013 and 2014. Together, they confirmed around one-third of trade transactions originated by African issuing banks.

Figure 2.11.

Top Confirming Banks for African Issuing Banks, 2o13-2014



[9] We request each respondent bank to list their top five confirming banks. These are then ranked by order of frequency of listing as part of the total confirming banks listed.

2.3. Trends in Income from Trade Finance

The average income from trade finance activities intermediated by commercial banks accounted for about 15 percent of their total income for the period 2013-2014 (Figure 2.12), slightly down from 17 percent for the period 2011 and 2012. The average share of income from trade finance activities is lower for banks (Figure 2.13) in Southern Africa (12 percent), Central Africa (13 percent) and East Africa (15 percent), and higher in West Africa (20 percent) and North Africa (20 percent).

Figure 2.12.

Share of Income from Trade Finance Activities in Banks' Total Income by Year

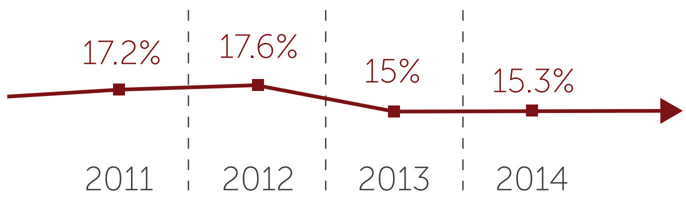
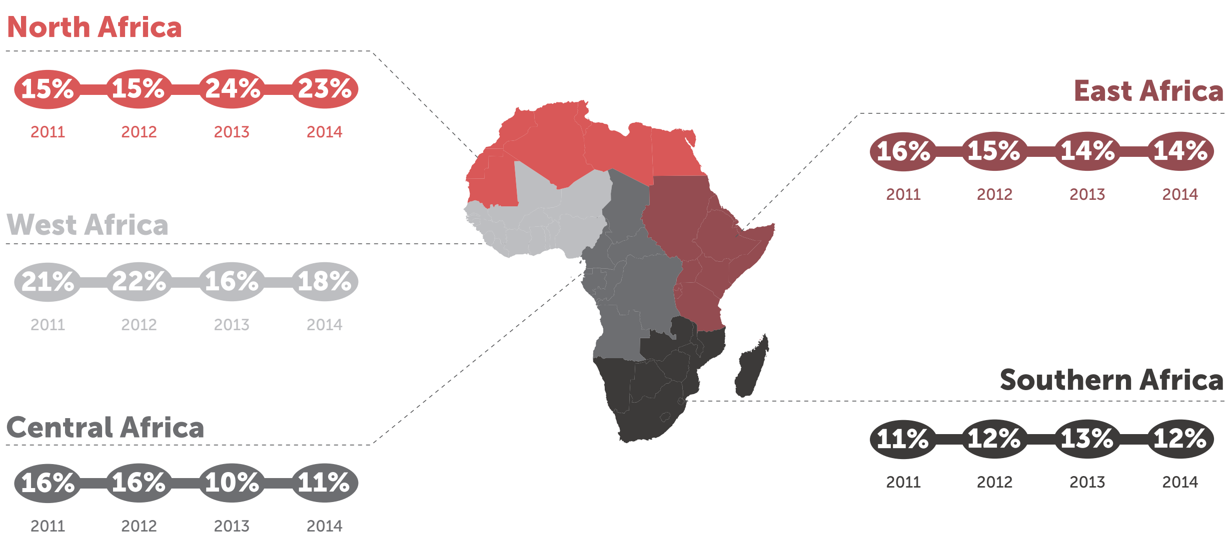


Figure 2.13.

Share of Income from Trade Finance Activities in Banks' Total Income by sub-Region



Trade finance is an important source of income particularly for banks operating in fragile states with the share of income from trade finance activities in the overall bank income averaging 21 percent compared to 15 percent for banks in non-fragile states (Figure 2.14). This is consistent with findings in section 2.2 on the high exposure of banks in fragile states to trade finance, making it a core activity for banks operating in financial markets that are dominated by short-term funding.

The share of income from trade finance activities of banks operating in low-income countries (17 percent) or in net oil exporting countries (18 percent) is slightly higher than the share observed for banks in middle-income and net oil importing countries (16 percent) (Figure 2.15 and Figure 2.16). In section 2.2, these banks were also found to be the most exposed to trade finance activities.

On average, majority privately-owned banks have the highest share of income from trade finance activities in their total bank income (17 percent) above the shares observed for majority foreign (15percent) and publicly-owned (14 percent) banks (Figure 2.17).

Figure 2.14.

Share of Income from Trade Finance Activities in Banks' Total Income by Fragility Level

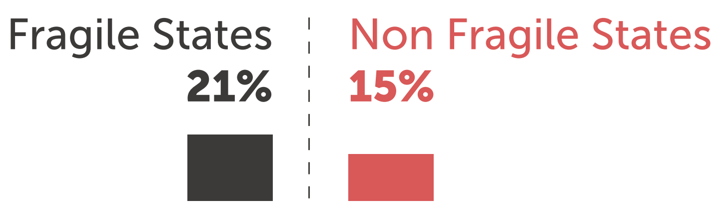


Figure 2.15.

Share of Income from Trade Finance Activities in Banks' Total Income by Oil Trade balance

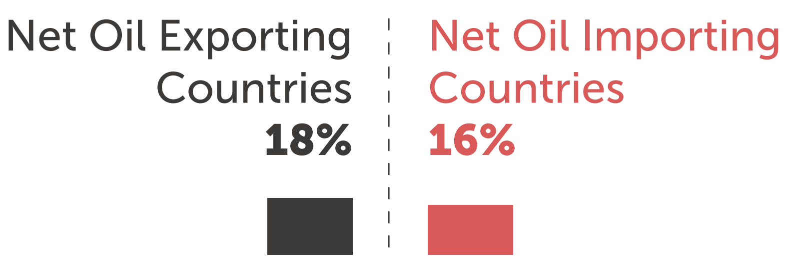


Figure 2.16.

Share of Income from Trade Finance Activities in Banks' Total Income by Country Income Level

Low-Income Countries	Middle-Income Countries
17%	**16%**

Figure 2.17.

Share of Income from Trade Finance Activities in Banks' Total Income by Bank Ownership Structure

Majority Foreign 15%
Majority Local & Private 17%
Majority Public 14%

2.4. Trade Finance Risk Profile in Africa

Financing trade has a myriad of risks associated with it and there are several reasons for this. First, exposure to adverse government actions (expropriation, embargo) or instability (war, crime) is a major political risk for banks. A wide variety of economic risks are also a source of concern for banks engaged in trade finance. These include sovereign risk, importer's or exporter's weak credit history, inability to fulfill payment obligations, damage to goods due to transportation challenges, and the failure to deliver goods on time or accept delivered goods. Since trade is based on foreign currency, foreign exchange risks emanating from currency instability, devaluation, and lack of currency are also major sources of concern for banks (Fingerand and Schuknecht, 1999).

All these factors make financing trade a risky activity. However, in comparison to risks associated with other bank activities, trade finance appears to be less risky. The relatively lower risk associated with trade finance could be the result of the four "S's": short term, self-liquidating structure, secured, and speedily liquidating. 'Short term' comes from the fact that the usual maturity of trade finance transaction is about six months. Moreover, trade finance is referred to as 'self-liquidating' since imported goods financed by banks can in turn be sold to pay back the bank's facility; as 'secured' since the transaction is backed-up by an underlying asset, usually the commodity being traded; and, finally, as 'speedily liquidating' given that the transaction is quickly completed thanks to the fact that banks may impose conditions to collect first export receipts and then pay off the loan[10]. Taken together, these attributes of bank-intermediated trade finance minimize the risk of default on trade finance assets.

According to the ICC (2013) the global default rate on trade credit for international transactions is less than 1 percent. When it comes to developing countries in general and Africa in particular, default rates of trade finance transactions are likely to be higher due to higher prevalence of market imperfections and the likelihood of being hit by more idiosyncratic shocks. However, like elsewhere in the world, trade finance transactions are expected to be relatively less risky compared to other bank activities. This is in fact corroborated by results from the survey. Figure 2.18 shows the evolution of default rates on trade finance activities in Africa. NPL ratios across all assets are added as elements of comparison. On average, default rates on trade finance activities in Africa increased by 1.5 percentage points during the 2013-2014 survey period compared to the 2011-2012 period where they stood at an average of 4 percent. However, for any given year of the survey period, default rates on trade finance assets are significantly lower than the average NPL ratio across all assets.

The relatively low default rates on trade finance activities hide important regional differences (Figure 2.19). Central and West Africa registered higher default rates with 9 percent and 7 percent respectively, while East (3 percent) and Southern Africa (2 percent) registered lower default rates on trade finance transactions. North Africa's default rate on trade finance was closer to the African average.

[10] See Boland P. (2011), "Risks Involved in International Trade Finance: A Banker's Perspective", (http://fita.org/aotm/0399.html, accessed on August 29, 2016) for more risks related to trade finance activities.

Figure 2.18.

Default Rates on Trade Finance Activities vs. Bank NPL Ratios by Year

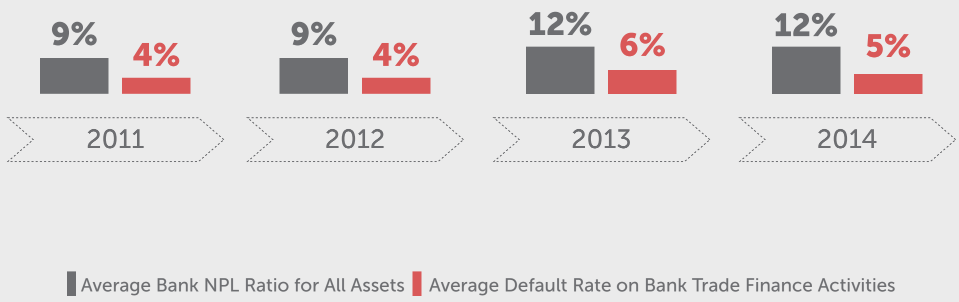
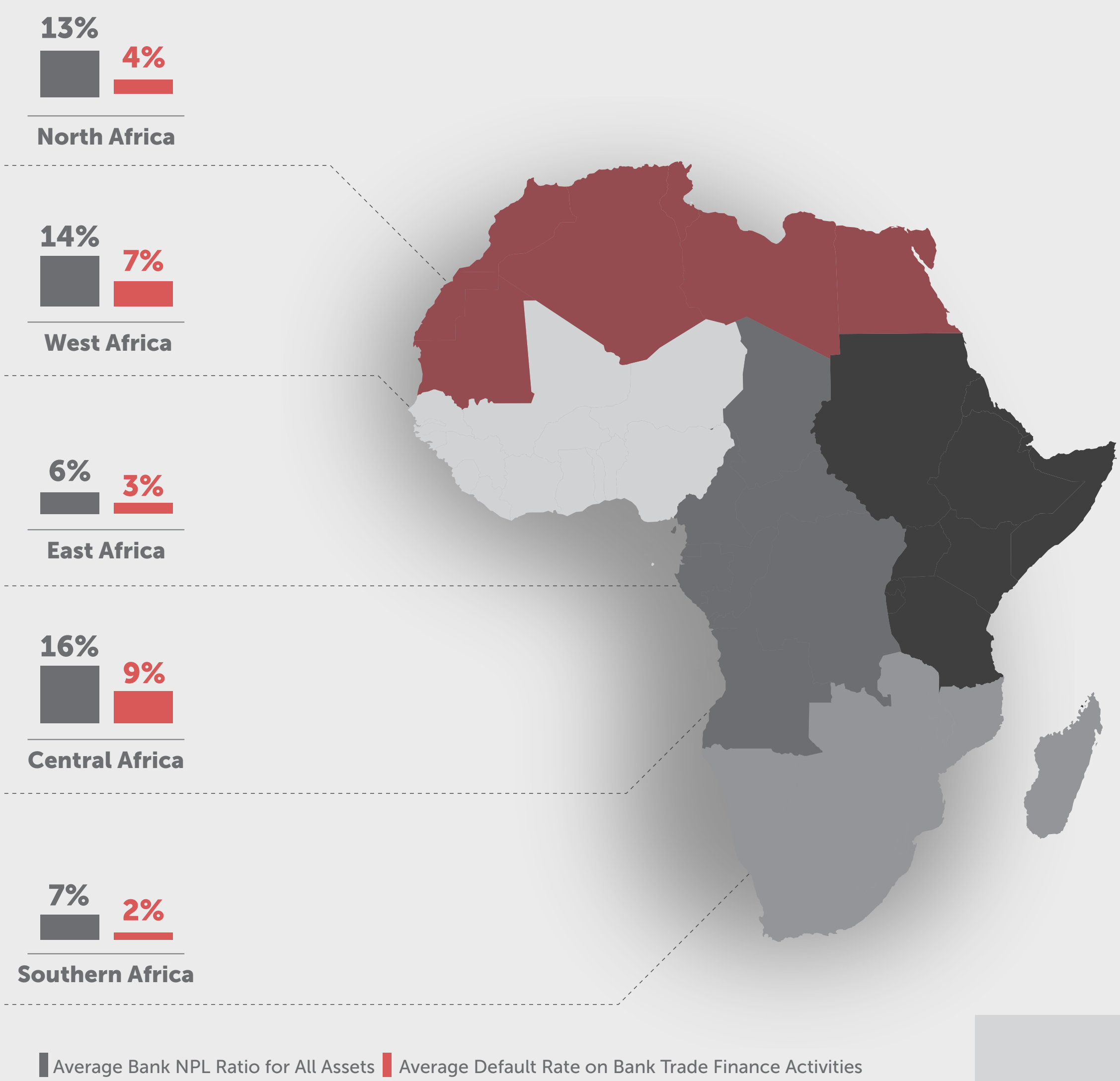


Figure 2.19.

Default Rates on Trade Finance Activities vs. Bank NPL Ratios by sub-Region



> "... for any given year of the survey period, default rates on trade finance assets are significantly lower than the average NPL ratio across all assets.

Reasons for disparities originate mainly from banks' ownership structure and, to a limited extent, from the country's level of fragility and income. Majority government-owned banks suffer from the highest rates of default on their trade finance transactions (8 percent), which is twice as much as the average rate reported by majority foreign and majority locally owned banks (4 percent) (Figure 2.20).

It is often the case that publicly-owned banks design trade finance programs to meet the demand of a particular segment of companies that wish to engage in trade but find themselves facing obstacles to access trade finance facilities from private commercial banks. Such segments are often prone to high risk of default that is likely to materialize in the absence of strong due diligence processes and capacity building programs. Beyond trade finance, majority publicly-owned banks also show the highest levels of NPLs with one-fifth of their loan portfolio categorized as non-performing, reflecting weaker risk management systems compared to the industry practice.

Countries' fragility and income levels also impact the average level of default on trade finance activities with banks in fragile states reporting default rates on their trade finance activities (6 percent) that are on average 2 percent higher than those of banks operating in non-fragile states (4 percent) (Figure 2.21). This is partly due to the challenging economic conditions and business environment that banks in fragile countries operate under. Similarly, banks in low-income countries report default rates on their trade finance activities (5 percent) that are 1 percent higher than those of banks in middle-income countries (4 percent) (Figure 2.22).

Figure 2.20.

Default Rates on Trade Finance Activities vs. NPL Ratios by Bank Ownership Structure

Majority Foreign		Majority Local & Private		Majority Public	
NPL Ratio for All Assets	**9%**	NPL Ratio for All Assets	**9%**	NPL Ratio for All Assets	**20%**
Default Rate on Trade Finance Activities	**4%**	Default Rate on Trade Finance Activities	**4%**	Default Rate on Trade Finance Activities	**8%**

Figure 2.21.

Default Rates on Trade Finance Activities vs. Bank NPL Ratios by Fragility Level

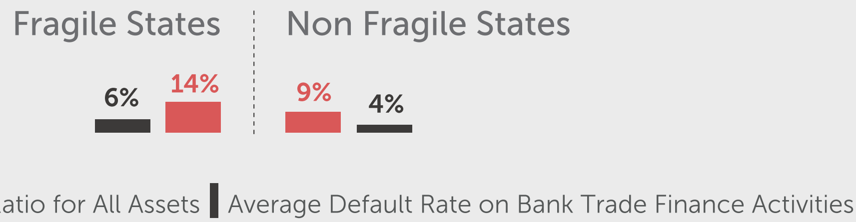
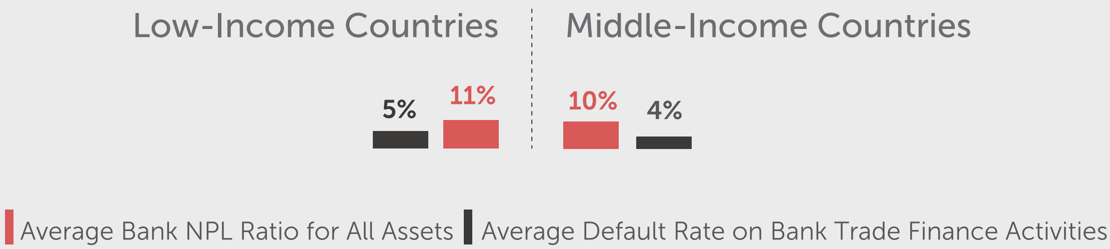


Figure 2.22.

Default Rates on Trade Finance Activities vs. NPL Ratios by Income Level



Chapter 3

Trade Finance Gap in Africa

The trade finance gap remains sizeable

The value of the trade finance gap in Africa is estimated at USD 91 billion in 2014 which constitutes a slight drop as compared to USD 94 billion in 2013. Banks report an average rejection rate for letters of credit applications of 6.1 percent in 2014 which has slightly worsened as compared to 2013 (5.3 percent). Weak credit history and insufficient collateral are the major reasons why banks reject trade finance requests from clients.

CHAPTER 3

3.1. Non-Negligible Rejection Rates for Letters of Credit

Understanding the nature and extent of unmet demand for trade finance is important, if one is concerned with helping policymakers better address the relevant constraints. Banks do not fund all trade finance requests received from customers. This mirrors the access to finance challenges facing commercial banks' customers on the continent and suggests that the trade finance segment is not an exception. The survey provides some insights on the rejection rate of customer requests related to letters of credit applications, size of unmet demand and stated reasons for the rejections. For instance, banks report an average rejection rate for letters of credit applications of 6.1 percent in 2014 (Figure 3.1).

This average rejection rate of letter of credit applications in Africa hides significant regional heterogeneity. For instance is was 3.4 times higher in West Africa than in Southern Africa (Figure 3.2). The rejection rates in East and North Africa are more representative of the continent's average, which stands at 5.7 percent.

Rejection of letters of credit applications is slightly higher for banks in fragile states than for those operating in non-fragile states (Figure 3.3). This finding is intuitive as fragile states are associated with higher risks compared to non-fragile states. The result also reflects the fact that correspondent banks allocate lower levels of confirmation headroom to commercial banks operating in fragile states (Figure 3.9).

Figure 3.1.

Rate of Rejection of Letters of Credit Applications by Year

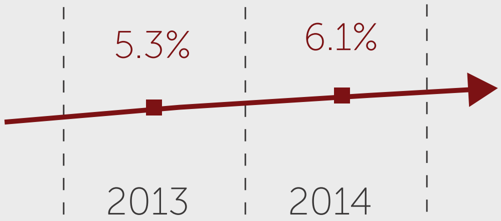


Figure 3.2.

Rate of Rejection of Letters of Credit Applications by sub-Region

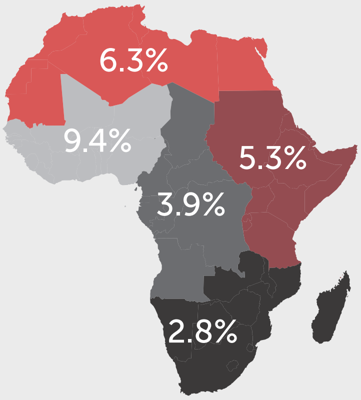


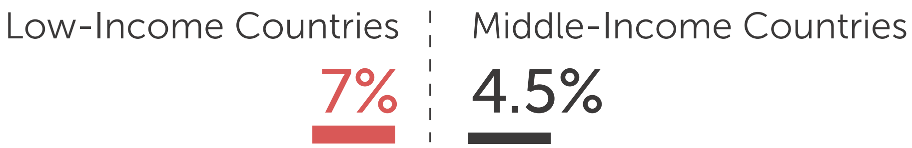
Figure 3.3.

Rate of Rejection of Letters of Credit Applications by Fragility Level

The rejection rate of letters of credit applications are higher for banks established in low-income countries compared to those operating in middle-income countries (Figure 3.4). There is an obvious correlation between income-level differences and banks' rejection of letters of credit applications. Various reasons may explain this correlation. Among them, higher-income countries are likely to have more financially solid, creditworthy, and established applicants. Those customers tend to be more financially literate and have a better credit history as well as an understanding of how to prepare credit applications. In contrast, customers in lower-income countries face numerous challenges, including, but not limited to higher political and economic risks, in addition to individual firm-level idiosyncratic risks such as impaired credit profile and balance sheets, and weak connections to creditworthy counter-parties.

Figure 3.4.

Rate of Rejection of Letters of Credit Applications by Income Level



As Figure 3.5 shows, the rejection rate for letters of credit applications is higher for majority government-owned banks (7.4 percent) compared to the majority local and privately-owned and the majority foreign-owned banks (at 6.2 and 5.5 percent respectively). One reason could be the higher number of applications that publicly owned banks receive. Indeed, there is a perceived government guarantee associated to well-established publicly-owned banks which attracts more depositors and, in turn, more banking services applicants including for trade finance facilities[11].

[11] www.fbv.kit.edu/symposium/11th/Paper/02EmpiricalBankingI/weill.pdf

Figure 3.5.
Rate of Rejection of Letters of Credit Applications by Bank Ownership Structure

Majority Foreign 5.5%
Majority Local & Private 6.2%
Majority Public 7.4%

Banks operating in net oil exporting countries appear to be less inclined to reject letters of credit applications (4 percent), whereas banks in net oil importing countries are more inclined to do so (6.2 percent) (Figure 3.6).

Figure 3.6.
Rate of Rejection of Letters of Credit Applications by Oil Trade Balance

Net Oil Exporting Countries	Net Oil Importing Countries
4%	6.2%

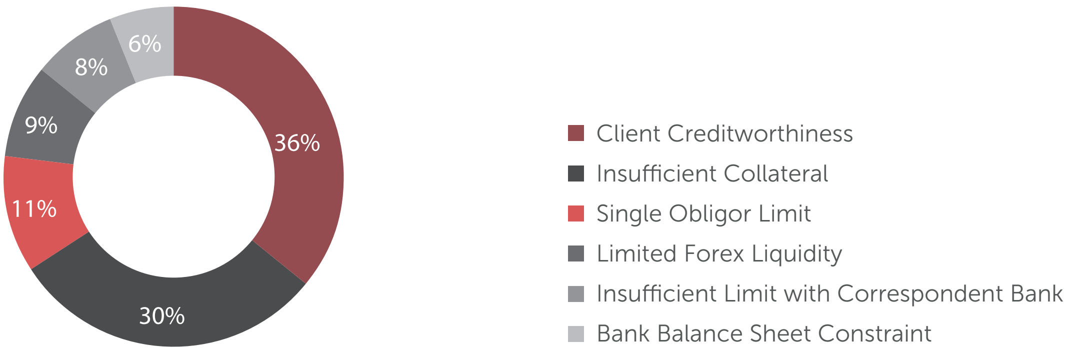
3.2. Creditworthiness and Sufficient Collateral: Key to a Successful Trade Finance Facility Application

Banks cite a number of common reasons for their decisions to reject trade finance applications from some clients (Figure 3.7). The most frequently reported reason relates to concerns about the customers' creditworthiness (36 percent). The absence of credit history of borrowers implies that African banks have more difficulties in appraising the credit risk of their clients (Gajigo et al., 2014).

The asymmetry of information related to the lack of credit history creates some market uncertainty which makes banks consider the borrower not creditworthy and the transaction as risky. In the African context, characterized by imperfect markets and weak credit information systems, it is clear that banks use creditworthiness as an underwriting tool that helps them minimize risks.

However, comparing with AfDB's first trade finance survey, rejection of trade finance applications due to creditworthiness has slightly decreased by four percentage points. This may be due to the improvement in the profile of customers requesting letters of credit or the fact that some efforts have been made to bridge the information gap, thereby reducing risks as perceived or estimated by banks. Indeed, it is worth noting that several countries have made efforts to put in place credit registries and credit bureau databases, as well as some regulatory framework geared towards improving transparency and easing of information asymmetries.

Figure 3.7.
Most Frequently Reported Reasons for Banks' Rejection of Trade Finance Facilities Applications, 2013-2014



> " ... responding banks reported the lack of creditworthiness and insufficient collateral as the most common reasons for rejecting trade finance applications

The second most frequently reported reason for banks' rejection of customers' trade finance requests is insufficient collateral (30 percent). Indeed, collateral requirements by banks may be as high as 100 percent of the value of the traded goods. The collateral requirement is a feature common to commercial banks on the continent which use this as a security for risky transactions, including those in the trade finance segment. It has long been known that creditworthiness and lack of collateral are the major challenges for access to all types of financing in Africa (Bigsten et al, 2003). This is corroborated by the finding of this report, which shows that responding banks reported the lack of creditworthiness and insufficient collateral as the most common reasons for rejecting trade finance applications. This result reflects the general weak credit infrastructure in Africa's financial systems, rather than any peculiarities of the trade finance market.

Beyond the two major reasons for rejection of trade finance facilities applications stated above, banks in oil exporting countries are specifically more constrained by their limited forex liquidity compared to banks in net oil importing countries (single obligor limit reported as a third most important reason for rejection). This result suggests that, in times of drop in the global prices of commodity, and as the availability of foreign currency on the market becomes limited, the banks will be inclined to reject more trade finance facility applications (Figure 3.8).

Banks in fragile states, on the other hand, are more concerned about limits with their correspondent banks when making the decision to accept or reject trade finance facility applications compared to banks operating in non-fragile states (single obligor limit reported as a third most important reason for rejection). Indeed, correspondent banks allocate smaller headroom to banks in countries with a high risk rating compared to more stable countries. During the resurfacing of a conflict or turmoil, the exposure of correspondent banks to fragile states is further reduced, which translates into a constraint for banks operating in such countries leading them to reject a higher number of trade finance facilities applications (Figure 3.9).

A closer look at banks' ownership structure shows that majority government-owned banks are more concerned about customers' balance sheet when reviewing trade finance facilities applications compared to majority local private or foreign banks (single obligor limit reported as a third most important reason for rejection) (Figure 3.10).

Figure 3.8.

Most Frequently Reported Reasons for Banks' Rejection of Trade Finance Facilities Applications by Oil Trade Balance

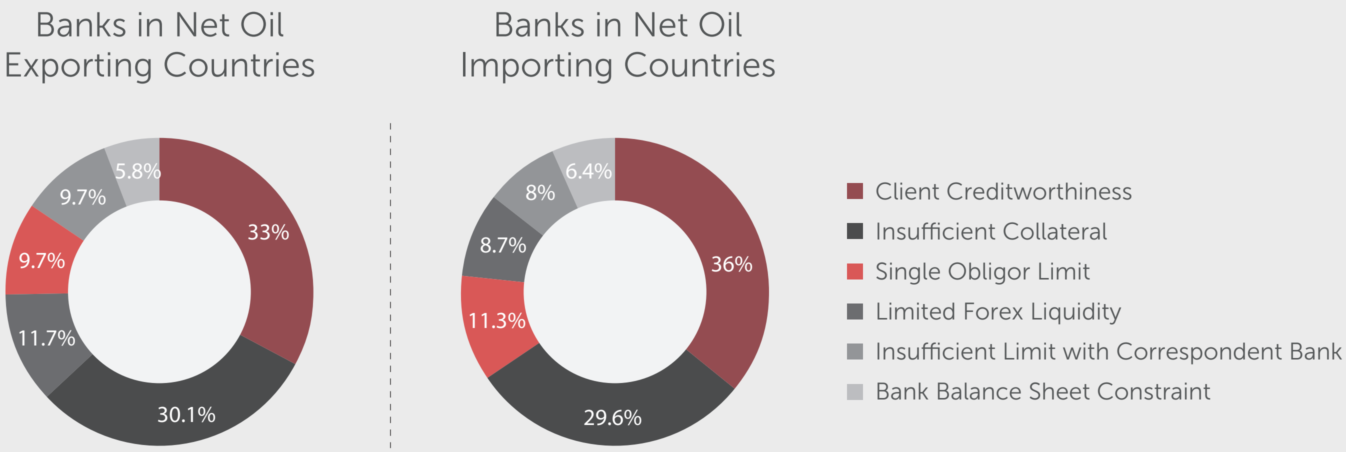


Figure 3.9.

Most Frequently Reported Reasons for Banks' Rejection of Trade Finance Facilities Applications by Fragility Level

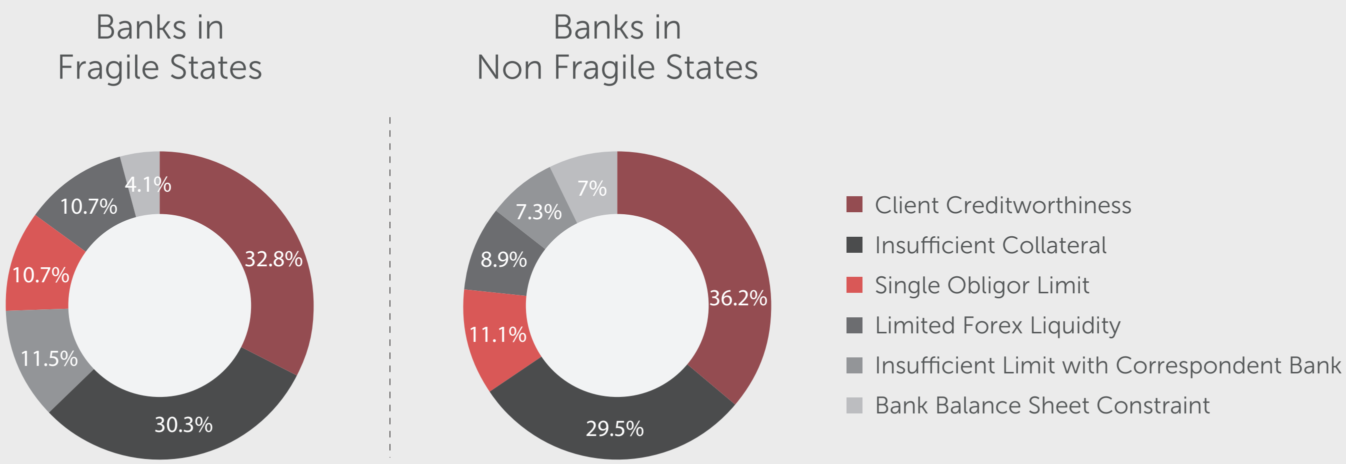
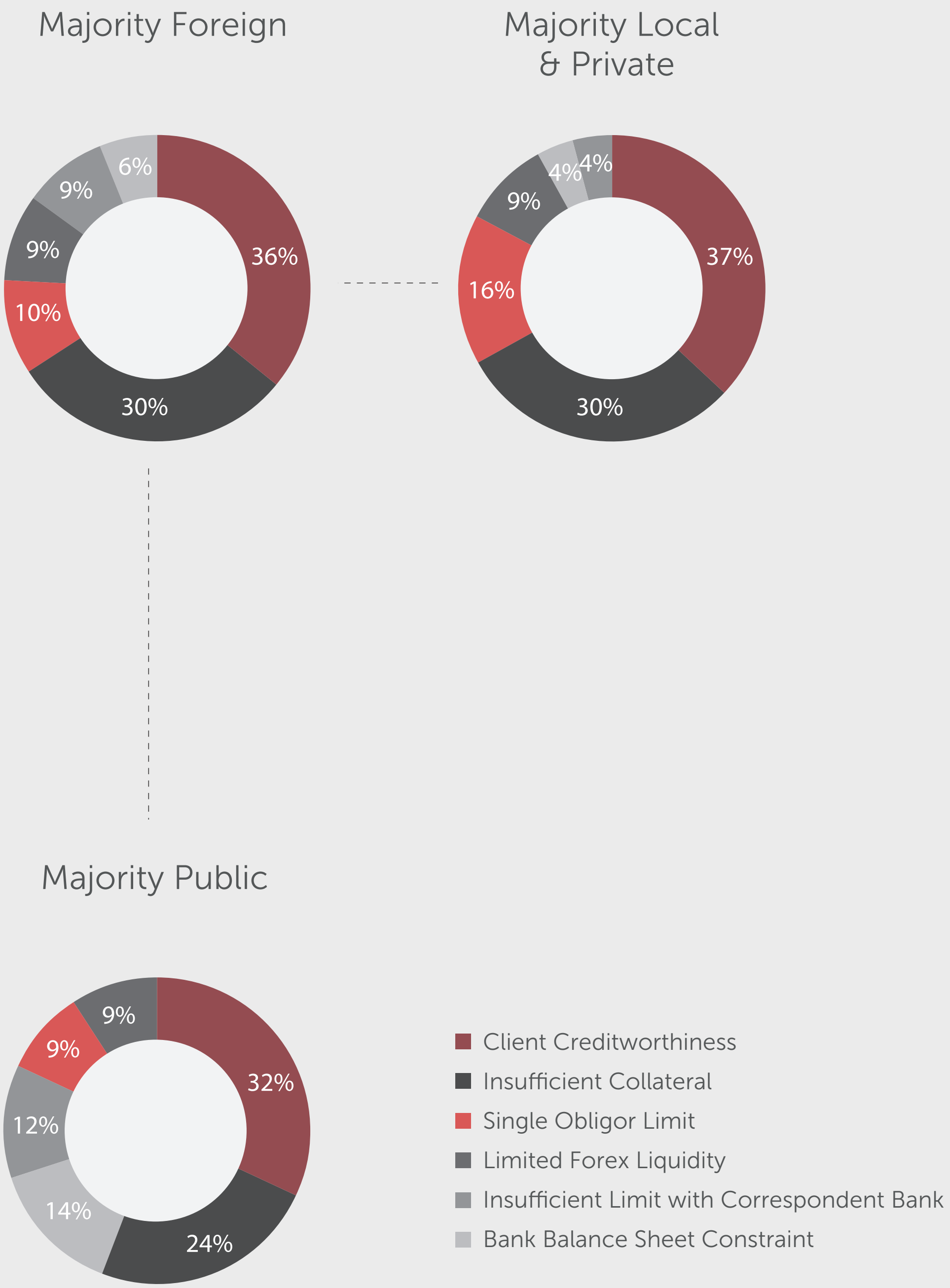


Figure 3.10.
Most Frequently Reported Reasons for Banks' Rejection of Trade Finance Facilities Applications by Bank Ownership Structure



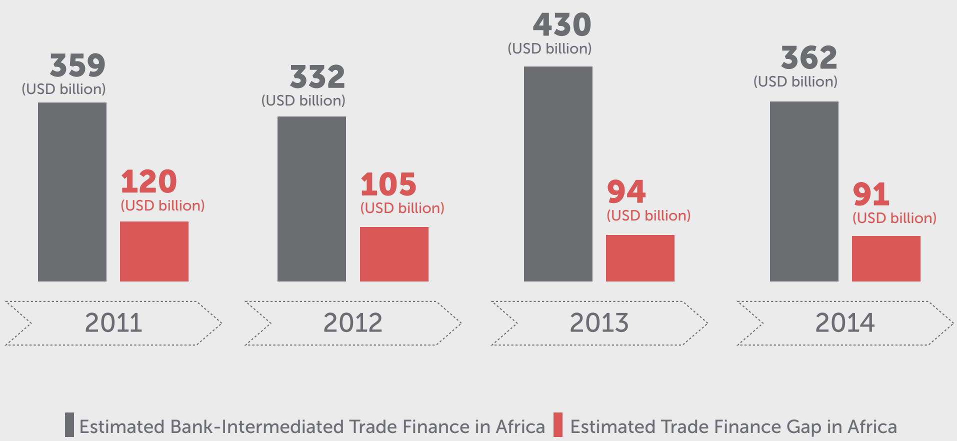
3.3. Unmet Demand is Significant

The size of the bank-intermediated trade finance gap is a good indicator of the degree of companies' access to banks' trade finance facilities. It also gives a feel of how much additionality DFIs such as the AfDB, concerned with the development of the African trade, could bring to this market. However, it is worth noting that measuring the trade finance gap is not an easy task for a number of reasons (DiCaprio and Yao, 2017). The first relates to the fact that there is not a unique definition of trade finance activities in which banks engage. Banks can have various definitions of what constitutes their trade finance portfolios due to different legislation and practices across countries or regions. Consequently, the estimated value of the trade finance gap should be treated as an indicative figure to be used cautiously, as it may involve some measurement errors. In this survey, trade finance refers to financing activities aimed at supporting external trade only.

Second, not all banks fully disclose the values of their trade finance portfolios or follow a separate accounting practice to make trade transactions easily visible in the books. Third, there is no detailed information on the quality of the rejected applications. This deflects from having an accurate understanding and estimate of the real demand, and the extent to which it is unmet. Consequently, this poses the risk of overestimating the size of the bank-intermediated trade finance gap.

In this report, a rough estimate of the size of the unmet demand is provided based on the estimated size of the trade finance market in Africa and the average rejection rate by banks. Accordingly, the estimated trade finance gap in Africa was approximately USD 94 billion in 2013 and USD 91 billion in 2014 (Figure 3.11). Given the estimated size of bank-intermediated trade finance in 2014 (USD 362 billion), unmet demand represents 25 percent of the total estimated size of this market in Africa. The comparative estimated gaps in 2011 and 2012 were USD 120 billion and USD 105 billion respectively. Although this trend may indicate a gradual reduction in the trade finance gap over time, what is evident is that the gap remains quite significant.

Figure 3.11.
Bank-Intermediated Trade Finance and Trade Finance Gap in Africa



Several factors may have worked in tandem to explain the reduction in the trade finance gap over 2011- 2014. Firstly, it is conceivable that policymakers recognized the significant size of the gap and took appropriate policy decisions to facilitate its gradual reduction. Secondly, the relatively accommodative monetary policies during this period resulted in increased foreign currency liquidity and decreased funding costs in general, thereby allowing banks to scale up support to trade finance for African traders.

The decline in Africa's total trade due to depressed commodity prices may have also contributed to a decrease in demand for letters of credit and hence lowered the bank-intermediated trade finance gap. Although this trend indicates a gradual reduction in the trade finance gap over time, what is evident is that the gap remains quite significant.

Chapter 4

Constraints to Trade Finance Growth

Various constraints hamper the growth of banks' trade finance portfolios

Competition is a major constraint that limits the growth of banks' trade finance portfolios. Regulatory requirements are another major constraint and could reflect concerns related to compliance with the international standards since the global financial crisis.

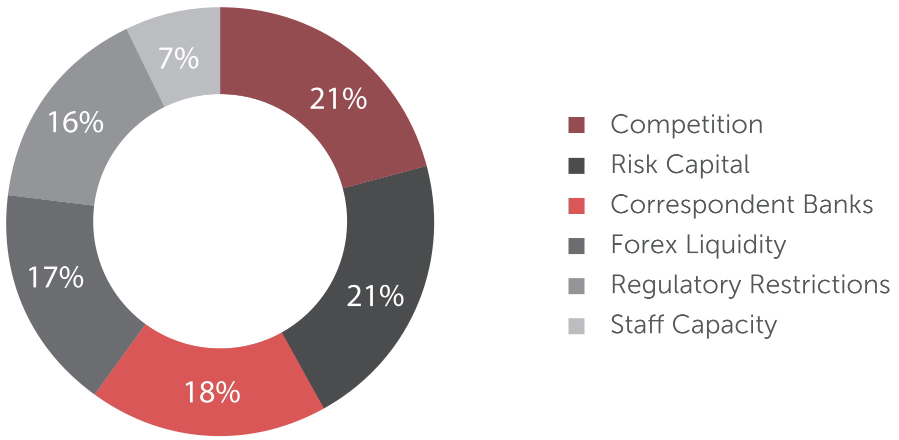
4.1. Constraints to Trade Finance Growth

CHAPTER 4

Understanding the constraints that limit growth in banks' trade finance portfolios is important for policymakers to be able to accurately design and implement policy interventions. Various constraints may limit expansion in banks' trade finance portfolios, including competition with other banks, limited forex liquidity, and regulatory restrictions.

The most frequently reported impediments to growth of banks' trade finance portfolios (Figure 4.1.) are competition (21 percent) and lack of sufficient risk capital (21 percent), followed by insufficient limits with correspondent banks (18 percent), foreign exchange liquidity (17 percent), and regulatory restrictions (16 percent).

Figure 4.1.
Most Frequently Reported Constraints to Growth of Banks' Trade Finance Portfolios, 2013-2014



> " Regulatory restrictions and risk capital requirements present considerable challenges to banks and are among the main constraints to expanding their trade finance portfolios.

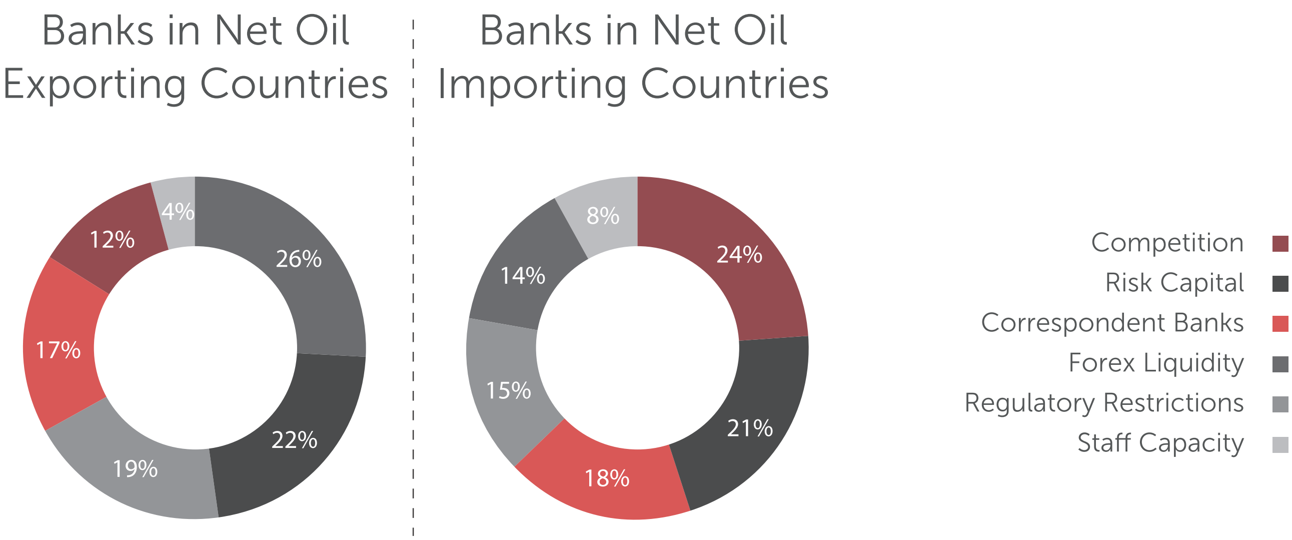
Competition is a common major constraint to growth of banks' trade finance portfolio in Africa. Trade finance activities are low-risk as demonstrated by the low default rate on trade finance relative to the overall NPL ratio of banks, its attractiveness related to its profitability and the fact that trade intermediation constitutes roughly 15 percent of total bank earnings in Africa. It is therefore not surprising that banks report competition from other financial institutions as a major constraint to the growth of their trade finance activities. While not necessarily bad for the trade finance environment as a whole, increased competition will put a strain on market shares of individual banks and may undermine the extent (extensive margin) and volume (intensive margin) of trade transactions, and is likely to be a cause of serious concern in such banks.

Regulatory restrictions and risk capital requirements present considerable challenges to banks and are among the main constraints to expanding their trade finance portfolios. This is of particular concern since international standards, especially anti-money laundering (AML) and KYC rules have become more stringent since the global financial crisis and may be even more so, when banks will have to comply with Basel III requirements. The survey does not capture information that could help us assess whether regulatory challenges pointed out by the banks are related to the above mentioned compliance issues. However, it is conceivable that these new additional restrictions could lead global banks to decrease their trade finance activities in Africa. Indeed, evidence from surveys conducted by the Asian Development Bank (DiCaprio and Yao, 2017) shows that AML and KYC requirements are among the primary impediments for issuing banks in Africa.

Lack of foreign exchange liquidity also appears to be a weighing constraint. This is obvious, as the bulk of international trade transactions are priced in US dollars (Goldberg and Tille, 2008). In addition, when it comes to trade finance transactions, 80 percent of letters of credit are denominated in US dollars (ICC, 2012). Consequently, banks' limited refinancing options in US dollars can be a major constraint undermining their capacity to finance trade (Brandi and Schmitz, 2015).

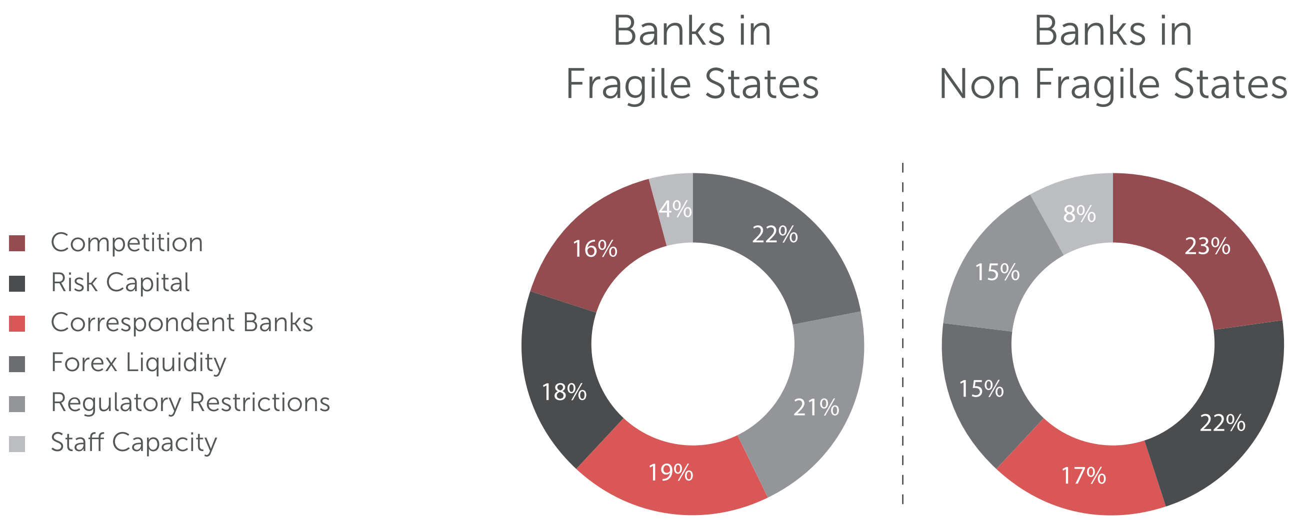
However, the weight of these constraints depends on country specificities. For instance, the most frequently reported constraint for banks operating in net oil exporting countries is foreign exchange liquidity whereas banks in net oil importing countries rank this constraint in the fifth position (Figure 4.2). Although this observation may seem counter-intuitive, it reflects the sensitivity of foreign exchange reserves and the economy in general to variations in commodity prices in natural resource-rich countries. During the survey period all the net oil exporting countries were faced with dwindling foreign exchange reserves. Indeed, there was a reduction of 17% in gross international reserves of net oil-exporting countries between 2011 and 2014 (AfDB data portal).

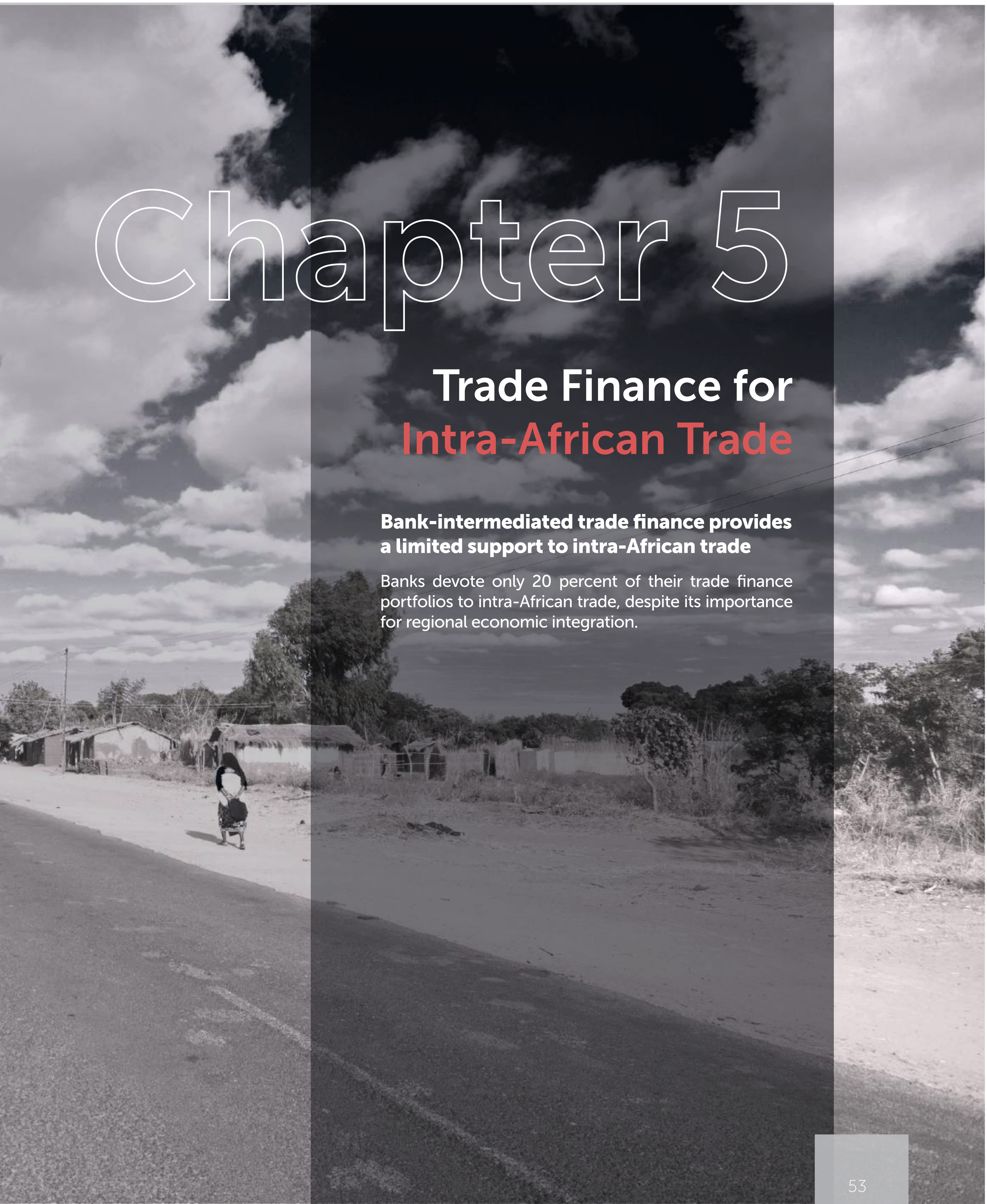
Figure 4.2.
Most Frequently Reported Constraints to Growth of Banks' Trade Finance Portfolios by Oil Trade Balance



For banks operating in fragile states, foreign exchange liquidity and regulatory restrictions are the two major constraints while banks in non-fragile states report competition and risk capital as the two top constraints (Figure 4.3). As a matter of fact, countries hit by conflict undergo restrictions on financial flows and have more difficulty sourcing and maintaining consistent levels of foreign exchange.

Figure 4.3.
Most Frequently Reported Constraints to Growth of Banks' Trade Finance Portfolios by Fragility Level





Chapter 5

Trade Finance for Intra-African Trade

Bank-intermediated trade finance provides a limited support to intra-African trade

Banks devote only 20 percent of their trade finance portfolios to intra-African trade, despite its importance for regional economic integration.

CHAPTER 5

5.1. Intra-African Trade is Still Limited

Intra-regional trade refers to the exchange of goods and services between countries that belong to the same region or economic zone. Beyond the classical benefits of trade such as stimulating economic growth, increasing the choice of products that are available to consumers, and allowing producers to extend their market beyond the local markets, intra-regional trade is an important objective for policymakers concerned with promoting regional economic integration. Better regional integration is in turn expected to speed up convergence and increase economies of scale.

It can also favor the development of cross-border infrastructure and is a good vehicle to catalyze intra-regional investment. In addition, greater regional integration helps landlocked countries to be less constrained by unfavorable boundaries. In Africa, where 16 of the 54 countries are landlocked, intra-regional trade is of great importance.

Table 5.1. Share of Intra-Regional Trade in Africa by Sub-Region (percentage)

	2000	2011-2012	2013-2014
Central	1.2	2.5	2.1
East	17.7	20.1	18.1
North	2.5	3.7	5.3
Southern	11.7	17.1	18.9
West	8.9	7.2	9.4
Africa	9.2	13.1	15.3

Source: Authors' calculations based on data from AfDB data portal and World Trade Organization..

Compared to other regions of the world, Africa's trade is still dominated by international trade instead of intra-regional trade. In 2014, intra-regional trade accounted for 63 percent of total trade for the European Union, 50 percent for North America and 52 percent for Asia, while it accounted for only 15 percent of total trade for Africa.

The share of intra-African trade is not uniformly distributed across Africa's sub-regions (Table 5.1). North Africa and Central Africa have the lowest share of intra-African trade, 5.3 and 2.1 percent, respectively, while East and Southern Africa have the highest share between 18 and 19 percent, respectively, reflecting the fact that both COMESA and SADC are implementing free trade areas[12].

> " The patterns in bank-intermediated trade finance devoted to support intra-African trade across Africa's regions seem to be consistent with the degree of intra-regional trade in the continent...

[12] It should be noted that regional integration and intra-regional trade in COMESA and SADC are still limited owing partly to some risks and weaknesses in the design of regional trade agreements, as pointed out by Khandelwal (2004).

5.2. Share of Banks' Trade Finance Portfolios Devoted to Intra-African Trade

In 2014, banks provided USD 362 billion to fund trade finance transactions in Africa. However only 20 percent of this amount was devoted to intra-African trade. This share seems to be stable over time with a slight increase between 2013 and 2014 (Figure 5.1).

Nonetheless it is important to note that bank-intermediated trade finance devoted to supporting intra-African trade is not uniformly distributed across sub-regions (Figure 5.2). North and Central Africa have the lower shares and Southern and East Africa have the higher shares. The share for West Africa (17.4 percent) over the period 2011 to 2014 is closer to the African average.

The patterns in bank-intermediated trade finance devoted to support intra-African trade across Africa's regions seem to be consistent with the degree of intra-regional trade in the continent and reflect similar issues as described in the previous section.

The ownership profile in the banking sector seems to have an effect on the extent to which banks are willing to fund and support transactions between African trading partners (Figure 5.3). Majority government-owned banks allocate the lowest share of their trade finance portfolios (10 percent) to finance trade within Africa. This share is almost half the share allocated by majority private- (18 percent) and foreign-owned banks (22 percent).

The same rationale applies to African banks operating in net oil exporting countries (Figure 5.4) that dedicate a smaller share of their trade finance assets to support intra-African trade (10 percent) as opposed to banks in net oil importing countries (21 percent).

Figure 5.1.
Average Share of Banks' Trade Finance Assets Supporting Intra-African Trade by Year

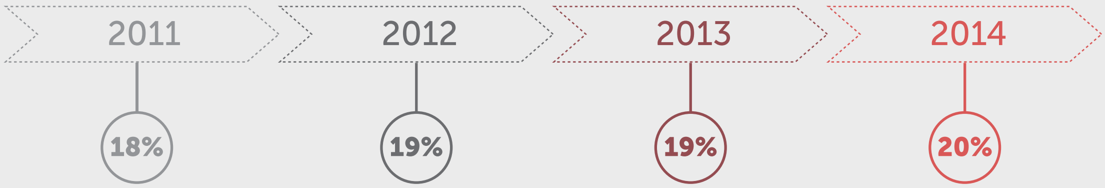


Figure 5.2.
Average Share of Banks' Trade Finance Assets Supporting Intra-African Trade by Sub-Region

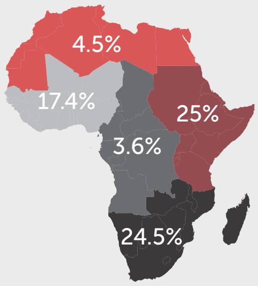
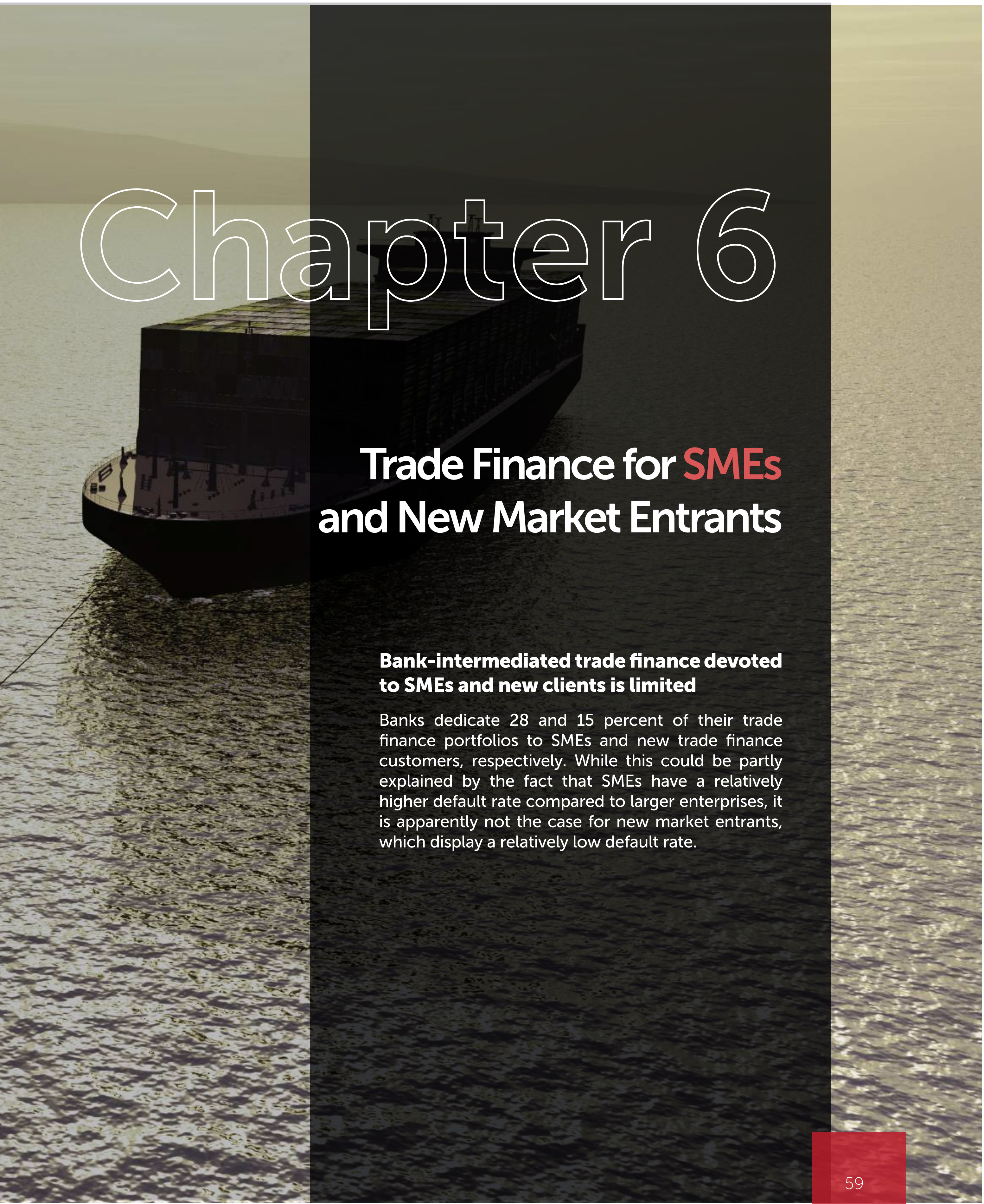


Figure 5.3.
Average Share of Banks' Trade Finance Assets Supporting Intra-African Trade by Bank Ownership Structure

Majority Foreign 22%
Majority Local & Private 18%
Majority Public 10%

Figure 5.4.
Average Share of Banks' Trade Finance Assets Supporting Intra-African Trade by Oil Trade Balance

Net Oil Exporting Countries	Net Oil Importing Countries
10%	21%



Chapter 6

Trade Finance for SMEs and New Market Entrants

Bank-intermediated trade finance devoted to SMEs and new clients is limited

Banks dedicate 28 and 15 percent of their trade finance portfolios to SMEs and new trade finance customers, respectively. While this could be partly explained by the fact that SMEs have a relatively higher default rate compared to larger enterprises, it is apparently not the case for new market entrants, which display a relatively low default rate.

CHAPTER 6

6.1. SMEs' Access to Trade Finance is Relatively Low

Access to trade finance is critical for SMEs to expand or intensify their international trade activities. But trade finance often does not come easily for SMEs. Estimates suggest that, globally, 47 percent of proposed trade finance transactions are submitted by SMEs against 14 percent by large corporates. However, SMEs' trade finance proposals are rejected 52 percent of the time while 87 percent of large corporates had their trade finance proposals approved (DiCaprio et al., 2015). Our survey suggests that SMEs in Africa face similar difficulties in their attempt to access financing for trade. Indeed, only 28 percent of banks' trade finance facilities are extended to SMEs in Africa. This is significantly low given that SMEs account for more than 80 percent of firms in the continent. The relatively low share of banks' trade finance portfolio devoted to SMEs could be explained by the higher risk perception associated with funding SMEs (see below, section 6.3). It could also be explained by the high costs (administrative, due diligence, etc.) that come from making multiple smaller transactions versus one big transaction for a large enterprise.

Given the importance of SMEs in African economies, trade finance could benefit this particular segment if banks are encouraged to dedicate more resources that increase SMEs participation in international trade. This however will not be an easy task given the risks related to financing SMEs and the risk-averse position taken by commercial banks not only in trade finance transactions but in banking in general on the continent. Therefore, encouraging banks to serve SMEs would require putting in place mechanisms to de-risk trade finance transactions and eventually bringing banks to tailor their underwriting processes to better serve SMEs. Such efforts would be transformational in the sense that it is expected that as SMEs gain access to trade finance, they would tend to participate in international trade and become more productive, more profitable, and likely able to offer better-quality and better paying jobs (Melitz, 2003; Lawless, 2009 and Wagner, 2012).

6.2. Trade Finance Assets: Highly concentrated on large corporates and limited exposure to new market entrants

The report examines the distribution of trade finance portfolios among the ten biggest customers and new trade finance customers of commercial banks. It is important to put the focus on trade finance for new customers given the evidence that increasing the extensive margin of trade in developing countries can substantially boost trade (Baldwin and Gu, 2003; Stiebale, 2011; Nagaraj, 2014). New customers, in this report, refer to those that have for the first time, within the past 12 months, received a trade finance facility from commercial banks. This provides a window through which one can assess how access to trade finance promotes market access for new entrants.

In 2014, the ten biggest customers of banks on average accounted for about 58 percent of the total trade finance portfolios while new clients accounted for only 15 percent (Figure 6.1). The data shows that trade finance is highly concentrated among a few top clients. This large concentration may be explained by the fact that larger corporates tend to be more financially solid, less risky and have well-established long-term relationships with banks. By contrast, the low exposure to new market entrants can be related to the fact that these clients come with no trade finance track record, are not yet considered by banks as reliable counterparts, and would require more due diligence. Similarly to SMEs, commercial banks may also be facing significant challenges appraising the creditworthiness of new market entrants, even though evidence shows that they are not necessarily risky as compared to SMEs or trade finance customers in general (section 6.3). Hence, when it comes to improving access to trade finance for new traders (notably exporters) and SMEs, there is scope for banks in conjunction with DFIs to put in place targeted and well-tailored interventions geared towards de-risking trade finance transactions and facilitating access to trade finance for these groups of customers.

Even across sub-regions, there is a consistent pattern of high concentration of trade finance assets among top clients. The ten biggest customers of commercial banks make up over 60 percent of the trade finance portfolios in East and Southern Africa, and about half the trade finance portfolios in North and West Africa. On the other hand, less than one-fifth of banks' trade finance portfolios is dedicated to new trade finance customers, across all sub-regions (Figure 6.2).

Figure 6.1.
Distribution of Trade Finance Portfolio across Customer Groups by Year

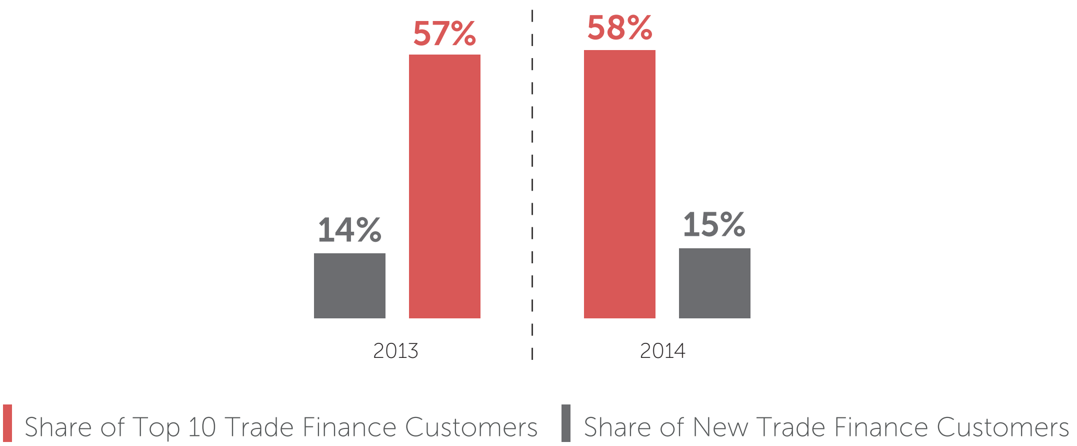
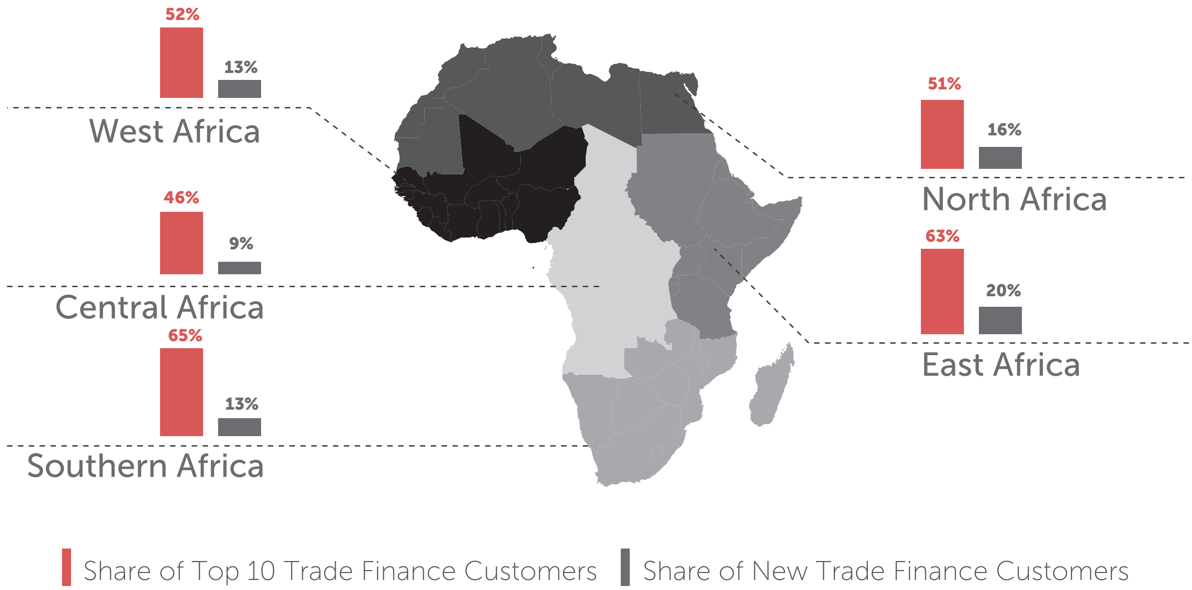


Figure 6.2.
Distribution of Trade Finance Portfolio across Customer Groups by sub-Region



A similar general pattern can be observed across banks' ownership structure and countries' specificities (income level, fragility, and oil resources availability). However, variations are observed: majority government-owned banks dedicate a higher share of their trade finance portfolio to new customers compared to the majority private local and foreign-owned banks (Figure 6.3). As highlighted in section 2.4, it is often the case that public banks design trade finance programs to meet the demand of a particularly underserved segment of companies such as new traders.

Figure 6.3.
Distribution of Trade Finance Portfolio across Customer Groups by Bank Ownership Structure

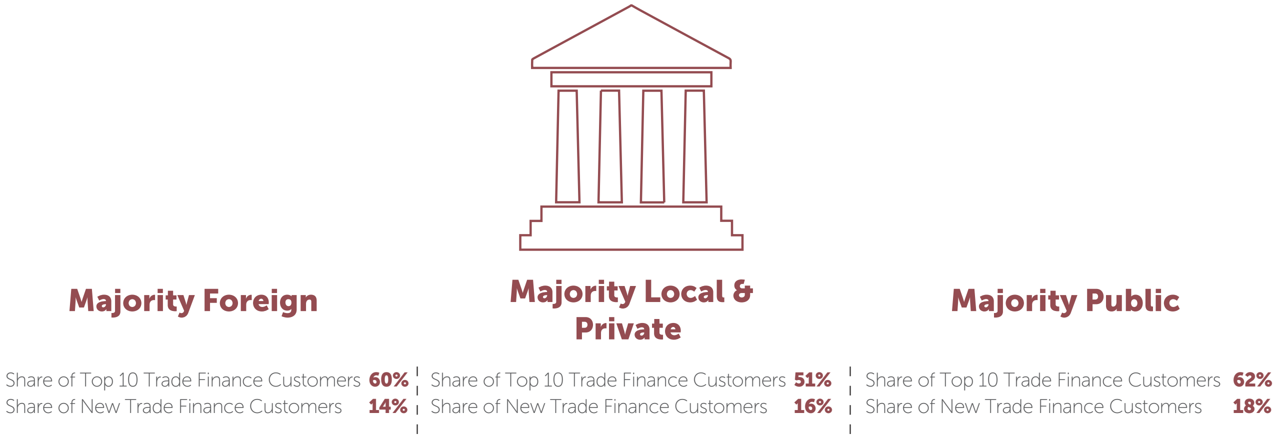


Figure 6.4.
Distribution of Trade Finance Portfolio across Customer Groups by Income Level

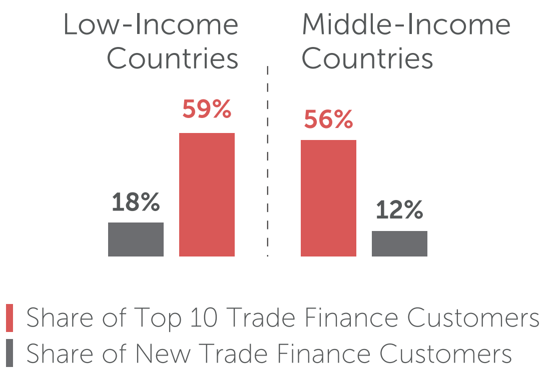


Figure 6.5.
Distribution of Trade Finance Portfolio across Customer Groups by Fragility Level

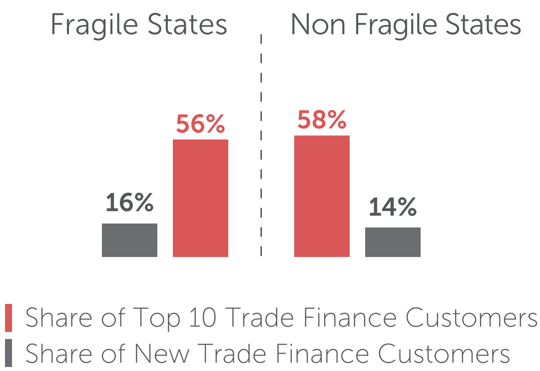
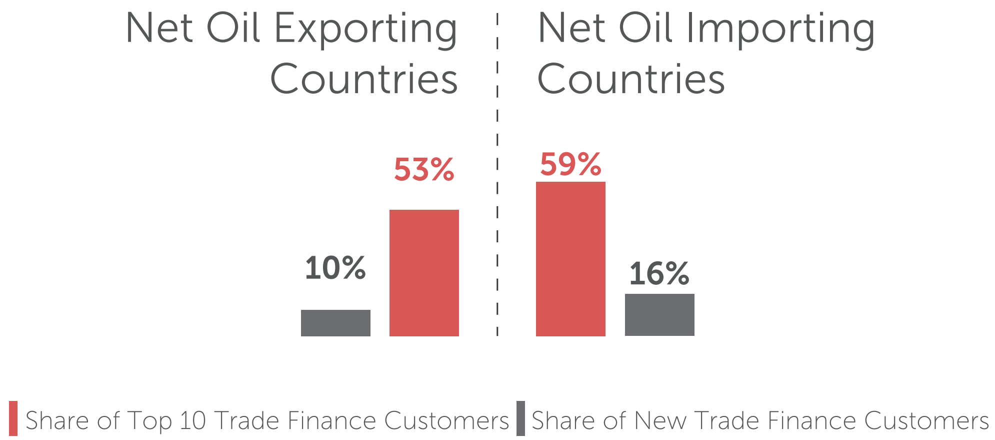


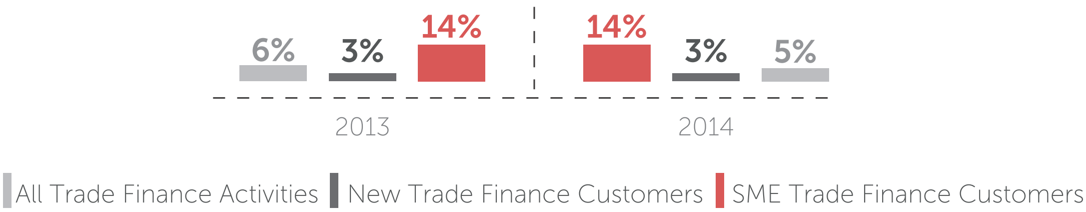
Figure 6.6.
Distribution of Trade Finance Portfolio across Customer Groups by Oil Trade Balance



6.3. Default Rate for Trade Finance Transactions: SMEs Seem Riskier than First Time Applicants

The default rate on trade finance assets in Africa remains low in general, although it is relatively higher for SMEs. The survey shows that SME trade finance default rate was about 14 percent compared to 5 percent for all trade finance customers over the period 2013-2014 (Figure 6.7). It is reported that, new applicants for trade finance facilities, having an average default rate of 3 percent, are not necessarily riskier. The low share of the trade finance portfolio dedicated to new clients could potentially stem from the fact that the involved banks have adopted relationship lending as their modus operandi, and therefore put a premium on long-term relationships. This could be a result of the lack of enforced legal and regulatory frameworks coupled with the lack of sufficient credit information that bring banks to adopt such a mechanism to manage credit risk and ensure repayment (Beck et al., 2011). This implies, therefore, higher costs of undertaking thorough due diligence on new trade finance clients before getting them on board, which can in turn constitute barriers to trade finance for some new entrants. This also calls for the need to revisit banks' underwriting processes and particularly their lending approach to move from relationship lending to transaction-based lending for the benefit of new entrants.

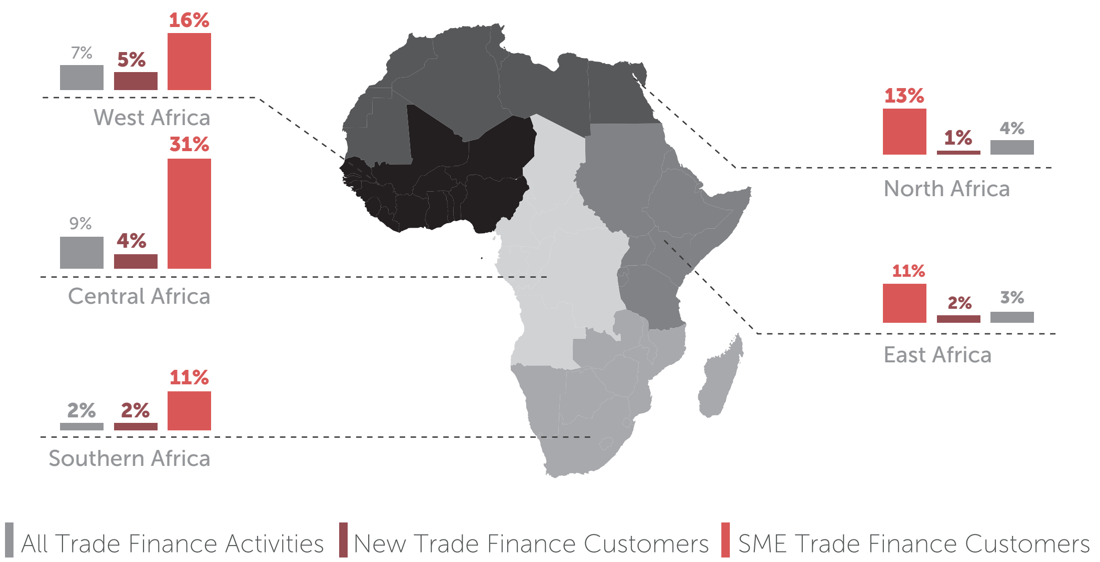
Figure 6.7.
Average Default Rate on Banks' Trade Finance Activities across Customer Groups by Year



The low level of exposure to new trade finance applicants, despite a relatively lower risk profile, also features when we examine the default rate at the sub-regional level (Figure 6.8). In North Africa, the average default rate of new trade finance customers is around 1 percent, while in East and Southern Africa, the default rate is around 2 percent. It is noted, however, that SMEs are still considered high risk for banks engaged in trade finance activities.

In Central Africa, the SME trade finance default rate stands at 31 percent, the highest among all the sub-regions and almost double that of West Africa (16 percent), the sub-region with the second highest SME trade finance default rate. East and Southern Africa have the lowest default rates on SME trade finance transactions at 11 percent.

Figure 6.8.
Average Default Rate on Banks' Trade Finance Activities across Customer Groups by sub-Region



A breakdown by banks' ownership structure shows differences in the reported default rate on trade finance activities (Figure 6.9). Majority privately and locally-owned banks show the lowest default rates, not only on all trade finance activities but also on their trade finance portfolios supporting new customers and SMEs. Majority publicly-owned banks on the other hand show the highest levels of default rates potentially reflecting a credit risk system that is below the standards in application in the trade finance industry.

New trade finance customers are performing better than average trade finance customers. This shows across bank ownership structure (Figure 6.9), state fragility (Figure 6.10), and country income levels (Figure 6.11). It is plausible to conclude that, given the relationship based business nature of trade finance, commercial banks are not inclined to take risk on new trade finance customers, and select only those that meet the most stringent creditworthiness requirements.

Figure 6.9.
Average Default Rate on Banks' Trade Finance Activities across Customer Groups by Bank Ownership Structure

Majority Foreign

All Trade Finance Activities	**4%**
New Trade Finance Customers	**3%**
SME Trade Finance Customers	**15%**

Majority Local & Private

All Trade Finance Activities	**4%**
New Trade Finance Customers	**2%**
SME Trade Finance Customers	**12%**

Majority Public

All Trade Finance Activities	**8%**
New Trade Finance Customers	**5%**
SME Trade Finance Customers	**15%**

Figure 6.10.
Average Default Rate on Banks' Trade Finance Activities across Customer Groups by Fragility Level

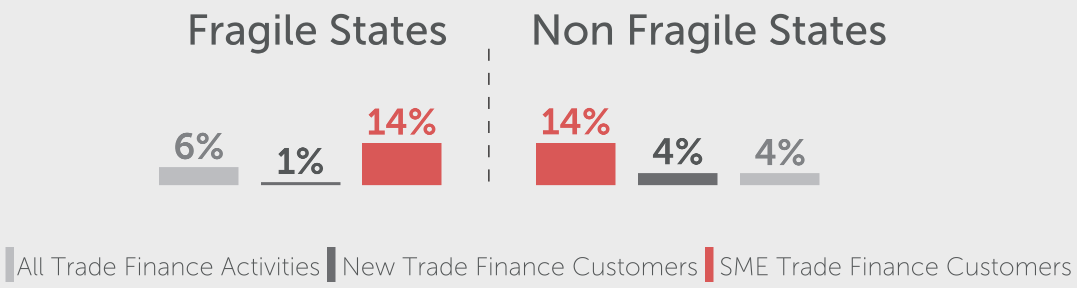
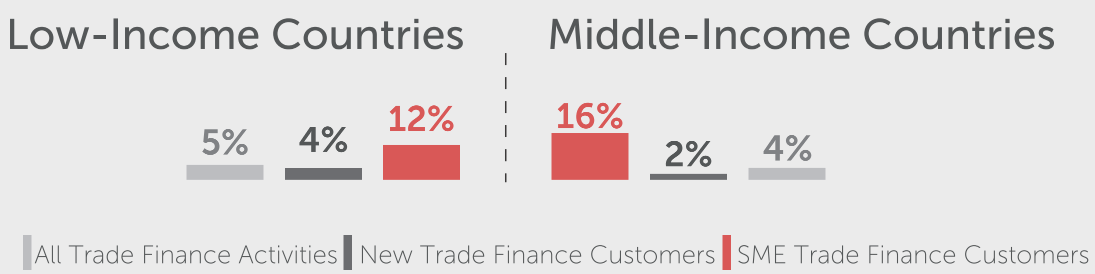


Figure 6.11.
Average Default Rate on Banks' Trade Finance Activities across Customer Groups by Income Level




AfDB

Chapter 7

The AfDB's Trade Finance Program

AfDB and other DFIs are helping to fill both the financing and information gaps

Since the global financial crisis, the AfDB has set up a full-fledged Trade Finance Program to help Africa's trade finance community overcome challenges they are facing. The AfDB and other DFIs will continue to strengthen their resolve to help reduce the funding and knowledge gaps in Africa's trade finance market.

CHAPTER 7

7.1. The AfDB's Trade Finance Program

Many continental and regional DFIs have been engaged in trade finance in Africa for many years, some going as far back as the 1980s. Global and continental DFIs such as the International Finance Corporation (IFC), European Bank for Reconstruction and Development (EBRD), International Islamic Trade Finance Corporation (ITFC) and CDC Group UK (CDC) provide both trade finance guarantees and liquidity solutions in Africa. The IFC provides mainly guarantees and covers the entire continent but excludes government-owned banks whereas EBRD's coverage is restricted to a few countries in North Africa. The ITFC covers only its member countries in Africa while CDC covers a number of countries but is a fairly new entrant in the market. Although regional DFIs such as Afreximbank, The Eastern and Southern African Trade and Development Bank (PTA Bank) and the African Trade Insurance Agency only serve their member countries and as such do not cover the entire continent, they have become increasingly active despite their balance sheet and credit rating constraints compared to the larger and 'AAA' rated Multilateral Development Banks (MDBs).

In the 1980s and 1990s, AfDB was only indirectly engaged in trade finance through equity investment and liquidity support to the special purpose regional trade finance institutions such as Afreximbank and PTA Bank. However, the 2008/2009 global financial crisis was a watershed moment when many global banks that are pivotal to trade finance retrenched to their core markets and drastically reduced their correspondent banking relationships and funding lines to emerging markets in general, not least in Africa. As a result, the G20 called on MDBs, DFIs and other development partners to step up and play a more active role in supporting trade in emerging markets. The AfDB responded to this call by setting up a TFI in 2009 with a wallet of USD 1 billion. The TFI provided USD 500 million in liquidity support to African banks and the other USD 500 million was earmarked for partnership with the IFC under its Global Trade Liquidity Program to support African Financial Institutions.

The AfDB's decision to engage in trade finance in a structured manner was therefore informed in large part by the experience gained from the successful implementation of the TFI on the one hand and on the other by the realization that there was a huge market gap that neither the private sector nor the combined efforts of regional DFIs and MDBs could fill on their own in spite of their best efforts.

It was against this backdrop that in February 2013 the Bank set up a full-fledged Trade Finance Program (TFP), similar to those of the other MDBs, to serve all countries in Africa. The overall objective of the TFP is to address the acute shortage of trade finance on the continent by providing guarantees to major international banks and trade finance liquidity support to local financial institutions and soft commodity aggregators/corporates. These facilities are used to provide financing to SMEs and local corporates and promote both intra-African and international trade. The program seeks to encourage and expand trade finance activities of international financial institutions who work primarily with smaller domestic banks in Africa to cater to the needs of SMEs and local corporates. Other target segments include soft commodity aggregators that support networks of small farmers and commodity traders.

Another objective of the TFP is to support countries in times of crisis by providing counter-cyclical assistance. It has been observed that during political or economic crises trade lines from international banks to local banks are usually among the first to be curtailed, thereby hampering the ability of companies in affected countries to import vital inputs or promote exports. Although the TFP alone cannot prevent the worst effects of a crisis, it can help to lessen some of them. By engaging more actively in trade finance and playing to its comparative advantages, the AfDB complements the efforts of private sector institutions, regional DFIs, and other MBDs active in Africa.

7.2. The Trade Finance Products

The TFP was set up to offer three complementary products: (i) the Risk Participation Agreement (RPA); (ii) the Trade Finance Line of Credit (TFLOC); and (iii) the Soft Commodity Finance Facility (SCFF). In addition to these, the program makes selective use of equity and technical assistance instruments to enhance the risk-bearing and operational capacities of local financial institutions.

Under an RPA, the Bank shares the credit risk (usually up to 50 percent) of a portfolio of eligible trade transactions originated by local banks in Africa and underwritten by partner confirming banks. The RPA product provides partial risk mitigation to regional and international commercial banks for the risk taken on local issuing banks in Africa. The wholesale approach of RPAs relies on these international banks to perform credit/risk analysis of the issuing banks, as well as to originate, process, and monitor the transactions. The Bank's role is to issue guarantees in favor of these carefully selected commercial banks whose origination, corporate governance, and credit administration processes are considered to be robust.

The TFLOC has a maximum tenure of 3.5 years and is deployed exclusively to finance trade-related transactions. The facility is used to support local financial institutions in providing various trade finance solutions (pre- and post-shipment financing, capital expenditure financing, receivables financing, and working capital) to SMEs and to corporates in the international trade sector.

Under the SCFF, the Bank supports the export marketing of soft agricultural commodities (such as cocoa and coffee) in Africa, including support for value addition activities prior to export. The SCFF has a maximum tenure of two years and is targeted at commodity aggregators and physical commodity trading companies. Typical clients include commodity aggregators such as Ghana's Cocobod—engaged in the purchase and export marketing of soft commodities.

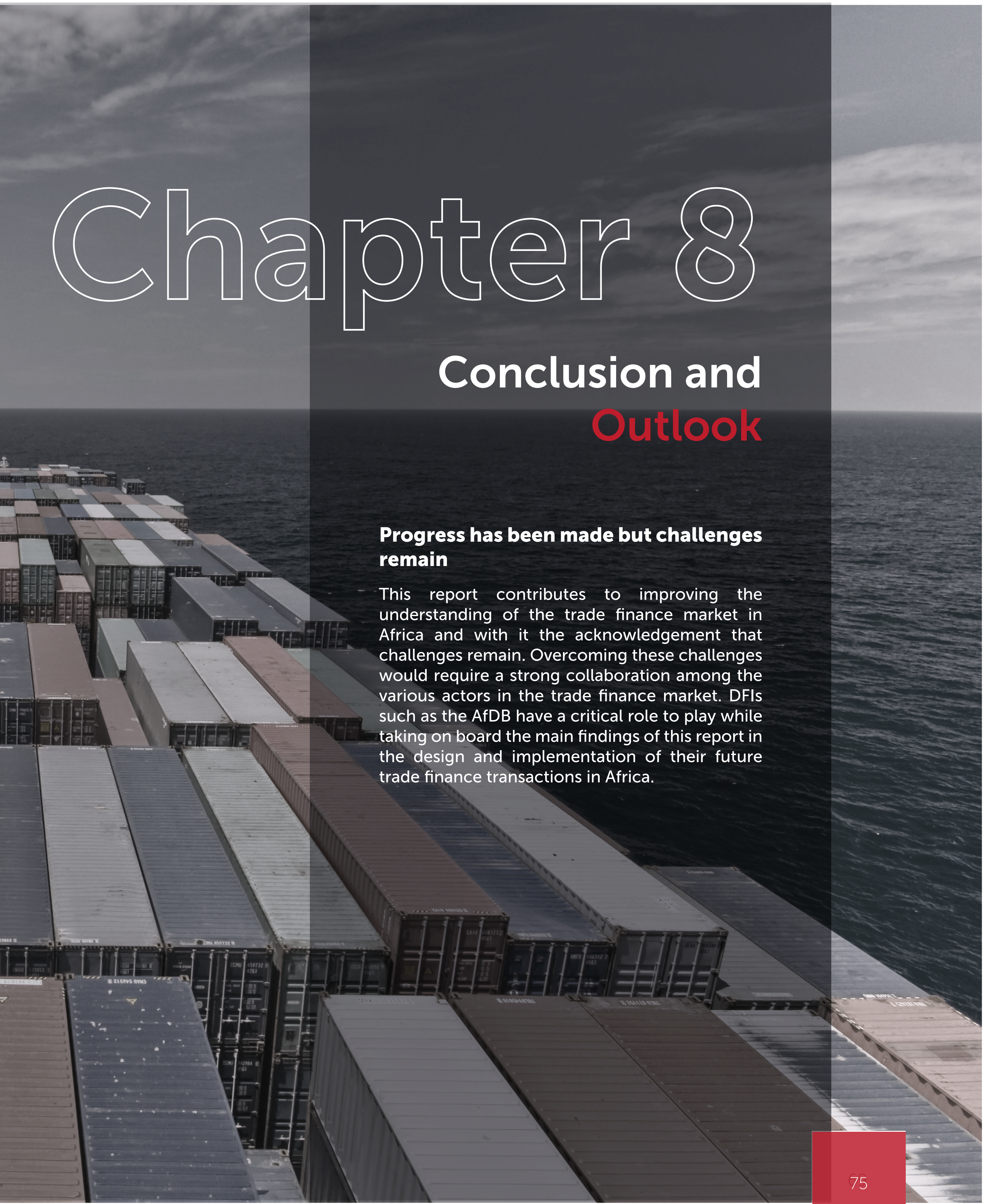
7.3. Achievements

From August 2013, when the first transactions were consummated, to December 2015 the TFP has supported more than 1000 trade transactions involving 85 financial institutions in at least 20 African countries, for a cumulative trade value of approximately USD 3 billion. Of this amount intra-African trade accounted for more than USD 600 million, representing at least 20 percent of total trade supported. The bulk of the Bank's trade support was provided in the form of RPAs (portfolio guarantees). Similarly, over 62 percent of all transactions have a tenure of less than six months, signifying the short-term nature of trade finance transactions in general.

The program has also provided significant support for the import and export of essential commodities and intermediary goods that are vital to the socio-economic development of African countries. For example, 'Agriculture, Forestry, and Fisheries' and 'Manufacturing' respectively account for 22 percent and 25 percent of the total value of trade supported.

These achievements demonstrate that trade finance instruments have the propensity to reach and impact many countries, sectors, financial institutions, target beneficiary SMEs, and local corporates in a very short time period.

Overall, the AfDB's TFP has been a relevant response to demand for trade finance risk mitigation in Africa. Risk coverage was provided for banks in more than 20 countries, most of which are low-income countries and/or fragile and transitioning states. These include Guinea, Liberia, The Gambia, Ethiopia, and Zimbabwe—countries where international banks provide very limited trade finance credit lines due to various risk considerations. The single most important factor that attracted international banks to the TFP and most particularly to the RPA product is the Bank's 'AAA' rating which provides them with capital relief under the Basel regulatory framework. By transferring part of the risk of local banks in Africa to AfDB, international banks are able to expand the amount of trade they finance on the continent. The Bank's 'AAA' rating also allows it to borrow at cost effective rates and hence provide stable and competitive foreign exchange funding to domestic banks for trade finance purposes.



Chapter 8

Conclusion and Outlook

Progress has been made but challenges remain

This report contributes to improving the understanding of the trade finance market in Africa and with it the acknowledgement that challenges remain. Overcoming these challenges would require a strong collaboration among the various actors in the trade finance market. DFIs such as the AfDB have a critical role to play while taking on board the main findings of this report in the design and implementation of their future trade finance transactions in Africa.

Looking ahead, there is still a lot to be done to bridge the trade finance gap in Africa. The market is evolving and demand continues to outstrip supply many fold. While, this constitutes a plausible argument for DFIs additionality in the trade finance area, it also provides an opportunity to fine-tune their targeting methods to ensure that those in need, including SMEs, new market entrants, firms in fragile states and low-income countries, do benefit from trade finance facilities.

The findings show also that trade finance is a powerful instrument which, if well designed, could go a long way to foster intra-African trade and regional integration. This calls for closer collaboration among the different suppliers of liquidity and risk mitigation on the continent in order to create the necessary synergy and to better complement one another. For example, the various MDBs would all be better off and indeed contribute to the attainment of their common objective of reducing the trade finance gap in Africa through greater exchange of information, co-sharing of risk, sound financial sector policy, regulatory reforms, and joint thematic research initiatives.

In the course of implementing the TFP, the AfDB has learnt a number of lessons that could be used to refine the TFP to better respond to market needs. For instance, there is growing demand for single transaction guarantees (direct guarantees) from both local and international banks. In addition to introducing new instruments to satisfy this demand, it is also important to expand and enhance capacity building initiatives to assist local banks improve their understanding of trade finance products and related operational services. It would also be useful to encourage and support them in the process of tailoring their underwriting processes and lending approach, and to improve the credit information systems, in order to better meet the demand. Similarly, KYC and regulatory compliance challenges faced by international banks with respect to their African correspondent banks need to be tackled more vigorously to avert any meltdown in the withdrawal of these international banks from Africa or in the exiting of correspondent banking relationships, as was witnessed during the global financial crisis.

The outlook in the medium to long term is improving given the slight decrease in the estimated trade finance gap on the continent. Yet, the short-term challenges arising from the fall in commodity prices and weak growth in many of Africa's key external markets suggest that DFIs like AfDB have an even bigger role to play in assuring adequate availability of trade finance liquidity and risk-mitigation solutions.

Bibliography

Auboin, Marc (2011), "Trade Finance under the Current Basel Regulatory Framework: What are the Issues?" in Chauffour, J.-P. and Malouche, M., Trade Finance during the Great Trade Collapse, World Bank: Washington, DC, 385-392.

Baldwin, J.R. and Gu, W. (2003), "Export-Market Participation and Productivity Performance in Canadian Manufacturing", Canadian Journal of Economics, 36(3), 634-657.

Beck, Thorsten, Samuel Maimbo, Issa Faye, and Thouraya Triki (2011), Financing Africa: Through the crisis and beyond. World Bank: Washington DC, 131.

Bigsten, A., Collier, P., Dercon, et al. (2003), Credit Constraints in Manufacturing Enterprises in Africa, Journal of African Economies, 12(1), 104-125.

BIS (2014), "Trade Finance: Developments and Issues", CGFS Papers No 50, Bank for International Settlements: Basel.

Brandi C. and Schmitz B. (2015), "Financing Global Development: The Potential of Trade Finance", Briefing Paper 10/2015, German Development Institute: Bonn.

DiCaprio A. and Yao Y. (2017), "Drivers of Trade Finance Gaps", Institute Working Paper No 678, Asian Development Bank, page 49-77.

DiCaprio A., Beck S., and Daquis, J.C. (2015), "2015 Trade Finance Gaps, Growth, and Jobs Survey", ADB Briefs 45, Asian Development Bank: Manila.

Fingerand, K.M. and Schuknecht, L. (1999), "Trade, Finance and Financial Crises", WTO Special Studies, No 3. World Trade Organization: Geneva.

Gajigo, O., Triki, T., and Drammeh, L. (2014), "Trade Finance in Africa", African Development Bank: Abidjan.

GIIN (2015), "The Landscape for Impact Investing in West Africa", Global Impact Investing Network, New York.

Goldberg, Linda and Tille, Cédric (2008), "Vehicle Currency Use in International Trade", Journal of International Economics, 76(2), 177-192.

ICC (2012), "Rethinking Trade and Finance", International Chamber of Commerce: Paris.

ICC (2013), "Rethinking Trade & Finance: An ICC private sector development perspective", International Chamber of Commerce: Paris.

Khandelwal, P. (2004): "COMESA and SADC: Prospects and Challenges for Regional Trade Integration", IMF Working Papers No. WP/04/227.

Lawless, M. (2009), "Firm Export Dynamics and the Geography of Trade", Journal of International Economics, 77(2), 245-254.

Melitz, M.J. (2003), "The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity", Econometrica, 71(6), 1695-1725.

Nagaraj, P. (2014), "Financial Constraints and Export Participation in India", International Economics, 140 (December), 19-35

Stiebale, J. (2011), "Do Financial Constraints Matter for Foreign Market Entry? A Firm-Level Examination", The World Economy, 34(1), 123-153.

Triki, T. and Gajigo, O. (2012): "Credit Bureaus and Registries and Access to Finance: New evidence from 42 African countries", AfDB Working Paper Series, No 154, October.

Wagner J. (2012), "International Trade and Firm Performance: A Survey of Empirical Studies since 2006", Review of World Economics, 148(2), 235-267.

WTO (2016), "Trade Finance and SMEs: Bridging the Gaps in Provision", World Trade Organization: Geneva.

Appendix

Figure A.1. Country Distribution of the Respondent Banks, 2011-2014

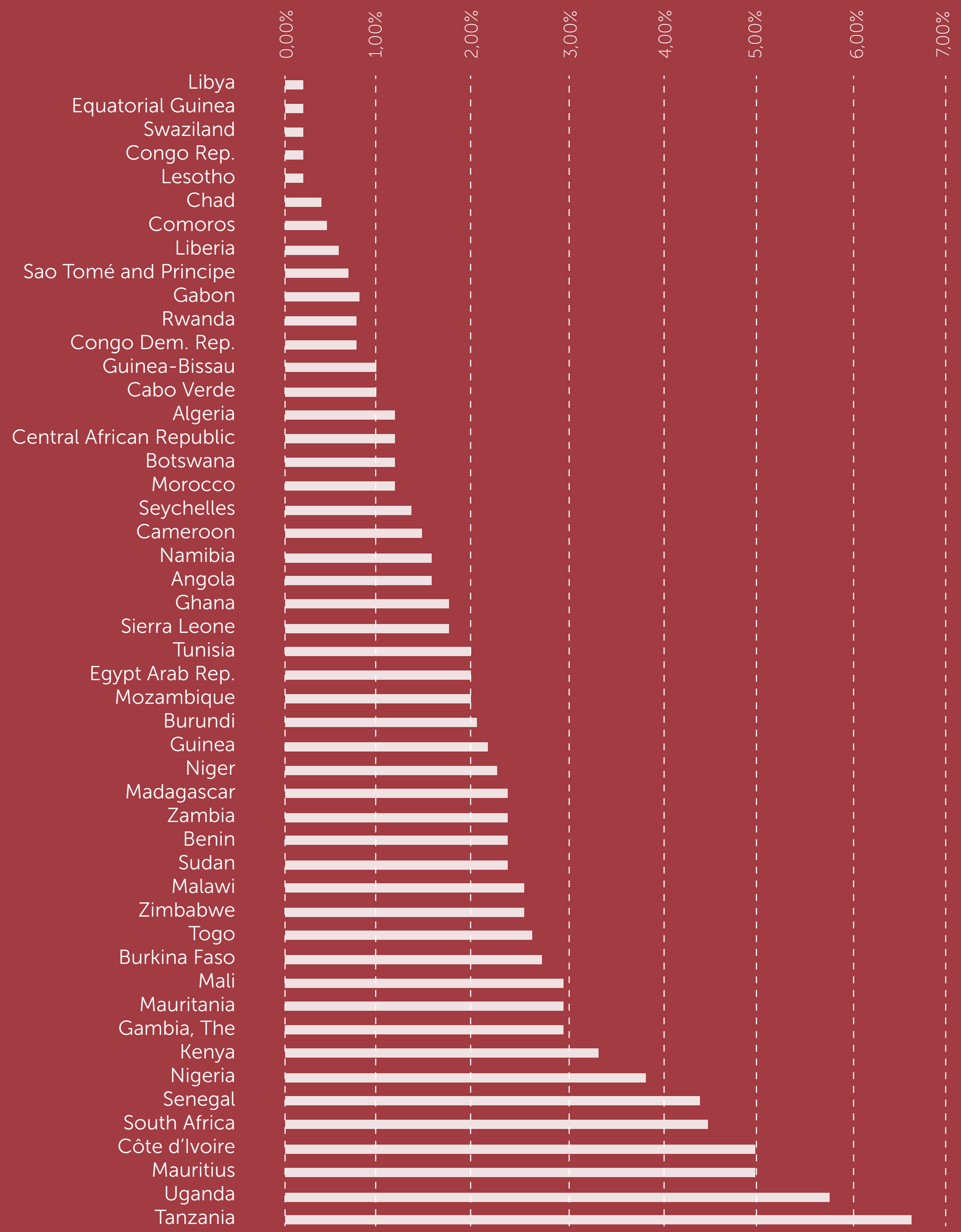


Table A.1. Breakdown of African Countries by sub-Region

CENTRAL	EAST	NORTH	SOUTHERN	WEST
Angola	Burundi	Algeria	Botswana	Benin
Cameroon	Comoros	Egypt, Arab Rep.	Lesotho	Burkina Faso
Central African Rep.	Kenya	Libya	Madagascar	Cabo Verde
Chad	Rwanda	Mauritania	Malawi	Côte d'Ivoire
Congo, Dem. Rep.	Sudan	Morocco	Mauritius	Gambia, The
Congo Rep.	Tanzania	Tunisia	Mozambique	Ghana
Equatorial Guinea	Uganda		Namibia	Guinea
Gabon			Seychelles	Guinea-Bissau
São Tomé and Príncipe			South Africa	Liberia
			Swaziland	Mali
			Zambia	Niger
			Zimbabwe	Nigeria
				Senegal
				Sierra Leone
				Togo

Table A.2. Country Categorization by Income Level*, Fragility** and Net Oil exporters***

LOW-INCOME COUNTRIES	FRAGILE STATES	NET OIL EXPORTERS
Benin	Burundi	Algeria
Burkina Faso	Central African Rep.	Angola
Burundi	Chad	Cameroon
Central African Rep.	Comoros	Chad
Chad	Congo, Dem. Rep.	Congo, Dem. Rep.
Comoros	Côte d'Ivoire	Congo, Rep.
Congo, Dem. Rep.	Guinea	Equatorial Guinea
Gambia, The	Guinea-Bissau	Gabon
Guinea	Liberia	Libya
Guinea-Bissau	Madagascar	Nigeria
Kenya	Mali	Sudan
Liberia	Sierra Leone	
Madagascar	Somalia	
Malawi	Sudan	
Mali	South Sudan	
Mozambique	Togo	
Niger	Zimbabwe	
Rwanda		
Sierra Leone		
Tanzania		
Togo		
Uganda		
Zimbabwe		

* World Bank country classification. ** AfDB country classification 2014/2015. *** Côte d'Ivoire and Egypt were net oil exporters in 2011 (including crude oil, refinery feedstocks and oil products).

UNDERSTANDING THE TRADE FINANCE LANDSCAPE IN AFRICA

AFRICAN DEVELOPMENT BANK GROUP

This survey, the second of its kind carried out by the African Development Bank (AfDB), aims to better understand the trade finance landscape in Africa. In 2013, the AfDB established a Trade Finance Program to extend lines of credit and enter into risk participation agreements with eligible financial institutions active in Africa. The results from this second survey will build on the knowledge gained from the first one and help the AfDB improve the design of its Trade Finance Program in order to meet African banks' trade finance demand. Throughout the survey, trade finance refers to financing activities in years 2013 and 2014 aimed at supporting external trade only. The information provided in this survey will be held in the strictest of confidence. Any questions about this survey should be directed to: Mr. Eugene Bempong Nyantakyi (e.bempong-nyantakyi@afdb.org; +22520264527), Mr. Mouhamadou Sy (m.sy@afdb.org; +22520264505) and Mrs. Mouna Ben Dhaou (m.bendhaou@afdb.org; +22520261943).

Basic information

1. Country		3. Year established in country	
2. Name of bank		4. Your bank is... [please choose one of the 4 alternatives]	1. Majority local & privately-owned 2. Majority foreign & privately-owned 3. Majority government-owned 4. Other [please specify]

Bank level questions	2013	2014
5. What was the value of your bank's total assets (on and off-balance sheet)?	Currency: Value:	Currency: Value:
6. What was the value of your bank's total equity (Tier 1)?	Currency: Value:	Currency: Value:
7. What was the total value of your bank's customer deposits (both local and foreign currency)?	Currency: Value:	Currency: Value:
8. What was the total value of your bank's net after-tax profits?	Currency: Value:	Currency: Value:
9. What was your bank's gross non-performing loan ratio?	%	%
10. What was the share of total bank customers' deposits that had maturities of less than or equal to 1 year?	%	%
11. What was the share of total bank loans that had maturities of **more** than 1 year?	%	%
12. Of all the loans approved by your bank, what was the most common tenor? [please choose one of the 4 alternatives]	1. [0 to 12 months] 2. [13 to 36 months] 3. [37 to 60 months] 4. [above 60 months]	1. [0 to 12 months] 2. [13 to 36 months] 3. [37 to 60 months] 4. [above 60 months]

Your bank's trade finance portfolio	2013	2014
13. In either **2013** or **2014**, did your bank engage in trade finance activities (letters of credit, trade finance loans, bonds, guarantees, etc.)?	1.Yes 2. No	1.Yes 2. No [if No, stop here]
14. What proportion of your bank's total income came from trade finance activities?	%	%
16. What share of your bank's trade finance portfolio represented new trade finance customers? These are customers with whom your bank established a relationship of no longer than 12 months during that year.	%	%
17. What share of your bank's trade finance portfolio represented Small and Medium-sized Enterprises (SMEs)?	%	%
18. What was the average default rate on your trade finance activities?	%	%
19. What percentage of the average default on your trade finance activities was attributed to SMEs?	%	%
20. What share of your bank's default rate, from all its trade finance assets or transactions, represented the default of new trade finance customers? These are customers with whom your bank established a relationship of no longer than 12 months during that year.	%	%
21. Has your bank served as a confirming bank for letters of credit, avalised bills, bonds or guarantees issued by another bank from a different country throughout the year?	1.Yes 2. No [if No, skip questions 22 and 23]	1.Yes 2. No [if No, skip questions 22 and 23]

22. What was the total value of letters of credit, bills and bonds issued by banks in other countries **(globally)** and confirmed/avalised/guaranteed by your bank?	Currency: Value:	Currency: Value:
23. What was the total value of letters of credit, bills and bonds issued by banks in other **African** countries and confirmed/avalised/guaranteed by your bank?	Currency: Value:	Currency: Value:
24. List your top 5 confirming banks (CB).	1. CB Name: 2. CB Name: 3. CB Name: 4. CB Name: 5. CB Name:	
25. Do you expect your trade finance portfolio to be larger in value in 2015 relative to 2014?	1.Yes 2. No	
26. What are the biggest constraints to the growth of your trade finance portfolio **globally**? [please select a maximum of 3 among the 7 alternatives]	1. Risk capital constraint 2. Competition 3. Limited staff capacity 4. Limited forex liquidity	5. Insufficient limits with correspondent banks 6. Regulatory restrictions 7. Other [please specify]
27. What are the biggest constraints to the growth of your trade finance portfolio in **Africa**? [please select a maximum of 3 among the 7 alternatives]	1. Risk capital constraint 2. Competition 3. Limited staff capacity 4. Limited forex liquidity	5. Insufficient limits with correspondent banks 6. Regulatory restrictions 7. Other [please specify]
28. What are the main reasons for your bank's rejection of trade finance facility applications by customers? [please select a maximum of 3 among the 7 alternatives]	1. Client credit worthiness 2. Bank balance sheet constraint 3. Single obligor limit 4. Insufficient collateral	5. Insufficient limits with correspondent banks 6. Limited forex liquidity 7. Other [please specify]

Off-balance sheet trade finance transactions	2013	2014
29. What was the total value of off-balance sheet trade finance transactions/assets (documentary or commercial or standby letters of credit, promissory notes, bills of exchange, guarantees, etc.) issued by your bank in the whole year?	Currency: Value:	Currency: Value:
30. Of your total off-balance sheet trade finance transactions, what percentage constituted intra-African trade?	%	%
31. What was the total **number** of letters of credit issued by your bank in the whole year?		
32. What was the total value of the letters of credit issued by your bank in the whole year?	Currency: Value:	Currency: Value:
33. What was the average letter of credit's opening fee per quarter charged by your bank?	%	%
34. Approximately what percentage of letters of credit applications in general did you reject?	%	%
35. Approximately what percentage of letters of credit applications from SMEs did you reject?	%	%

On-balance sheet trade finance transactions	2013	2014
36. What was the total value of on-balance sheet trade finance transactions/assets (e.g. short-term trade finance loans such as pre or post shipment loans, trade-related revolving credit, export factoring, etc.) approved by your bank in the whole year?	Currency: Value:	Currency: Value:
37. What percentage of the on-balance sheet trade finance transactions constituted intra-African trade?	%	%
38. What percentage of the on-balance sheet trade finance facility applications received from clients was approved by your bank?	%	%
39. What percentage of the on-balance sheet trade finance facility applications from SMEs was rejected by your bank?	%	%

CLOSING THE TRADE FINANCE GAP IN AFRICA

AFRICAN DEVELOPMENT BANK GROUP

This survey is being carried out by the African Development Bank (AfDB). The goal is to help the AfDB better understand the trade finance landscape in Africa. The AfDB has recently started a trade finance program where it is extending lines of credit and entering into risk participation agreements with eligible financial institutions active in Africa. The results from this survey will help the AfDB improve the design of the trade finance program in order to help African banks meet their trade finance demand. Throughout the survey, trade finance refers to financing activities aimed at supporting external trade only. The information provided in this survey will be held in the strictest of confidence. Any questions about this survey should be directed to: Mr. Ousman Gajigo (o.gajigo@afdb.org ; +216 7110 3755) and Mrs. Thouraya Triki (t.triki@afdb.org ; +216 7110 3009).

Basic information

1. Country		3. Year established in country	
2. Name of bank		4. Your bank is... [please choose one of the 4 alternatives]	1. Majority local & privately-owned 2. Majority foreign & privately-owned 3. Majority government-owned 4. Other (please specify)

Bank level questions	Currency	2011	2012
5. What is the value of bank's total assets (on and off-balance sheet)?			
6. What is the value of bank's total equity (Tier 1)?			
7. What is the total value of bank's customer deposits (both local and foreign currency)?			
8. What is the total value of bank's net after-tax profits?			
9. What is the bank's gross non-performing loan ratio?			
10. What share (%) of total bank customers' deposits has maturities of less than or equal to 1 year? [please choose one]		1. [0% to 75%] 2. [76% to 89%] 3. [90% to 100%]	1. [0% to 75%] 2. [76% to 89%] 3. [90% to 100%]
11. What share (%) of total bank loans has maturities of more than 1 year? [please choose one]		1. [0% to 24%] 2. [25% to 49%] 3. [50% to 74%] 4. [75% to 100%]	1. [0% to 24%] 2. [25% to 49%] 3. [50% to 74%] 4. [75% to 100%]
12. What is the range of annual interest rate (%) paid on customers' deposits? [please choose one]		1. [0% to 9%] 2. [10% to 14%] 3. [15% to 24%] 4. [25% and above]	1. [0% to 9%] 2. [10% to 14%] 3. [15% to 24%] 4. [25% and above]
13. Of all the loans approved by the bank, what range in months is the most common tenor? [please choose one]		1. [0 to 12 months] 2. [13 to 36 months] 3. [37 to 60 months] 4. [above 60 months]	1. [0 to 12 months] 2. [13 to 36 months] 3. [37 to 60 months] 4. [above 60 months]

Your bank's trade finance portfolio		2011	2012
14. In either 2011 or 2012, did your bank engage in trade finance activities (letters of credit, trade finance loans, bonds, guarantees, etc.)?		1.Yes 2. No	1.Yes 2. No [if No, stop here]
15. What proportion (%) of the bank's total income comes from trade finance activities?			
16. What is the average default rate for the bank from all its trade finance assets or transactions?			
17. Has this bank served as a confirming bank for letters of credit or bonds or guarantees issued by another bank from a different country?		1.Yes 2. No [if No, skip question 18]	1.Yes 2. No [if No, skip question 18]
18. What is the total cumulative value of the transactions in which this bank has served as a confirming bank for letters of credit, bonds and guarantees issued by banks in other countries?			
19. List the top 5 confirming banks (CB) that have confirmed or provided guarantees for the letters of credit issued by your bank.		1. CB Name__ 2. CB Name__ 3. CB Name__ 4. CB Name__ 5. CB Name__	1. CB Name__ 2. CB Name__ 3. CB Name__ 4. CB Name__ 5. CB Name__

20. Do you expect your trade finance portfolio to be larger in value in 2013 relative to 2012?		1.Yes 2. No
21. What is biggest constraint to the growth of your trade finance portfolio? [please select a maximum of 3 while indicating their order of importance]		1. Capital constraint 2. Limited economic growth 3. Limited bank capacity 4. Forex liquidity 5. Forex volatility 6. Bank regulations 7. Other (specify)
Off-balance sheet trade finance transactions	**2011**	**2012**
22. What is the total cumulative value of off-balance sheet trade finance transactions/assets approved (documentary or commer cial or standby letters of credit, promissory notes, bills of exchange, guarantees, etc.) by the bank in the whole year?		
23. From this off-balance sheet trade finance transactions, what % constituted intra-African trade? If no exact value is available, an estimate is OK.		
24. What is the total number of letters of credit issued by your bank?		
25. What is the approximate rejection rate (%) of your bank for letters of credit applications? [please choose one]	1. [0% to 9%] 2. [10% to 19%] 3. [20% to 29%] 4. [over 30%]	1. [0% to 9%] 2. [10% to 19%] 3. [20% to 29%] 4. [over 30%]
26. What is the total cumulative value of the letters of credit issued by the bank?		
27. What is the total average fee rate (%) on quarterly basis charged by your bank (for opening, advising, etc.) with regards to letters of credit? [please choose one]	1. [0% to 0.5%] 2. [0.6% to 1%] 3. [1.1% to 2%] 4. [above 2%]	1. [0% to 0.5%] 2. [0.6% to 1%] 3. [1.1% to 2%] 4. [above 2%]
28. What are the main reasons for denying letters of credit applications from customers? [please select a maximum of 3 while indicating their order of importance]	1. Client credit worthiness 2. Balance sheet constraint 3. Single obligor limit 4. Product or instrument limit 5. Insufficient limits with your confirming/LC re-issuance bank 6. Forex liquidity 7. Other [please specify]	1. Client credit worthiness 2. Balance sheet constraint 3. Single obligor limit 4. Product or instrument limit 5. Insufficient limits with your confirming/LC re-issuance bank 6. Forex liquidity 7. Other [please specify]
On-balance sheet trade finance transactions	**2011**	**2012**
29. What is the total cumulative value of on-balance sheet trade finance transactions/assets (e.g. short-term trade finance loans such as pre or post shipment loans, trade-related revolving credit, export factoring, etc.) approved by the bank in the whole year?		
30. From this on-balance sheet trade finance transactions, what % constituted intra-African trade? If no exact figure is readily available, please provide your best estimate.		
31. Of the trade finance facility applications received from clients, approximately what % is approved by your bank?		
32. What is the main reason for your bank's rejection of trade finance facility applications by firms? [please select a maximum of 3 while indicating their order of importance]	1. Client credit worthiness 2. Balance sheet constraint 3. Single obligor limit 4. Product or instrument limit 5. Forex liquidity 6. Other [please specify]	1. Client credit worthiness 2. Balance sheet constraint 3. Single obligor limit 4. Product or instrument limit 5. Forex liquidity 6. Other [please specify]

List of Figures

List of Figures

Figure 2.1. Share of Commercial Banks Engaged in Trade Finance Activities by Year 20

Figure 2.2. Share of Commercial Banks Engaged in Trade Finance Activities by sub-Region 21

Figure 2.3. Share of Commercial Banks Engaged in Trade Finance Activities by Bank Ownership Structure 21

Figure 2.4. Bank-Intermediated Trade Finance and Total African Trade Volume by Year 21

Figure 2.5. Bank-Intermediated Trade Finance Assets and Total Bank Assets by Year 23

Figure 2.6. Bank-Intermediated Trade Finance Assets and Total Bank Assets by sub-Region 23

Figure 2.7. Bank-Intermediated Trade Finance Assets and Total Bank Assets by Fragility Level 25

Figure 2.8. Bank-Intermediated Trade Finance Assets and Total Bank Assets by Income Level 25

Figure 2.9. Bank-Intermediated Trade Finance Assets and Total Bank Assets by Oil Trade Balance 25

Figure 2.10. Bank-Intermediated Trade Finance Assets and Total Bank Assets by Bank Ownership Structure 25

Figure 2.11. Top Confirming Banks for African Issuing Banks, 2o13-2014 26

Figure 2.12. Share of Income from Trade Finance Activities in Banks' Total Income by Year 27

Figure 2.13. Share of Income from Trade Finance Activities in Banks' Total Income by sub-Region 27

Figure 2.14. Share of Income from Trade Finance Activities in Banks' Total Income by Fragility Level 28

Figure 2.15. Share of Income from Trade Finance Activities in Banks' Total Income by Oil Trade balance 28

Figure 2.16. Share of Income from Trade Finance Activities in Banks' Total Income by Country Income Level 29

Figure 2.17. Share of Income from Trade Finance Activities in Banks' Total Income by Bank Ownership Structure 29

Figure 2.18. Default Rates on Trade Finance Activities vs. Bank NPL Ratios by Year 31

Figure 2.19. Default Rates on Trade Finance Activities vs. Bank NPL Ratios by sub-Region 31

Figure 2.20. Default Rates on Trade Finance Activities vs. NPL Ratios by Bank Ownership Structure 33

Figure 2.21. Default Rates on Trade Finance Activities vs. Bank NPL Ratios by Fragility Level 33

Figure 2.22. Default Rates on Trade Finance Activities vs. NPL Ratios by Income Level 33

Figure 3.1. Rate of Rejection of Letters of Credit Applications by Year 37

Figure 3.2. Rate of Rejection of Letters of Credit Applications by sub-Region 37

Figure 3.3. Rate of Rejection of Letters of Credit Applications by Fragility Level 37

Figure 3.4. Rate of Rejection of Letters of Credit Applications by Income Level 38

Figure 3.5. Rate of Rejection of Letters of Credit Applications by Bank Ownership Structure 39

Figure 3.6. Rate of Rejection of Letters of Credit Applications by Oil Trade Balance 39

Figure 3.7. Most Frequently Reported Reasons for Banks' Rejection of Trade Finance Facilities Applications, 2013-2014 40

Figure 3.8. Most Frequently Reported Reasons for Banks' Rejection of Trade Finance Facilities Applications by Oil Trade Balance 42

Figure 3.9. Most Frequently Reported Reasons for Banks' Rejection of Trade Finance Facilities Applications by Fragility Level 42

Figure 3.10. Most Frequently Reported Reasons for Banks' Rejection of Trade Finance Facilities Applications by Bank Ownership Structure 43

Figure 3.11. Bank-Intermediated Trade Finance and Trade Finance Gap in Africa 45

Figure 4.1. Most Frequently Reported Constraints to Growth of Banks' Trade Finance Portfolios, 2013-2014 48

Figure 4.2. Most Frequently Reported Constraints to Growth of Banks' Trade Finance Portfolios by Oil Trade 50

Figure 4.3. Most Frequently Reported Constraints to Growth of Banks' Trade Finance Portfolios by Fragility Level 51

Figure 5.1. Average Share of Banks' Trade Finance Assets Supporting Intra-African Trade by Year 57

Figure 5.2. Average Share of Banks' Trade Finance Assets Supporting Intra-African Trade by Sub-Region 57

Figure 5.3. Average Share of Banks' Trade Finance Assets Supporting Intra-African Trade by Bank Ownership Structure 57

Figure 5.4. Average Share of Banks' Trade Finance Assets Supporting Intra-African Trade by Oil Trade Balance 57

Figure 6.1. Distribution of Trade Finance Portfolio across Customer Groups by Year 62

Figure 6.2. Distribution of Trade Finance Portfolio across Customer Groups by sub-Region 62

Figure 6.3. Distribution of Trade Finance Portfolio across Customer Groups by Bank Ownership Structure 63

Figure 6.4. Distribution of Trade Finance Portfolio across Customer Groups by Income Level 63

Figure 6.5. Distribution of Trade Finance Portfolio across Customer Groups by Fragility Level 63

Figure 6.6. Distribution of Trade Finance Portfolio across Customer Groups by Oil Trade Balance 64

Figure 6.7. Average Default Rate on Banks' Trade Finance Activities across Customer Groups by Year 65

Figure 6.8. Average Default Rate on Banks' Trade Finance Activities across Customer Groups by sub-Region 65

Figure 6.9. Average Default Rate on Banks' Trade Finance Activities across Customer Groups by Bank Ownership Structure 66

Figure 6.10. Average Default Rate on Banks' Trade Finance Activities across Customer Groups by Fragility Level 67

Figure 6.11. Average Default Rate on Banks' Trade Finance Activities across Customer Groups by Income Level 67

Figure A.1. Country Distribution of the Respondent Banks, 2011-2014 78

List of Tables

List of Tables

Table 5.1. Share of Intra-Regional Trade in Africa by Sub-Region (percentage) 54

Table A.1. Breakdown of African Countries by sub-Region 79

Table A2. Country Categorization by Income Level, Fragility and Net Oil Exporters 79

Questionnaire 1. Understanding The Trade Finance Landscape In Africa (2015) 80

Questionnaire 2. Closing The Trade Finance Gap In Africa (2013) 82

African Development Bank Group
Avenue Joseph Anoma
01 BP 1387 Abidjan 01
Côte d'Ivoire

About AfDB's Trade Finance Report

The aim of AfDB's Trade Finance study is to provide policymakers and financial institutions engaged in trade finance a comprehensive insight into various aspects of bank-intermediated trade finance supply in Africa.

In comparison to the first Trade Finance Report, the current one examines the extent to which new trade finance clients—those that have for the first time requested financing from commercial banks to export or import goods—are able to gain access to trade finance facilities offered by banks and the concentration of trade finance assets among commercial banks' top clients.

The report is based on a primary survey conducted by the AfDB. Two survey questionnaires were distributed to commercial banks in 2013 and 2015 in order to report on their trade finance activities during the periods 2011-2012 and 2013-2014 respectively. The questionnaires reached around 900 commercial banks in Africa, of which 272 banks in 45 countries completed the first survey and 246 banks in 43 countries completed the second survey.

BANQUE AFRICAINE DE DEVELOPPEMENT
AFRICAN DEVELOPMENT BANK
AFRICAN DEVELOPMENT FUND
FONDS AFRICAIN DE DEVELOPPEMENT
AFRICAN DEVELOPMENT BANK GROUP