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Supporting trade finance for trade expansion and diversification in West Africa*

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A joint study by the WTO and IFC established that the low share of trade supported by trade finance (25%) in the four largest economies of West Africa (Nigeria, Côte d'Ivoire, Ghana and Senegal) was a major constraint in further expanding and diversifying trade flows and trade integration.** Raising trade finance use in the region to the African average of 40% of trade flows, would result in an increase in the region's trade flows of 8% annually, 80% in ten years.

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* The views expressed in this article are those of the authors, and do not necessarily those of the WTO and IFC.
** WTO and IFC, 2022, Trade Finance in West Africa, available at www.wto.org and www.ifc.org.

Introduction and context

Developing country Members regularly identify a lack of trade finance as a major obstacle to participating in global trade — with micro, small and medium-sized enterprises, and businesses led by women being the most affected. Côte d'Ivoire, supported by the African, Caribbean and Pacific Group, have been submitting requests these issues to be discussed at the WTO.

In parallel, the WTO Secretariat and International Finance Corporation (IFC, the private arm of the World Bank Group) introduced an enhanced partnership to improve the diagnostic of trade finance gaps in selected underserved regions, helping to detect needs for capacity-building and financial lines by the IFC. Lack of access to trade finance can be a significant barrier to trading. Previous research had shown that the higher a country's level of economic development, the higher the share of merchandise trade supported by trade finance: 60 to 80% across developed countries, 40% for the average of the African continent.

The WTO and IFCtook a «deeper dive» into the four main economies of Ecowas (named Ecowas4 for the purpose of this article), namely Nigeria, Côte d'Ivoire, Ghana and Senegal. A survey of all banks – over 90, has been carried out, to quantify the trade finance market, provide evidence on the size and nature of the gap between the supply and demand of trade finance, and evaluate its impact on trade flows and performance. revealing that trade finance was not only scarcer than the continent's average, but was also costlier for the few importers and exporters which demands were accepted.

Findings

The survey established that the total size of the trade finance market in the Ecowas4 in 2021 was $42 billion, only supporting about 25% of these countries' merchandise trade flows of $168 billion in that year. The rate of coverage of trade finance is therefore well below the published estimates for Africa of about 40 percent, or advanced country levels between 60–80 percent. At the individual country level, trade finance covers between 21 per of total trade in Nigeria and 41 percent in Ghana. The 25% coverage rate is itself an average of the four countries. At the individual country level, trade finance supported 41% of Ghana's trade flows, 33% of Côte d'Ivoire's, 21% of Nigeria's and only 15% of Senegal's (table 1).

The main reasons for such low coverage are not only the high rejection rates of applications (ranging from 23% in Senegal to 26% in Ghana), but also from the fact that importers and exporters have given up asking trade finance to banks, as a result of high collateral requirements, high interests rates (much higher than the average of emerging markets), and past rejections.

Although relatively scarce, when available trade finance is key enabler of traditional exports and imports in the region. Pre-export finance is in high demand for the four countries' main exports, particularly crude oil in Nigeria, cocoa and rubber in Côte d'Ivoire, and cocoa in Ghana. Meanwhile, large imports of medicine and medical equipment, refined oil, transport equipment, and food benefit from import finance and letters of credit. However, harnessing trade opportunities through global value chains and expansion into new products and services will require deeper and more diverse trade finance markets, particularly in relation to products such as intermediate and capital goods.

Banks are the main suppliers of trade finance in the ECOWAS4. The 10 largest banks in the four countries account for more than two-thirds of the trade finance market, although smaller banks have a higher proportion of their assets dedicated to trade finance and receive two-thirds of

Table 1 : Bank-Intermediated Trade Finance in the ECOWAS4

	Côte d'Ivoire	Ghana	Nigéria	Sénégal	Total
Total number of surveyed banks	28	23	19	19	89
Respondent banks [#]	24	23	19	12	78
Respondent banks involved in trade finance [#]	22	23	18	12	75
Respondent banks involved in trade finance [%]	92	100	95	100	96
Average value of trade finance portfolio [$ Million]	381	410	1 174	108	537
Total merchandise trade in 4 countries [$ Billion]	29	23	99	14	165
Size of bank-intermediated trade finance [$ Billion]	**10**	**9**	**21**	**2**	**42**
Average percentage of bank-intermediated trade finance in ECOWAS4 [%]	**33**	**41**	**21**	**15**	**25**

Source : WTO and IFC (2022), Trade Finance in West Africa, Geneva.

total requests. The market structure does not play in favour of innovation, and in such small markets, pressure for change is small. «Scale» effects lead the largest firms towards the largest banks, which make available a larger network of international correspondent relationships internationally and can accept larger demands for large transaction values, due to the size of their balance sheets. With increased bank competition in the region, large banks compete on attracting the «best» customers. Such self-selection effects play against new firms, including SMEs in new sectors, with limited financial experience and credit history. Hence, local trade finance markets are focused only on well-established bulk exporters and importers using traditional trade finance products such as pre-export financing for commodities and letters of credit for trusted importers – leaving little scope for new entrants in the markets, particularly small and medium sized enterprises in new sectors. Consumer goods are the most frequently supported products, with 90 percent of respondent banks providing financing for this category, while sectors such as agriculture and infrastructure are identified by bankers as facing the largest shortfalls in the provision of trade finance. It was also established by the study that capital goods, on the import side, and exports of new products (new agri-food clusters) which could be important for the countries' integration into regional value-chains, are receiving proportionally less support.

Average rejection rates for trade finance applications by banks in the ECOWAS4 are high, amounting to 21 percent of requests and 25 percent of their total value, according to the survey. For larger banks catering to bigger clients with more resources, deeper pools of collateral and stronger credit histories, the rejection rate is lower, at 13 percent of requests and 19 percent of their value. On the other hand, smaller banks report a 23 percent average rejection rate, and 25 percent in value terms. These rates are significant in view of the low risk profile of trade finance, regionally and internationally.

These rejections suggest an overall trade finance gap between supply and demand in the ECOWAS4 of about $14 billion annually. Rejection will not always directly reflect a shortage of trade finance as some companies will have been turned down because they are not creditworthy. Refusal will also not always mean foregone trade as some rejected firms will find alternative sources of funding.

Rejected trade finance applications encourage traders to turn to sub-optimal alternatives such as using their own funds or borrowing through family networks and other informal channels. This can be less efficient, riskier and more costly. Self exclusion from the trade finance market - possibly in reaction to previous rejections - may also be leading firms to withdraw from international trade altogether.

Banks have mentioned barriers that limit their ability to provide more trade finance. These include challenges from foreign correspondent banks - lenders providing banking services to financial institutions in other jurisdictions - insufficient collateral against the high perceived risks of borrowers, particularly relating to SMEs, and shortages of low-cost funding for trade finance. The survey also found that, on average, ECOWAS4 lenders have less extensive networks of correspondent banking relationships than their counterparts elsewhere in Africa and in other regions. Opportunities to expand the number of international partners executing cross-border transactions with ECOWAS4 banks would make the market more competitive and help ease a blockage to trade finance highlighted by nearly all the respondents in the survey.

The survey also found the cost of trade finance to be high in the four countries by international standards. The average net cost of borrowing for the purpose of trading (the interest rate charged to the trader minus the national policy rate) is estimated to be as high as 6 percent in Ghana, 9 percent in Côte d'Ivoire and Senegal, and up to 17 percent in Nigeria. SMEs typically face higher costs than large corporates, with premiums for trade loans or import financing potentially costing almost twice as much as for large firms. Additionally, even though the merchandise itself often qualifies as collateral in international trade, banks in the survey reported they often ask for further collateral on the basis that unreliable legal enforcement makes it difficult to seize and resell merchandise.

Implications and way forward

A novelty of study was to design an analytical framework allowing for counterfactual calculations, indicating how much more trade flows would be generated by that much more trade finance availability and reduced cost in the region. The framework can be applied to any region in the world. It is based on the conversion of quantities (or missing quantities) of trade finance, and of its prices (up and down) into traditional trade costs/taxes used in quantifiable general equilibrium models analysing trade. The framework and model characteristics are explained in Auboin, Beckkers, and De Quarti (2023).

It was calculated that, based on data gathered in the survey, removing bottlenecks to trade finance could boost Ecowas4 trade in goods by 8%, or nearly $13 billion per year, under a scenario where the provision of trade finance is increased to the African average while fees and spreads are brought down to international benchmark levels. Raising the availability of trade finance in line with the global average could boost Ecowas4 merchandise exports and imports by 16% or some $26 billion annually. In both cases, intra-Ecowas trade is the biggest beneficiary of improved trade finance access, according to the simulations. Meanwhile, most of the estimated impact would come from increased coverage of trade finance, with a more modest contribution from lower trade finance prices. Coordinated action by the corporate sector, financial institutions, national policymakers, regulators, and international organizations could help reduce trade finance gaps in the Ecowas4. The most effective actions would include increasing the provision of trade finance through traditional and new instruments, more firmly integrating trade finance into the implementation of the AfCFTA, and expanding the range of firms that can access trade finance by working with large and small banks to provide new or extend their existing offerings to SMEs. Strengthening correspondent banking relationships making more data available to support decision-making, andeffective enforcement of rules for collateral could also significantly broaden access to trade finance. Alternative forms of trade finance via supply chain finance (including factoring), trade finance funds or working capital e-platforms are currently embryonic in the region and could be expanded.

Technology solutions could facilitate the adoption of new instruments such as supply chain mapping and digital financing while also helping banks develop more sophisticated internal credit risk assessment systems, particularly for smaller companies and new entrants to the trade finance market. A higher level of digitization could also help reduce the processing costs for trade finance instruments. Banks and other institutions can also provide training and outreach to smaller and women-owned firms to better inform them of what facilities are available and help them to access the market.

The WTO and IFC have not only disseminated the study widely in the countries concerned, but are also following-up with either additional technical assistance on trade finance and/or further support in attracting more banks in operating in the region.

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