EVALUATING BII'S FINANCIAL SERVICES PORTFOLIO

Evaluating BII's trade finance programme: A case study of two Master Risk Participation Agreements

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CONTACT INFORMATION

IPE Global Limited

IPE Global House, B-84, Defence Colony, New Delhi, 110024, **India**

www.ipeglobal.com

Genesis Analytics (Pty) Ltd

Office 3, 50 Sixth Road, Hyde Park, **Johannesburg**
WeWork, Fox Court, 14 Grays Inn Road, **London**
3rd Floor, Maryland Mall, 350 Ikorodu Road, Maryland, **Lagos**
4th Floor, West Park Suites, Ojijo Road, Parklands, **Nairobi**

www.genesis-analytics.com

AUTHORS

Betty Chiwayu, Dr Michael Fuchs, Souleima Abdennebi, Zsofia Kovacs, Sophia Sifuma

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Acronyms

ADB .... Asian Development Bank
AfDB .... African Development Bank
AML-CFT .... Anti-money laundering and combating the financing of terrorism
BII .... British International Investment
CAGR .... Compound Annual Growth Rate
CBN .... Credit bill negotiated
COO .... Countries of Operations
DFI .... Development Finance Institution
DI .... Development impact
EBRD .... European Bank for Reconstruction and Development
FI .... Financial institution
FMO .... Dutch Entrepreneurial Development Bank
FX .... Foreign currency
GFC .... Global financial crisis
GTFP .... Global Trade Finance Program
IDS .... In-depth study
IFC .... International Financial Corporation
KYC .... Know your customer
LC .... Letter of credit
MRPA .... Master Risk Participation Agreement
MSME .... Micro, Small, and Medium-sized Enterprise
PSI .... Productive, sustainable, and inclusive
SME .... Small and Medium-sized Enterprise
S&P .... Standard and Poor's
TFP .... Trade Facilitation Programme
TSCF programme .... Trade and Supply Chain Finance programme
WTO .... World Trade Organisation

Executive Summary

Rationale and context

In 2019, the Foreign, Commonwealth & Development Office (FCDO) commissioned Genesis Analytics and IPE Global to independently evaluate British International Investment's (BII) Financial Institutions (FI) portfolio (re-named Financial Services).

The purpose of this evaluation is to better understand the development outcomes and impacts associated with BII's investments in the financial services sector. It consists of two phases: an evidence and portfolio-level review completed in 2020 (phase one), and a series of in-depth case studies (phase two).

Our phase one review provided evidence that trade finance can have positive medium to long-term effects on international trade growth in Africa and Asia.[1] The review also highlighted that targeting trade finance towards small and medium-sized enterprises (SMEs) is likely to be highly beneficial. This is because in addition to other benefits, trade finance offers businesses a working capital buffer, to which they often do not have access.

However, due to the lack of data on importers and exporters being reached by BII's trade finance portfolio, the phase one evaluation found limited evidence on the extent trade finance is beneficial to importers and exporters. As such, the evaluation team identified trade finance as one of areas of interest for an in-depth study for phase two of the evaluation process, with the intent of exploring the impact of trade finance on importers and exporters.

This report presents findings of the evaluation team's analysis of BII's Trade and Supply Chain Finance (TSCF) programme and in-depth case studies of two Master Risk Participation Agreement (MRPAs) between BII and two international and regional commercial banks. In this study, reference is made to these two MRPAs as 'MRPA A' and 'MRPA B'. The development impact (DI) thesis underpinning the two agreements are presented below:

Box 1: DI thesis underpinning MRPA A

> Significant impact on economic activity and job creation/preservation, by providing businesses with access to trade credit that may otherwise contract. The FI indicated […] that the MRPA allows them to do business that they would otherwise not have been able to support in difficult places […] In addition, the MRPA is expected to reduce risk in the most challenging markets affected by negative risk perception.

Box 2: DI thesis underpinning MRPA B

> Significant impact on economic activity and job creation/preservation, by providing businesses with access to trade credit that may otherwise contract. […]. The FI requires a partner like BII to not only share the risk of dealing with domestic banks in difficult economic climates, but also to manage their single issuing bank limit constraint.[2]

In 2022, BII updated its approach to impact management and introduced the Productive, Sustainable, and Inclusive (PSI) framework to inform investments covering its 2022 – 2026 strategy period.[3] Although BII established the framework after launching the TSCF programme and signing the two MRPAs, the objectives of the TSCF programme align closely with the goals of the new impact framework.[4]

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1 Sunderji, S., Nixon Williams, D., Fuchs, M., Wyatt, A., Verrinder, N. (2020). Evaluating CDC's Financial Institutions Portfolio. Genesis Analytics and IPE Global.

2 Single obligor limits determine banks' maximum exposure level to individual borrowers.

3 British International Investment. (2022). 2022-2026 Technical Strategy.

4 One of the TSCF's objectives is "Economic opportunities: BII aims to narrow the supply-demand gap for trade and supply chain finance, increase trade volumes and promote inclusive and sustainable value chains. BII's intention is to contribute to long-term growth, employment creation, poverty reduction and supply chain resilience". Source: BII. (2021). What's the impact of investing in trade and supply chain finance?

This study has three main objectives:

1. To understand the impact of BII's TSCF programme on confirming FIs that hold an MRPA with BII.
2. To understand the effects of the programme on issuing banks whose trade finance is confirmed by the FIs holding an MRPA with BII.
3. To analyse the impact of the programme on importers and exporters, who are the users of trade finance products financed by the issuing banks.

The assessment was conducted across five countries namely: Bangladesh, Kenya, Nigeria, Mozambique, and Pakistan.

The team used a combination of quantitative and qualitative research methods to investigate these issues and assemble knowledge on trade finance, including:

- Desk research;
- Analysis of BII's internal monitoring data; and
- Key informant interviews with BII's trade finance team, two confirming banks, 11 issuing banks that acquire trade confirmation through BII's MRPAs, and 18 importer and exporter clients that receive trade finance from these issuing banks.

Why trade finance and BII's TSCF programme are important

Trade finance is a key enabler of international trade, which is a key driver of regional economic integration, economic growth, and poverty reduction.[5] It facilitates international trade by making it easier for importers and exporters to transact by ensuring payments for goods are secure. Trade finance reduces the risk to exporters relating to payment for goods delivered, while at the same time also reducing risk faced by importers regarding safe receipt of goods. Approximately 80 per cent of international trade is supported by trade finance.[6] Therefore, trade finance plays a pivotal role in ensuring the uninterrupted cross-border movement of goods and capital.

Despite the importance of trade finance, there is high unmet demand for trade finance and the trade finance gap remains persistently large.[7] The Asian Development Bank (ADB) has highlighted that the global trade finance gap has surpassed the $2 trillion mark.[8, 9]
Back in 2014, the gap was estimated to be as large as $1.4 trillion, with more than half of this gap in Africa and Asia.[10]

Access to affordable trade financing is especially challenging for SMEs and women-led businesses, which experience high rejection rates for their trade finance requests. Globally, more than half (52 per cent) of trade finance requests by SMEs are rejected, compared to only 7 per cent for multinational companies.[11]

5 IMF. (2001). Global Trade Liberalization and the Developing Countries.
6 WTO. (2016). Trade finance and SMEs: Bridging the gaps in provision.
7 ADB. (2022). Toward Inclusive Access to Trade Finance: Lessons from the Trade Finance Gaps, Growth, and Jobs Survey.
8 Ibid.
9 The trade finance gap represents the difference between the estimated demand for trade finance and the supply of available trade finance from financial institutions. As the basis for its estimates of the trade finance gap, ADB uses rejected applications for trade finance funding. Source: Beck, S. (2022). Your Questions Answered: What is the Trade Finance Gap and Why Does it Matter? ADB.
Note: The trade finance gap refers to the difference between the demand for trade finance and the supply of trade finance available to facilitate international trade transactions, thus abstracting from the demand for trade finance that might arise from un- or under-serviced segments of the market.
10 ADB. (2022). Toward Inclusive Access to Trade Finance: Lessons from the Trade Finance Gaps, Growth, and Jobs Survey. | Afrexim. (2020). Survey of Impact of COVID-19 on African Trade Finance. | WTO. (2016). Trade finance and SMEs: Bridging the gaps in provision.
11 WTO. (2016). Trade finance and SMEs: Bridging the gaps in provision.

In 2015, BII launched its Trade and Supply Chain Finance (TSCF) programme, which provides funded and unfunded trade finance support to boost trade in Africa and South Asia.[12] The programme forms part of BII's overarching efforts to foster long-term growth, generate employment opportunities, alleviate poverty, and enhance the resilience of supply chains.[13] Through the programme, BII aims to improve the availability of trade finance and in turn increase the facilitation of trade. Ability to trade will enable businesses to have access to a greater diversity of more affordable and better-quality goods, including finished products, business inputs, and capital equipment.[14]

Since launching the TSCF, BII has supported trade finance transactions worth over $29.3 billion in Africa and South Asia. Of the $29.3 billion trade finance transactions supported, BII's commitment was approximately $10.2 billion across 177 local issuing banks through MRPAs and trade loans with 12 global and regional banks, and one asset manager.[15] BII's TSCF programme is designed to assume 50 per cent or more of the confirming banks' exposure on each approved trade finance transaction. Therefore, BII's trade finance commitments are lower than the total value of trades supported due to the risk-share agreement.

BII's trade finance contribution has largely been in the form of MRPAs. They make up 94 per cent of BII's $10.2 billion trade finance commitment under the TSCF programme between January 2015 and September 2023. Unfunded participation make up 88 per cent of BII exposure, while funded participation constitute 12 per cent. **Since the inception of the TSCF programme, BII's MRPA trade finance support has been on an upward trajectory:** between 2015 and 2022, the total value of BII's MRPA commitment increased by 51 per cent compounded annual growth rate (CAGR) to reach $1.6 billion in 2022 over more than 1,500 transactions. This is a significant increase from $92 million in 2015 over 60 transactions. In terms of reach, 47 per cent of BII's MRPA commitment under the TSCF programme (equivalent to $4.5 billion) has been in Africa, and 53 per cent ($5.1 billion) in South Asia.

Findings and lessons: a case study of two MRPAs

This study focused on five evaluation questions which are presented below, along with the findings and lessons drawn from the evaluation.

QUESTION 1: What are the benefits and impacts of trade finance on confirming financial institutions?

Finding 1.1: BII's trade finance programme allows confirming banks to expand their trade finance offerings in countries where they have reached the ceiling for their exposure.

With BII's TSCF programme designed to assume more than 50 per cent of the confirming banks' exposure on each approved trade finance transaction, **BII's MRPAs enabled FIs to confirm an increasing number of trade finance transactions.**[16] This is because the significant risk assumed by BII reduces the confirming banks' need to set aside capital, and thus allows the banks to expand their trade finance portfolios beyond their country limits in certain countries where demand for trade finance remains high.

Monitoring data shows that confirming FIs experienced an overall increase in the total value of trade finance transactions confirmed through the two sample MRPAs, particularly MRPA A. Between 2018 and 2021, the total value of both the amount of trade finance transactions funded through MRPA A and BII's exposure to the confirming bank increased, growing at 22 per cent CAGR and 18 per cent CAGR, respectively. A 30 per cent decrease from the previous year in the total value of trade supported is observed in 2022. Under MRPA B, after experiencing

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12 Funded trade finance support/participation refers to risk participation whereby BII provides the confirming bank with funds based on the risk-sharing arrangement should clients of issuing banks be unable to fulfil their trade finance obligations. Unfunded trade finance support/participation refers to risk participation where BII provides a 'guarantee' to compensate the confirming bank should clients of the issuing bank fail to fulfil their trade finance obligations e.g. Letter of Credit Confirmations.

13 Note: The impact pathway through which BII aimed to achieve this is explained in the next section. | BII. (2020). CDC Group unveils record levels of trade finance to Africa and South Asia.

14 Ibid.

15 BII. (2023). Trade and Supply Chain Finance (TSCF) programme database.

16 Although the amount of risk BII takes on each transaction confirmed varies, BII takes up to 80 per cent of the risk on each transaction confirmed through one of the MRPAs being analysed, and up to 70 per cent on each transaction confirmed through the second MRPA being analysed.

an annual growth of 149 per cent to reach a peak of $761 million in trade finance transactions in 2019, with BII's exposure being $190 million, the total value of both the amount of trade finance transactions and BII's exposure under MRPA B has been on a downward trajectory.

The differing trend observed since the COVID-19 pandemic between the two MRPAs (i.e. an upward trend with MRPA A and a downward trend with MRPA B) is likely to be partly attributable to the contrast in trade finance support provided by BII during the pandemic to the two confirming banks (discussed below). At the same time, the declining trend observed in 2022 across the two MRPAs is likely due to a combination of factors including the end of COVID-19 lockdown restrictions, global macroeconomic uncertainties, global inflationary pressures, and rising interest rates.

Lesson 1.1: Risk-sharing agreements result in the expansion of trade finance limits in geographies supported by DFIs in the MRPA agreement(s). Confirming banks operate with limits on their trade finance exposure to clients in specific countries or regions. These limits are put in place to manage their risk exposure. When a DFI such as BII guarantees part of this exposure, the confirming bank can increase its trade finance limits, and thus support an increasing number of trade transactions.

Finding 1.2: Confirming banks reported an increase in trade finance confirmations coinciding with the improvements in the support provided by BII's MRPAs. BII made several adjustments to the two MRPAs to accommodate the growing demand for trade finance and to better meet the needs of confirming banks. These adjustments included an increase in the risk-share BII was willing to take on, an expansion of the size of the MRPAs and the introduction of funded participation. These adjustments contributed to confirming banks being able to increase their trade finance confirmations. For instance, under MRPA B, the inclusion of a funded participation and an increase in BII's risk-share in early 2019 coincided with a sharp increase in the total value of trade confirmations under the MRPA and thereby in BII's risk exposure.

Lesson 1.2: Increasing the size of the facility and the extent of risk-sharing as well as the introduction of funded agreements all work to reduce the risk exposure of confirming banks. DFI-funded risk-sharing agreements ease the liquidity situation of confirming banks, enabling them to extend more favourable trade finance terms to their clients. Equally important is the ability of a DFI to be agile and responsive to the needs of confirming banks. This is crucial to minimise disruptions in meeting trade finance demands.

Finding 1.3: BII's MRPAs enabled confirming banks to overcome challenges associated with entering markets that would otherwise be difficult to serve. BII enabled confirming banks to overcome challenges associated with entering new markets that would otherwise be difficult to serve. One of the key challenges for confirming banks operating in fragile and risky countries is the higher level of credit and political risk associated with these countries. Confirming banks noted they have been able to reach 'riskier' countries due to their risk-sharing agreements with BII as they provide an additional layer of risk mitigation by reducing the risk exposure borne by confirming banks.

BII's monitoring data shows that BII's MRPAs pivoted towards supporting Beta countries, and issuing banks in these countries, and these generally find it difficult to get confirmations at an affordable price.[17] The proportions of the total value of trade finance confirmations through MRPA A in low-income countries increased to 92 per cent in 2022, compared to 57 per cent in 2018. Similarly, with MRPA B, confirmations in Beta countries increased from 73 per cent in 2018 to 89 per cent in 2022. This coincides with BII's increasing focus on targeting a growing number of low-income countries through its trade finance portfolio.

17 BII divides countries within Africa and South Asia into four categories (Alpha, Beta, Gamma, and Delta) depending on their investment difficulty (with Alpha being the most fragile and poor countries). The investment difficulty of each country is measured by an equally weighted index combining five indicators: (i) market size (GDP PPP); (ii) income level (GDP/capita PPP); (iii) credit to the private sector (as percentage of GDP); (iv) 'Doing Business' rankings; and (v) a composite measure of fragility. | See Annex appendix for the full list of countries under each category.

Lesson 1.3: By partnering with confirming banks, DFIs can encourage confirming banks to support the development objectives of DFIs in their target countries (which are mainly low-income countries). As a result of DFIs' engagement, those issuing banks confirming their trade finance exposures with confirming banks will be able to increase their funding of trade flows in fragile and risky countries targeted by DFIs. Additionally, DFIs often possess extensive experience and knowledge in trade finance. Collaborating with a DFI can provide the confirming bank with access to specialised expertise, best practices, and guidance on navigating complex trade transactions.

QUESTION 2: What types of issuing banks are BII's risk-sharing facilities being extended to, and how has BII's risk-sharing facility affected these banks' risk appetite, their ability to extend trade finance to the market, and serve new client segments?

Finding 2.1: BII's focus countries for trade finance support are composed mainly of economies facing challenging macroeconomic environments, such as those in Africa and South Asia, and thus have poor credit ratings.

The majority of the issuing banks utilising the two MRPAs have low credit ratings (reflecting the credit ratings of their respective sovereigns): in 2022, 52 per cent of BII's trade finance participation under MRPA A supported issuing banks with a Moody's credit rating of B1, and under MRPA B, 61 per cent of BII's risk exposure was with B2-rated issuing banks.[18] Confirming banks generally consider issuing banks operating in these countries to be too vulnerable due to adverse business, financial and economic conditions. Under other circumstances, these issuing banks would struggle to acquire confirmations due to risk limits imposed by confirming banks. Therefore, BII's MRPAs have enabled issuing banks to access trade finance confirmations, even when operating in countries that are perceived as risky.

Lesson 2.1: DFIs' risk-sharing agreements can play a crucial role in enabling issuing banks that operate in challenging environments to secure trade finance confirmations. In sharing risk with confirming banks, DFIs increase trade finance lines offered to issuing banks in countries with poor credit ratings.

Finding 2.2: Limited availability of FX is a pervasive issue across the markets of analysis and limits the ability of issuing banks to confirm transactions. The markets analysed in this study (Bangladesh, Kenya, Nigeria, Mozambique, and Pakistan) are marred by limited availability of foreign currency (FX). Scarcity of FX constrains the ability of issuing banks to confirm transactions. Discussions with issuing banks and importers revealed that FX shortages in Nigeria and Mozambique were critical barriers preventing issuing banks from providing trade finance to their clients. Similarly, recent FX shortages in Pakistan and Bangladesh have exacerbated the challenges faced by issuing banks in making trade finance available to importers.[19] Therefore, shortage of FX among other factors, emerges as a barrier affecting the ability of importers to finance their trade transactions using letters of credit.

Lesson 2.2: While trade facilitation addresses the challenges faced by confirming banks in servicing more challenging markets, it cannot address the underlying causes of FX shortages which hamper growth in trade in less developed markets. The US dollar remains the preeminent currency used to settle trade transactions. A shortage of the dollar limits the provision of trade finance as trade finance instruments such as letters of credit are typically invoiced in dollars. While addressing FX challenges is key to enable trade growth, the responsibility for resolving this dilemma lies predominantly with the authorities of the target countries.

Finding 2.3: Benefits derived by issuing banks and consequently importers and exporters are compromised by the relatively long value chain in providing trade finance associated with MRPAs. The nature of MRPAs is such that DFIs do not have a direct effect on the pricing or structure of trade finance products offered to clients by issuing banks. MRPAs are not intended to directly influence the risk appetite of issuing banks or their willingness

18 Moody's. (2021). Rating Scale and Definition. | BII. (2022). Internal database.

19 Messenger, J. (2023). Pakistan faces ongoing commodity shortages as dollar crisis and lack of LCs take effect. Global Trade Review. | World Bank. (2023). Bangladesh Development Update - Trade Reform: An Urgent Agenda.

to service new customer segments in need of trade finance support. In addition, across the analysed countries, MRPAs had limited impact on the fee structures charged by issuing banks to their clients and the tenor period of these trade finance products.

BII does not operate as a confirming bank operating on SWIFT, and therefore cannot provide confirmation lines directly to issuing banks. Rather, BII's trade loans provide the opportunity to provide credit directly to issuing banks. BII's trade loans facility (including direct trade loans to businesses), an evaluation of which lies outside the scope of this study, made up 6 per cent of BII's commitment under the TSCF programme between January 2015 and September 2023.

Nevertheless, given that pricing of trade finance emerges as a barrier to access to trade finance, particularly for SMEs, trade finance instruments that provide affordable trade finance to target groups such as SMEs are desirable.

> **Lesson 2.3: DFIs could consider increasing trade finance support through direct engagement with issuing banks to enhance impact and promote additionality in their trade support programmes to deepen the impact and broaden the reach of trade finance support.** While requiring BII to assess and monitor the credit risk of issuing banks, direct involvement with issuing banks, such as through greater emphasis on trade loans, would facilitate the provision of trade finance to new customer segments and encourage issuing banks to offer affordable trade finance products and longer tenors to importers and exporters. BII currently provides trade loans to three regional banks in Africa and South Asia and intends to increase this form of trade finance support in 2024.

QUESTION 3: What type of businesses are being reached by issuing banks, what is their composition (size, ownership structure/gender of business owner etc.), what products do they offer, what are the sectors they operate in, and what is the financial performance of the businesses receiving trade finance?

Finding 3.1: Interviewed businesses that utilise trade finance products are mainly large corporations, employing a high number of individuals, that have access to trade finance from multiple banks. Interviews with issuing banks highlighted that trade finance remains concentrated among large businesses (employ over 300 individuals, and with revenues above $15 million). These businesses are often repeat customers of issuing banks, with multiple confirmation lines with several issuing banks in their country of operations. SMEs remain constrained in their ability to access trade finance. This highlights the need for targeted trade finance products to reach SMEs.

> **Lesson 3.1: DFI trade finance facilitation could more directly support SME clients of issuing banks.** While BII provides trade loans to issuing banks and guarantees, and funding directly to international commodity traders to support their import activity, the impact of such products on access to trade finance by SMEs lies outside the scope of this study.

QUESTION 4: To what extent has BII's risk-sharing facilities impacted the trade finance value chain and users of trade finance (importers/exporters)?

Finding 4.1: FX shortages have a negative impact on businesses' ability to access trade finance especially for net importing businesses and SMEs. Interviews with businesses highlighted that despite large corporations in the analysed countries having access to trade finance from multiple banks, they are still unable to meet their needs for trade finance due to ongoing FX shortages. In the case of SMEs, such FX shortages are layered on top of other factors that severely limit their access to finance as outlined above. Therefore, due to FX liquidity shortages, the evaluation found that trade finance needs of most businesses – especially SMEs and net importers – remain unmet.

> **Lesson 4.1: A concerted effort by country authorities would be required to address the macroeconomic imbalances that give rise to foreign exchange shortages**, including measures designed to (a) enhance the competitiveness of traded goods and services; (b) contain domestic demand for imported goods and services, for example, by managing fiscal expenditures; and (c) reduce reliance on foreign borrowing

given that repayment of foreign currency loans absorbs scarce foreign currency. Although important in creating greater balance on the foreign exchange market, discussion of such measures lies beyond the scope of the current study.

Finding 4.2: SMEs choose to not apply for trade finance, even though they need it. SMEs face costs for trade finance products that are almost twice as high as for larger firms.[20] This is primarily due to the perceived high risk of SME businesses. Therefore, issuing banks impose stringent collateral requirements on SMEs, which they find difficult to comply with. Therefore, SMEs choose not to apply for trade finance, even though they need it.

As noted above, BII's MRPAs do not intend to influence issuing banks, and therefore the amount of collateral and confirmation fees demanded by issuing banks. Nevertheless, the evaluation notes the importance of addressing these barriers to trade finance to enhance the ability of SMEs to engage in international trade. While lying outside the scope of this evaluation, it is noted that BII does provide targeted trade finance support in the form of trade loans and supply chain finance which is aimed at SMEs.

Lesson 4.2: To have a positive impact in reducing the SME trade financing gap, DFIs should explore introducing innovative SME-targeted trade finance products which are affordable and have lower collateral requirements. This will benefit smaller enterprises that struggle to provide traditional collateral. In addition to trade loans and supply chain finance, an approach being tested by BII is through the Trade Access programme (see Box 10).

QUESTION 5: During crises, such as the COVID-19 pandemic and the Ukraine-Russia conflict, what are the effects and impacts that can be attributed to trade finance at the confirming FIs, issuing FIs, and importer and exporter levels?

Finding 5.1: The COVID-19 pandemic demonstrated the critical importance of trade finance programmes in sustaining trade flows during crises. In response to the liquidity crisis caused by the COVID-19 pandemic, BII increased the size of the MRPA facility with selected confirming FIs and entered new risk-sharing facilities. BII's overall MRPA risk exposure under the TSCF programme increased by 47 per cent in 2020 (from 2019), with the aim of assisting confirming banks in continuing to provide trade financing. During this period, the total value of trade finance transactions supported by BII rose by 1 per cent. Although the increase in BII's trade finance risk exposure was not matched by an equivalent increase in the total value of confirmations during the pandemic, without BII's intervention, the overall volume of trade finance confirmations, rather than stabilising, would have been negatively impacted.

Lesson 5.1: While it is difficult to disentangle supply and demand side factors, BII's experience suggest that **DFIs may be able to encourage confirming banks to maintain their commitments to target countries during challenging times by providing additional funding and guarantees to confirming banks.** During the pandemic, BII increased the proportion of the risk it was willing to take on trade transactions to encourage confirming banks to maintain their trade finance commitments. Such countercyclical support provided by BII played a stabilising role during the pandemic.

20 Ibid.

1. Introduction

In 2019, the Foreign, Commonwealth & Development Office (FCDO) commissioned Genesis Analytics and IPE Global to independently evaluate British International Investment's (BII) Financial Institutions (FI) portfolio (renamed Financial Services). The purpose of this evaluation is to better understand the development outcomes and impacts associated with BII's investments in the financial services sector. It consists of two phases: an evidence and portfolio-level review completed in 2020 (phase one), and a series of in-depth case studies (phase two).

Our phase one review revealed that trade finance can have positive medium to long-term effects on international trade growth in Africa and Asia.[21] The review also highlighted that targeting trade finance towards small and medium-sized enterprises (SMEs) is likely to be highly beneficial. This is because in addition to other benefits, trade finance offers businesses a working capital buffer (explained in Section 3.4), to which they often do not have access.

However, due to the lack of data on importers and exporters reached by BII's trade finance portfolio, the phase one evaluation found limited evidence of the extent to which trade finance is beneficial to importers and exporters, and whether trade finance supports alleviation of the working capital constraint. As a result, the evaluation team recommended in the phase one review that an in-depth study should be conducted to comprehensively investigate the impact of BII's trade finance support at the level of importers and exporters.

Therefore, the purpose of this in-depth study is to assess the impact of trade finance beyond what is already documented in the large-scale general surveys conducted by the African and Asian Development Banks.[22] To achieve this, the study specifically examines the impact of BII's trade finance programme and incorporates findings and lessons from two case studies focused on BII's trade finance risk-sharing agreements with two confirming banks.[23] This study builds on observations relating to the engagement between the confirming banks and their issuing banks, and the relationships between the issuing banks and their clients. In other words, the importers and exporters who use trade finance products provided by these issuing banks. The focus countries of this study are Nigeria, Mozambique, Pakistan, Bangladesh, and Kenya.

1.1 How trade finance works

Trade finance encompasses financial instruments that are used to facilitate international trade by making it easier for importers and exporters to transact. By ensuring that payments are secure, trade finance instruments aim to reduce the risk for exporters relating to payment for goods delivered, while also reducing risk faced by importers regarding safe receipt of goods. Using financial instruments such as letters of credit, trade loans, guarantees and insurance, trade finance mitigates risks by increasing the security of payments and easing the availability of liquidity, thereby facilitating global trade.[24] Letters of credit (LCs) are the oldest and most common form of short-term trade finance provided by issuing banks to their clients.[25] They make up a significant proportion of BII's trade finance support to confirming banks (which confirm the LCs of issuing banks).[26] A total of 70 per cent of BII's trade finance risk exposure through risk-sharing agreements in 2022 was through LCs.

21 Sunderji, S., Nixon Williams, D., Fuchs, M., Wyatt, A., Verrinder, N. (2020). Evaluating CDC's Financial Institutions Portfolio. Genesis Analytics and IPE Global.

22 AfDB. (2020). Trade Finance in Africa: Trends Over the Past Decade and Opportunities Ahead - Policy Research Document 3. | ADB. (2023). 2023 Trade Finance Gaps, Growth, and Jobs Survey.

23 The identity of these two institutions will remain anonymous to avoid moral hazard, which could occur were issuing banks to be aware of BII's risk-sharing agreements with confirming banks. To maintain integrity, names of confirming banks are withheld.

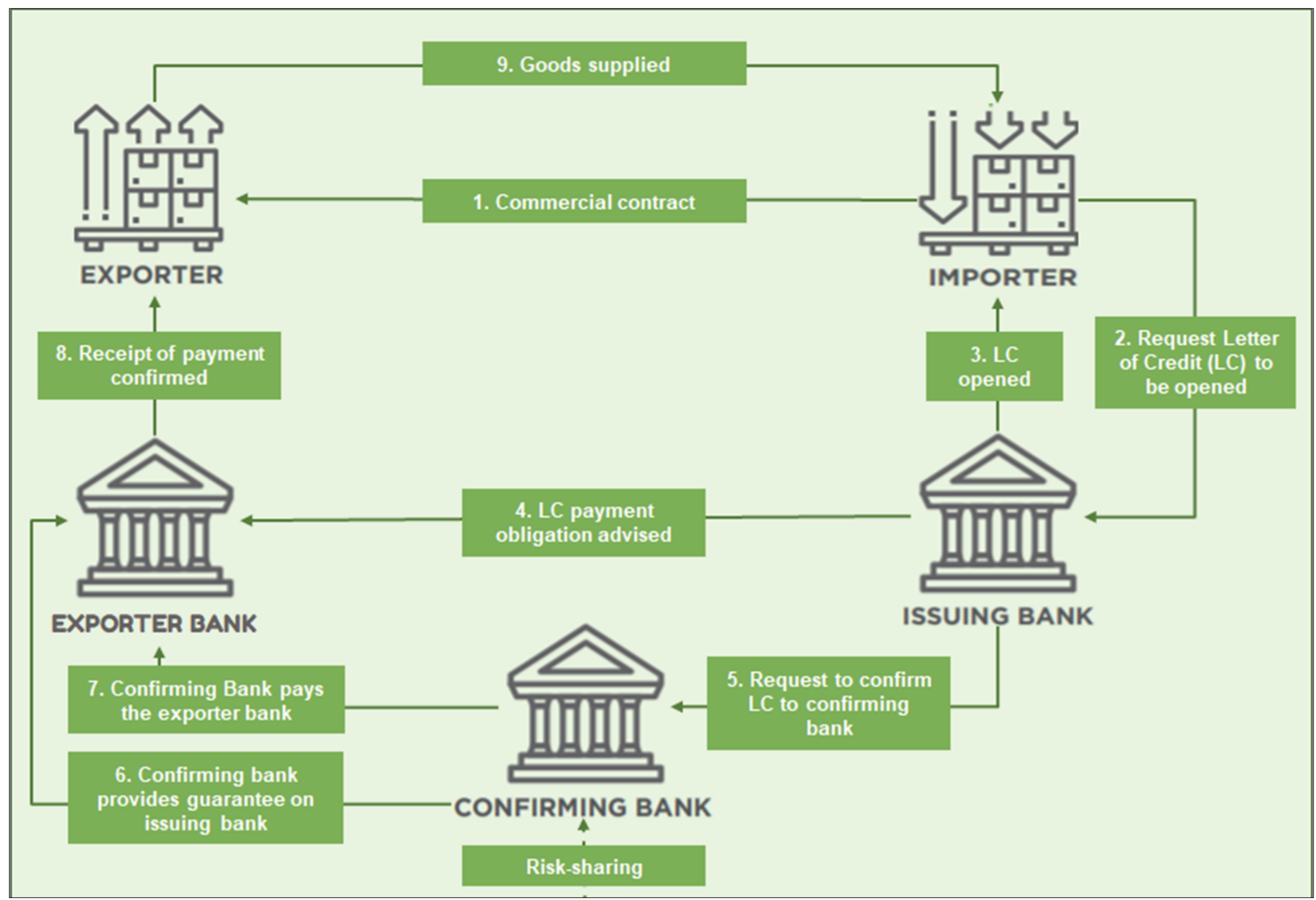
24 Beck, S. (2022). Your Questions Answered: What is the Trade Finance Gap and Why Does it Matter? ADB. | WTO. (2016). Trade finance and SMEs: Bridging the gaps in provision. | IFC. (2020). Why Trade Finance Matters - Especially Now.

25 Global Trade Review. (2022). Letter of Credit.

26 Note: BII does not provide trade finance support in the form of LCs. Confirming banks through their risk-sharing agreement with BII confirm LCs of issuing banks. Issuing banks provide LCs directly to their customers (importers and exporters).

Trade finance involves intermediaries who provide liquidity, manage risks, and ensure the settlement of payments and delivery of goods and services. Ideally, an exporter would prefer the importer to pay upfront for an export shipment to avoid the risk of the importer receiving the goods but refusing to pay. However, if the importer pays upfront, the exporter may accept the payment but fail to ship the goods. Trade finance employs intermediaries to manage the risk and ensure the settlement of payments and delivery of goods and services. Just as importantly, trade finance also acts as a temporary source of liquidity for importers, allowing them to delay payments for their imports for a predetermined period of time, defined by the tenor of the trade finance product, thus freeing up working capital.

Figure 1: The process of trade finance – Letter of Credit as an example[27]



Source: BII, 2021

In practice, trade finance transactions typically follow these steps:

1. The importer and exporter establish a commercial contract, where they agree on the terms of exchanging goods and services.
2. The importer requests an LC from their local issuing bank.
3. The importer's issuing bank approves and opens the LC, outlining the terms and conditions.
4. The importer's bank informs the exporter's bank about the LC.
5. The importer's bank seeks a reputable and recognised confirming bank. This confirming bank assumes the risk involved in the international trade transaction and guarantees that the exporter will receive payment, even if the importer's bank (known as the issuing bank) and its client default on the transaction. The confirming bank evaluates the terms and conditions and, if found appropriate by both parties, confirms the LC to the exporter's bank.

27 Sunderji, S., Nixon Williams, D., Fuchs, M., Wyatt, A., Verrinder, N. (2020). Evaluating CDC's Financial Institutions Portfolio. Genesis Analytics and IPE Global.

6. The confirming bank makes the required payment to the exporter's bank to facilitate the import. In some cases, goods may be received before payment, upon presentation of documents verifying the transaction.
7. Once the payment is received, the exporter's confirming bank confirms the payment to the exporter.
8. The exporter's bank pays the amount due to the exporter.
9. The exporter delivers the goods as agreed upon in the contract.

Development finance institutions (DFIs) such as BII play a significant role in the trade finance chain. They sign risk-sharing agreements with confirming banks, which enable these banks to increase their risk allocation limits for specific issuing banks, and also increase their country exposures beyond pre-existing limits. Issuing banks provide various trade finance products to their clients supported by the confirmations from risk-sharing agreements between DFIs and confirming banks. Thus, DFIs like BII can absorb risk from confirming banks' balance sheets by guaranteeing a portion of trade finance transactions.

1.2 Why trade finance is important

International trade is a key driver of regional economic integration, economic growth, and poverty reduction.[28] Trade supports economic development through specialisation and economies of scale as well as through international linkages provided by exports, imports, and global value chain participation. Such linkages lead to dissemination of technologies, know-how, and innovation. Empirical literature highlights that trade leads to increased productivity and employment, which in turn affect the long-term development outcomes of trading countries.[29] Overall, trade results in improved productivity, investment activity, technology/skills transfer, and competition, leading to economic growth and long-term developmental outcomes.

Without trade finance, global trade would grind to a halt.[30] Evidence suggests that approximately 80 per cent of international trade is supported by trade finance.[31] Therefore, trade finance plays a pivotal role in ensuring the uninterrupted cross-border movement of goods and capital.

But there is high unmet demand for trade finance and the trade finance gap remains persistently large.[32] The trade finance gap represents the difference between the estimated demand for trade finance and the supply of available trade finance from financial institutions.[33] The Asian Development Bank (ADB) highlighted that in 2014, the global trade finance gap was estimated to be as large as $1.4 trillion, with more than half of this gap concentrated in Africa and Asia.[34] As the years have progressed, this gap has continued to widen. It reached $1.7 trillion in 2020 amidst the COVID-19 pandemic. In 2022, the ADB estimated the global trade finance gap to have surpassed the $2 trillion mark.[35] The increase in the trade finance gap is in part due to global inflationary pressures (i.e. food, energy, and commodity price inflation), and growth in cross-border trade, among other factors.

Changing risk appetites of confirming banks can partly explain the trade finance gap. Since the global financial crisis (GFC) of 2008-2009, confirming banks have been more cautious about maintaining trade lines with issuing banks in emerging markets. This is partly due to the Dodd-Frank Wall Street Reform and Consumer Protection Act. Enacted in the wake of the GFC, the Dodd-Frank Act aims to prevent excessive risk-taking by commercial

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28 IMF. (2001). Global Trade Liberalization and the Developing Countries.
29 OECD. (2011). Trade for Growth and Poverty Reduction - How Aid for Trade Can Help.
30 IFC. (2020). Why Trade Finance Matters - Especially Now.
31 Ibid.
32 ADB. (2022). Toward Inclusive Access to Trade Finance: Lessons from the Trade Finance Gaps, Growth, and Jobs Survey.
33 As the basis for its estimates of the trade finance gap, ADB uses rejected applications for trade finance funding. See: Beck, S. (2022). Your Questions Answered: What is the Trade Finance Gap and Why Does it Matter? ADB.
Note: The trade finance gap refers to the difference between the demand for trade finance and the supply of trade finance available to facilitate international trade transactions, thus abstracting from the demand for trade finance that might arise from un- or under-serviced segments of the market.
34 ADB. (2022). Toward Inclusive Access to Trade Finance: Lessons from the Trade Finance Gaps, Growth, and Jobs Survey. | Afrexim. (2020). Survey of Impact of COVID-19 on African Trade Finance. | WTO. (2016). Trade finance and SMEs: Bridging the gaps in provision.
35 ADB. (2022). Toward Inclusive Access to Trade Finance: Lessons from the Trade Finance Gaps, Growth, and Jobs Survey.

banks, which was thought to have been a major contributor to the GFC. The Act restricted banks from trading with their own funds (the "Volcker Rule"), heightened monitoring of systemic risk, tightened regulation of financial products, and introduced consumer protection initiatives.[36] As a result, emerging markets saw a notable decline in the availability of trade finance liquidity. Risks were perceived as higher in these markets and more emphasis was placed on the weak credit ratings of issuing banks.[37]

In addition, banks have faced tightened capital requirements (as encompassed in Basel III), as well as increased compliance requirements associated with anti-money laundering and combating the financing of terrorism (AML-CFT) such as tightened know-your-customer (KYC) requirements. Responding to the GFC, Basel III established tougher capital standards through more restrictive capital definitions, higher capital to risk weighted assets requirements, additional capital buffers, and higher minimum capital requirements. As a result, banks are obliged to set aside more capital to support their exposure to risky assets, such as loans, bonds, and trade finance confirmations. In addition, the considerably tightened AML-CFT and KYC requirements make it more costly and time-consuming for banks to monitor compliance with such requirements across multiple jurisdictions. As a result, global confirming banks tended to focus on larger markets and clients and reduced trade finance liquidity in emerging markets.[38]

Moreover, with the planned implementation of Basel 3.1 reforms on banking supervision by US regulators, banks anticipate that the cost of providing trade finance will increase further. Regulatory changes include revised capital rules deeming bank debt that is more than 90 days overdue as defaulted exposure. This is particularly problematic for supply chain finance programmes, in which repayment terms can be stretched out and banks deal with very high volumes of often low-value receipts. As such, banks will likely reduce their risk appetite in providing trade finance products to more risky customers, particularly SMEs, and therefore could further increase the trade finance gap.[39]

Access to affordable trade finance is especially challenging for SMEs and women-led businesses, as they experience high rejection rates on their trade finance applications. Globally, more than half (52 per cent) of trade finance requests by SMEs are rejected, compared to only 7 per cent for multinational companies.[40] The gap is particularly pronounced for women-led businesses, with 70 per cent of applications either partially or fully rejected.[41] Thus, lack of access to trade finance particularly affects SMEs in emerging markets that struggle to engage in cross-border trade. The challenges faced by SMEs in accessing trade finance are similar to those they generally face in accessing credit from financial intermediaries.

Against this backdrop, BII has entered into risk-sharing agreements with commercial banks that support trade finance activities in Africa and South Asia. BII's risk-sharing agreements are designed to facilitate trade flows across its target countries by strengthening the appetite of confirming banks to engage with issuing banks operating in those countries.

1.3 BII's Trade and Supply Chain Finance programme

Established in 2015, BII's Trade and Supply Chain Finance (TSCF) programme forms part of its overarching efforts to foster long-term growth, generate employment opportunities, alleviate poverty, and enhance the resilience of supply chains.[42] Through the programme, BII aims to improve the availability of trade finance and in turn increase the facilitation of trade. Ability to trade will enable businesses to have access to a greater diversity of more affordable and better-quality goods, including finished products, business inputs, and capital equipment.[43]

36 Berman, N. (2023). What Is the Dodd-Frank Act? Council Foreign Relations.
37 WTO. (2016). Trade finance and SMEs: Bridging the gaps in provision.
38 Azis, I. Shin, H. (2014). Global Shock, Risks, and Asian Financial Reform. ADB.
39 Global Trade Review. (2024). Why trade finance banks and insurers aren't happy with US Basel proposals.
40 WTO. (2016). Trade finance and SMEs: Bridging the gaps in provision.
41 Beck, S. (2022). Your Questions Answered: What is the Trade Finance Gap and Why Does it Matter? ADB.
42 Note: The impact pathway to which BII aimed to achieve this is explained in the next section. | BII. (2020). CDC Group unveils record levels of trade finance to Africa and South Asia.
43 Ibid.

This is expected to improve production efficiency, thereby enhancing growth prospects of businesses and their capacity to create employment, and thereby contributing to the alleviation of household poverty.

The BII trade finance programme offers guarantees and provides liquidity to confirming banks to finance trade loans to businesses in Africa and South Asia. The TSCF programme helps bridge the supply gap for trade finance and supports trade undertaken by local businesses.[44] Local importing businesses are the primary target market of the programme, as the demand for trade finance is generally high among importers, while exporters can to a greater degree rely on financing provided by financial intermediaries in more advanced financial markets to which they deliver their products. Nevertheless, the programme is also available to exporters, enabling them to import inputs to production processes more easily.

Since launching the TSCF, BII has supported trade finance transactions worth over $29.3 billion of trade in Africa and South Asia reaching over 1,500 businesses in these markets between January 2015 and September 2023.[45] Of the $29.3 billion in trade finance transactions supported, BII's exposure is approximately $10.2 billion across 177 local issuing banks through Master Risk Participation Agreements (MRPAs) and trade loans with 12 global and regional banks, and one asset management FI.[46]

MRPAs represent 94 per cent of the total value of BII's exposure ($10.2 billion) under the TSCF programme between January 2015 and September 2023. Unfunded participation make up 88 per cent of BII exposure, while funded participation constitute 12 per cent.[47] Over this period, BII had MRPAs with nine confirming banks, reaching 30 countries and over 160 issuing banks. BII's risk exposure in African countries accounted for $4.5 billion (47 per cent) and South Asia accounted for $5.1 billion (53 per cent) of BII's MRPAs.

BII's MRPA trade finance support has been on an upward trajectory since its inception and until 2021 (see **Figure 2**). However, the introduction of BII's Climate Change Strategy in 2020, resulting in the phased removal of oil and gas (including refined petroleum products) from the list of eligible transactions by July 2022, has negatively impacted the total value of trade finance transaction supported by BII.[48] Nonetheless, since its inception in 2015, the total value of BII's MRPA risk exposure has risen steeply, by 73 per cent compounded annual growth rate (CAGR) to reach a peak of $2.4 billion in 2021, before declining to $1.6 billion in 2022 in part, due to the removal of exposure to the oil and gas industries.

While BII's exposure has grown significantly over the years, its contribution remains small compared to the trade flows of the relevant "risk countries".[49] In 2022, the total trade facilitated through MRPAs by BII accounted for roughly 0.01 per cent to 1.4 per cent of total trade values (imports plus exports) of the relevant countries denoted in **Figure 2**.[50] Among other factors, the low ratio in 2022 is a result of the fact that BII is no longer financing oil and gas (including refined petroleum products) imports, which make up the largest share of imports in Africa (see discussion below).

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44 BII. (2021). What's the impact of investing in trade and supply chain finance?

45 BII. (2023). Trade and Supply Chain Finance (TSCF) programme database.

46 Note: Exposure refers to the total value that BII commits in each trade finance transaction confirmed by a confirming bank, based on the risk-share agreement with that confirming bank. For instance, the total value of trade finance transaction that confirming FIs have confirmed using BII's TSCF programme amounts to $29.3 billion. Of this amount, BII guaranteed/provided trade loans amounting to $10.2 billion. Source: BII. (2023). Trade and Supply Chain Finance (TSCF) programme database.

47 Funded trade finance support/participation refer to risk participation whereby BII provides the confirming bank with funds to fulfil its trade finance obligations. Unfunded trade finance support/participation refers to risk participation where BII does not fund the confirming bank but instead provides a 'guarantee' to the confirming bank to fulfil its trade finance obligations e.g. Letter of Credit Confirmations.

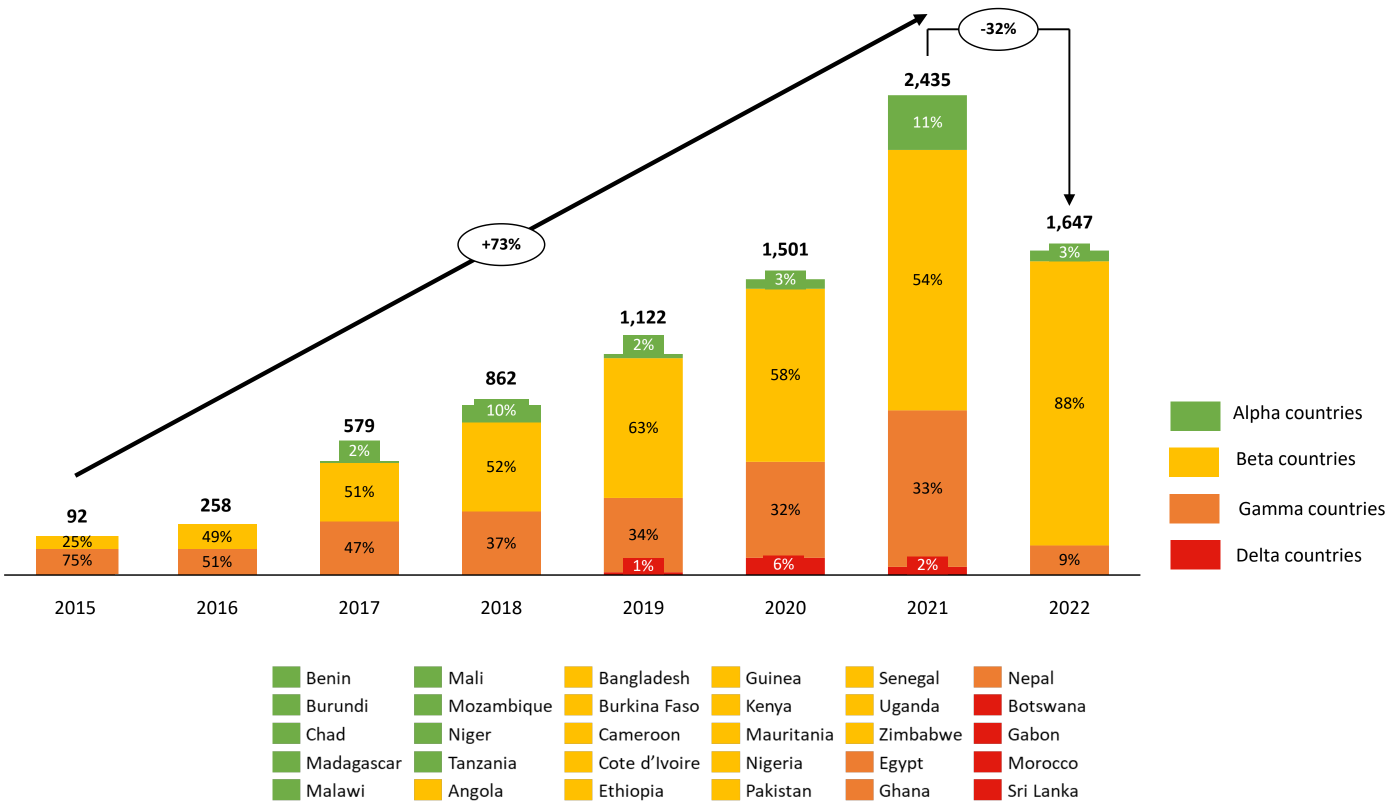
48 BII. (2020). Climate Change Strategy - Investing for clean and inclusive growth. | BII. (2020). BII's fossil fuel policy.

49 Risk countries is the term used to refer to the countries BII is taking a risk on by guaranteeing their trade finance transactions.

50 Genesis Calculation

Across the relevant countries, international trade represents a notable share of the relevant (risk) countries' gross domestic product (GDP). In 2022, the merchandise trade to GDP ratio of the supported South Asian countries ranged from 27.1 per cent to 42.2 per cent, while the ratio across African countries varied from 17.9 per cent to 128.5 per cent.[51] This shows how important trade is to the countries acquiring trade confirmations from BII's MRPAs, and consequently how reliant they are on trade finance facilitation. It is important to note that the size of BII's balance sheet limits the extent to which the TSCF programme can affect the trade exposure of targeted countries. Nevertheless, BII's TSCF programme has enabled confirming banks to significantly increase their confirmations over time.

Figure 2: The total value of BII's MRPA trade finance risk exposure, split by BII's country classification (USD million, 2015–2022)[52]



Source: BII

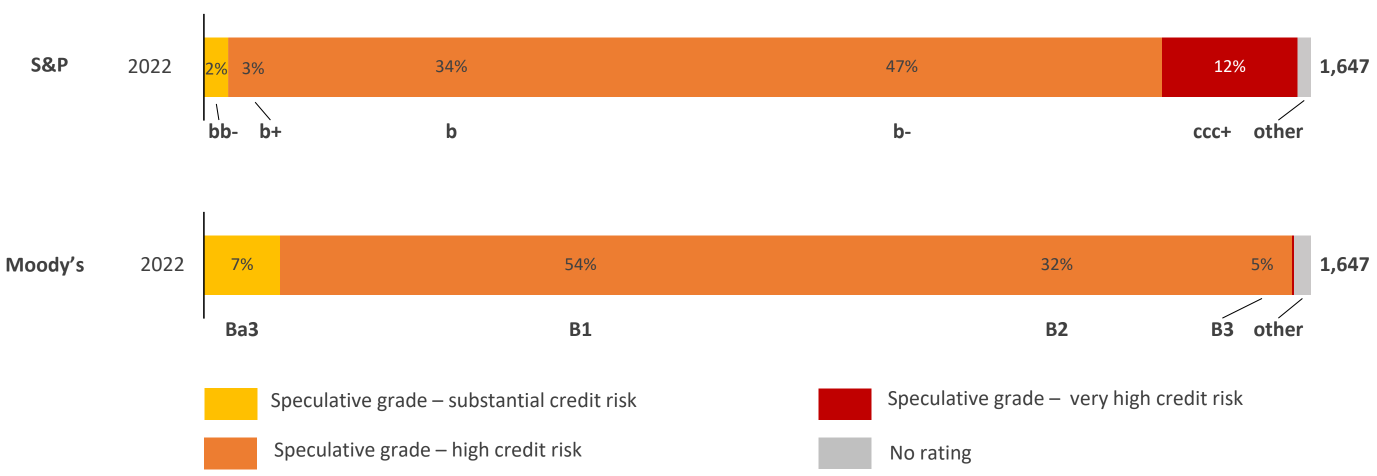
Note: BII groups countries in Africa and Asia into four categories namely: Alpha (representing the most fragile and poorest economies), Beta, Gamma, and Delta (representing the least fragile or relatively the least poor countries when compared to the other three categories). The list of countries has been shaded as per their expected development impact categorisation in BII's Impact Score introduced in the 2022–2026 Strategy Period. However, it is important to note that classification of some countries has changed over the years, based on their economic performance. For instance, under BII's 2018 development impact grid/score, Burkina Faso was classified as an Alpha country, and in the 2022-2026 strategy Burkina Faso falls under the Beta group. The graphical illustration, however, takes account of these changes in country classification, and depicts the proportion of BII's participation in each group in a given year based on the categorisation of each country in that strategy period.

51 Merchandise trade as a share of GDP is calculated as the sum of merchandise exports and imports divided by the value of GDP, all in current U.S. dollars. This ratio indicates a country's openness to trade and helps to assess the extent to which a country's economy relies on cross-border trade in physical goods. A higher percentage suggests a greater dependence on international trade for economic activity, while a lower percentage indicates a relatively smaller impact of merchandise trade on the overall economy. Source: World Bank. (2023). Merchandise trade (% of GDP).

52 BII. (2023). Trade and Supply Chain Finance (TSCF) programme database.

The TSCF programme has grown, and so has the reach of BII's MRPAs, particularly to countries with low-income populations (i.e. Alpha and Beta countries – see Figure 2).[53] An increasing number of countries have benefitted from BII's MRPAs, growing from seven countries in 2015 to a peak of 22 countries in 2021. More importantly, BII's reach to Alpha and Beta countries has increased. These countries are considered "low-income and fragile countries" in terms of investment in BII's 2022-2026 Strategy impact score.[54] In 2015, BII's risk exposure was mainly in Gamma countries, which made up 75 per cent of the total value of its participation, followed by Beta (25 per cent). BII did not have any exposure in Alpha countries, which generally struggle to acquire investments because they are "high risk" and the most difficult to invest in. However, BII's trade finance facilitation has shifted towards supporting Alpha and Beta countries, which made up 3 per cent and 88 per cent of its total risk exposure in 2022. Going forward, BII is focused on increasing the portfolio's exposure to difficult and high-risk markets (Alpha and Beta) and aims to reach a target of 15 per cent of its MRPA exposure to Alpha countries by 2026.[55]

Figure 3: The total value of BII's MRPA trade finance risk exposure, split by the credit ratings of the recipient countries (USD million, 2015–2022)[56]

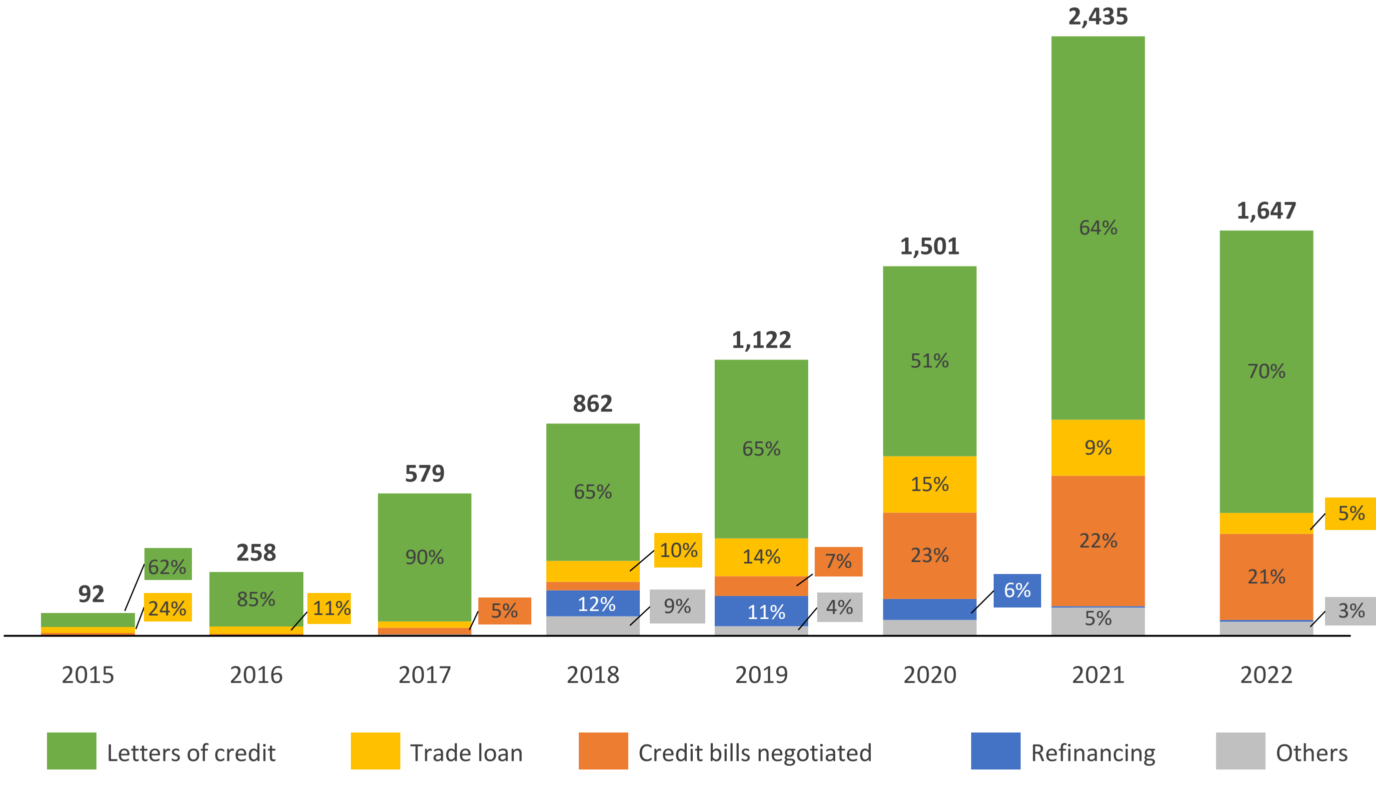


Source: BII

BII's TSCF has always targeted issuing banks in countries with low credit ratings. In 2022, participation in BII's trade finance programme was mainly by countries ranked as highly speculative on the Standard and Poor's (S&P) and Moody's sovereign credit rating scale. Similarly in 2015, 98 per cent of BII's exposure was in countries with credit rating 'b+', 'b' or 'b-' by S&P, and 96 per cent was in countries rated 'B1', 'B2' and 'B3' by Moody's. Low sovereign credit ratings are one of the top three barriers faced by issuing banks in expanding their trade finance operations.[57] These banks operate in high-risk countries with low sovereign credit ratings, so issuing banks have difficulty acquiring confirmations for the trade finance they provide.

53 BII divides countries within Africa and South Asia into four categories (Alpha, Beta, Gamma, and Delta) depending on their investment difficulty (with Alpha being the most difficult). The investment difficulty of each country is measured by an equally weighted index combining five indicators: (i) market size (GDP PPP); (ii) income level (GDP/capita PPP); (iii) credit to the private sector (as percentage of GDP); (iv) 'Doing Business' rankings; and (v) a composite measure of fragility. | See Annex for the full list of countries under each category.
54 BII. (2022). Impact Score - 2022-26 Strategy Period.
55 BII. (2023). Trade and Supply Chain Finance (TSCF) Strategy.
56 BII. (2023). Trade and Supply Chain Finance (TSCF) programme database
57 ADB. (2019). Trade Finance Gaps, Growth, and Jobs Survey.

Figure 4: The total value of BII's MRPA trade finance risk exposure, split by trade finance instrument (USD million, 2015 – 2022)[58]



Source: BII

The majority of trade finance products supported by BII's MRPA are letters of credit, as illustrated in Figure 4. The use of MRPAs is different across the confirming banks, as some banks rely heavily on letters of credit while others prefer trade loans. Between January 2015 and September 2023, BII's MRPA trade finance exposure in South Asia was mainly in the form of LCs (70 per cent) and credit bills negotiated (CBNs) (28 per cent). In Africa, LCs accounted for 57 per cent of BII's MRPA exposure in the region, while trade loans (20 per cent) were the second most commonly used product. Trade finance products are used differently across the two regions, mostly reflecting the preferences of issuing banks based on local market conditions.

While LCs continue to be the preferred trade finance product, there has been a notable rise in the use of CBNs, particularly since the COVID-19 pandemic. As in most emerging markets, countries in South Asia and Africa faced severe liquidity shortages during the pandemic. This was a result of capital flight, as investors sought safe haven assets amid tighter global conditions. A similar trend has been observed following Russia's invasion of Ukraine and the implementation of tighter monetary policy globally. Given strained liquidity, CBNs have increasingly become attractive for businesses, as they are tradeable and thus provide access to liquidity.

Although popular in both regions, the use of LCs is more prevalent in Asia compared to Africa, possibly because issuing banks in Africa have more difficulty in accessing FX liquidity compared to issuing banks in South Asia. African issuing banks have a stronger preference for trade loans as a source of short-term FX liquidity to support trade on an open account basis. Equally important is to note that the type of trade finance product offered to importers and exporters is dependent on the individual issuing bank's business model. Therefore, it is possible that issuing banks may offer different products with similar attributes to their clients (e.g., instead of providing trade loans, issuing banks provide CBNs), despite both products fulfilling similar functions (i.e. liquidity provision).

58 BII. (2023). Trade and Supply Chain Finance (TSCF) programme database. | Mathew, D. M. (2020). Sovereign Credit Rating. Geojit Foresight.

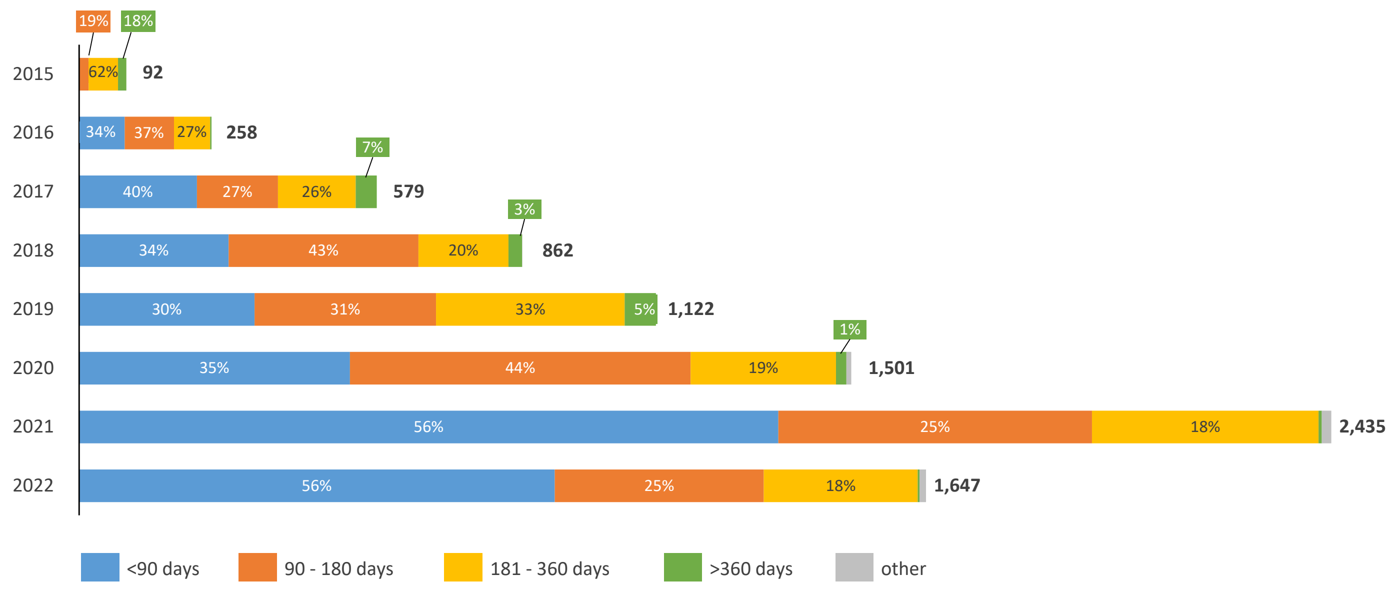
Box 3: Understanding key trade finance instruments demanded by most users of trade finance

Credit bills negotiated (CBN) refers to the process of discounting a letter of credit to generate cash and provide an advance to the exporter. CBNs allow the seller (exporter) to receive immediate payment for the goods or services provided, while deferring the payment obligation to the buyer (importer) to a later date. CBNs are useful at times where exporters are in high need of liquidity either due to increase in trading activities or due to other causes of tight liquidity.

A letter of credit (LC) is a contractual commitment made by the issuing FIs on behalf of a buyer of goods, to the benefit of a seller. LCs serve as a guarantee of payment to the seller, conditional upon the seller meeting his commitments to deliver the underlying goods.

Trade loans are fully revolving credit facilities that allow banks and traders to bridge the funding gap between the time of purchase of a product and the payment by the end buyer. They can be drawn upon as required to fund working capital requirements such as inventory procurement, and for cash flow management purposes.

Figure 5: The share of BII's MRPA trade finance risk exposure, split by tenor period (%, USD million, days, 2015–2022)[59]



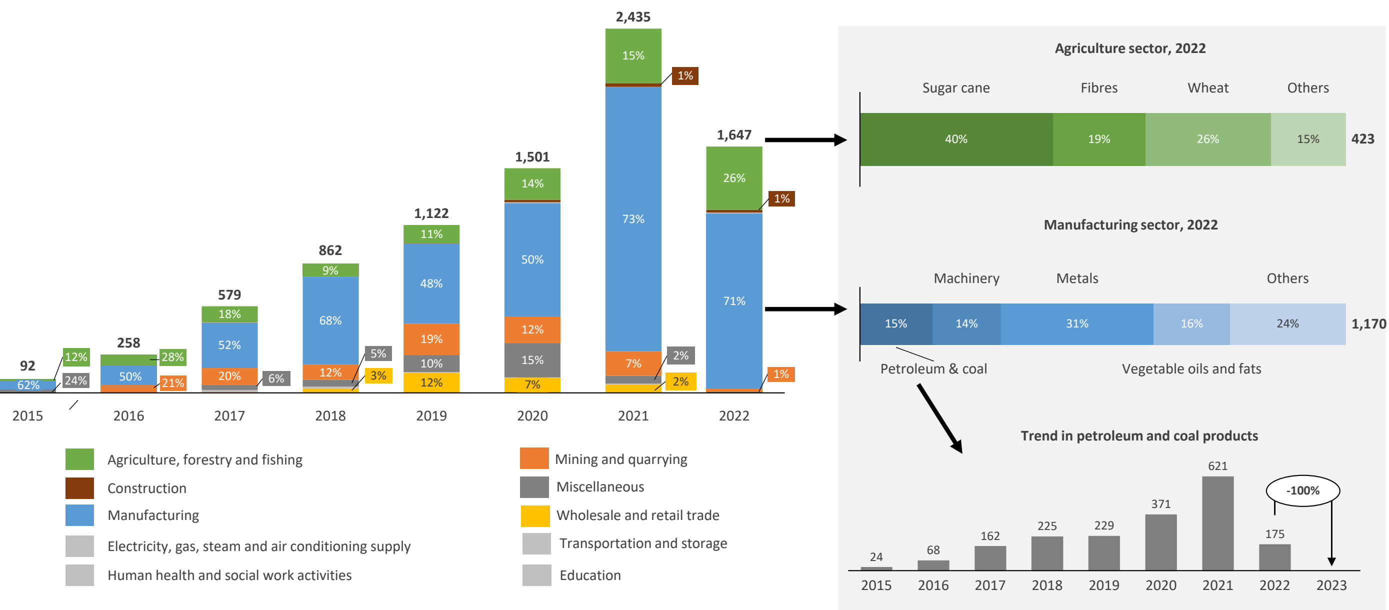
Source: BII

BII's trade finance facilitation has increasingly supported shorter-term transactions. When the TSCF programme started, medium- to long-term trade transactions (with a tenor period between 180 and 360 days) made up 62 per cent of BII's MRPA risk exposure. This has since declined to only 18 per cent in 2022. Similarly, longer-term tenor (more than 360 days) dropped from 18 per cent in 2015 to 0.22 per cent in 2022. BII's risk exposure pivoted towards shorter term (<90 days) transactions which constitute 56 per cent of BII's participation in 2022 compared to only 1 per cent in 2015. This aligns with the tenor risk that commercial banks have been willing to mitigate. On the whole, confirming banks have become more risk-averse and are less willing to provide issuing banks with longer term trade finance products. In addition to the tightening of regulations imposed on confirming banks (discussed in Section 1.2 above), deteriorating macroeconomic conditions in BII's target countries may have contributed to the reduced risk appetite of confirming banks (see discussion in Section 2 below). At the same time, the introduction of BII's Climate Change Strategy, resulting in the phased removal of oil and gas (including refined petroleum products) from the list of eligible transactions is likely to have contributed to fewer longer-term transactions being supported because, on average, petroleum transactions tend to have longer tenors.

59 BII. (2023). Internal Monitoring Database

The TSCF programme has mainly reached the manufacturing and agriculture sectors – sectors that BII considers having high propensity to generate employment and improve access to basic goods and services for households.[60] In 2022, 71 per cent of BII's MRPA risk exposure was in the manufacturing sector and 26 per cent in the agriculture sector. BII's trade finance facilitation in agriculture has increased over time, the main products supported being sugar cane, wheat, and plant-based fibres.

Figure 6: The total value of BII's MRPA trade finance risk exposure, split by sector and products (USD million, 2015–2022)[61]



Source: BII

Following the introduction of BII's Fossil Fuel Policy, BII has eliminated its exposure to trade activities related to coal, oil and gas (including refined petroleum products).[62] Historically, a large part of BII's contribution within the manufacturing sector was to finance trade in petroleum and coal products, making up 41 per cent of BII's MRPA risk exposure to the sector in 2015. However, with the introduction of BII's Fossil Fuel Policy at the end of 2020, which falls under BII's Climate Change Strategy, BII strategically worked with its confirming banks to eliminate all coal, oil and gas (including refined petroleum products) from the portfolio. This brought BII's exposures to fossil fuels to zero by July 2022, as shown in Figure 6 above. Increased support to trade activities in metal products, which rose from 4 per cent of total exposure in 2015 to 31 per cent in 2022, has partly compensated for the decline in fossil fuels.

Other DFIs have larger exposure to trade facilitation than BII. Other prominent DFIs supporting trade finance activities in emerging markets include the International Finance Corporation (IFC), the African Development Bank (AfDB) and the Asian Development Bank (ADB). BII's TSCF programme is fairly modest when compared to other DFIs such as the IFC's Global Trade Finance Programme (GTFP).

60 Under BII's 2022-2026 Impact Score, the manufacturing and agriculture sectors fall under BII's SMART (services, manufacturing, agriculture, real estate, and technology) industries which represent the lifeblood of any modern economy. BII considers these sectors as powerful job creators, which are critical for improving access to basic goods and services, can connect economies with international markets, and have the potential to grow through digital transformation. Source: BII. (2022). Impact Score - 2022-26 Strategy Period.

61 BII. (2023). Trade and Supply Chain Finance (TSCF) programme database | Mathew, D. M. (2020). Sovereign Credit Rating. Geojit Foresight.

62 The fossil fuel policy stipulates exclusions for new commitments into the vast majority of the fossil fuel value chain in line with its commitment to net zero emissions by 2050. Following the implementation of the Fossil Fuel Policy, BII allowed for a transition period of 18 months (from when it was introduced in December 2020 until 30 June 2022) for confirming banks to comply.

The table below shows the trade finance activity of these DFIs.

Table 1: DFI trade finance support

DFI	Period	Number of transactions	Total value of trade finance risk exposure (USD)
IFC[63]	2005–2020	68,000	USD 66.5 billion
ADB[64]	2009–2022	55,616 (60% SME related)	USD 64.8 billion
BII	2015–2022	7,379	USD 8.9 billion
AfDB[65]	2013–2022	2,600	USD 7.5 billion

1.4 Study approach and method

This in-depth study delves into the impact of two out of BII's nine MRPAs. The study refers to them as 'MRPA A' and 'MRPA B' for the purposes of the study. The confirming banks participating in these MRPAs are reputable leading international and regional banks that work with commercial (issuing) banks in the target countries when undertaking their trade finance activities. These issuing banks are established in target countries or are domiciled (have subsidiaries) in the countries where BII provides trade facilitation, spanning South Asia and Africa.

The two risk-sharing agreements encompassed by this study targeted emerging markets in South Asia and Africa, and are underpinned by the following development impact (DI) thesis:

Box 4: DI thesis underpinning MRPA A

"Significant impact on economic activity and job creation/preservation, by providing businesses with access to trade credit that may otherwise contract. The FI indicated [..] that the MRPA allows them to do business that they would otherwise not have been able to support in difficult places [...] In addition, the MRPA is expected to reduce risk in the most challenging markets affected by negative risk perception."

Box 5: DI thesis underpinning MRPA B

"Significant impact on economic activity and job creation/preservation, by providing businesses with access to trade credit that may otherwise contract. [...] The (BII trade finance deal) team will ensure that eligible countries align with BII's development agenda and include markets that would otherwise struggle to access trade finance products. The FI requires a partner like BII to not only share the risk of dealing with domestic banks in difficult economic climates, but also to manage their single obligor limit constraint."[66]

In 2022, BII updated its approach to impact management and introduced the Productive, Sustainable, and Inclusive (PSI) framework to inform investments covering its 2022 – 2026 strategy[67] period. Although the PSI framework was not in place at the time the TSCF programme was launched and the risk-sharing agreements were signed, the objectives[68] of the TSCF programme align closely with it, as outlined below.

63 IFC. (2021). Global Trade Finance Program (GTFP).
64 ADB. (2023). Trade and Supply Chain Finance (TSCF) Program.
65 AfDB. Annual Development Effectiveness Review 2022.
66 Single obligor limits determine banks' maximum exposure level to individual borrowers.
67 BII. (2022). Productive, Sustainable and Inclusive Investment 2022 – 26 Technical Strategy.
68 One of the TSCF programme's objectives is: "Economic opportunities: BII aims to narrow the supply-demand gap for trade and supply chain finance, increase trade volumes and promote inclusive and sustainable value chains. BII's intention is to contribute to long-term growth, employment creation, poverty reduction and supply chain resilience".

Box 6: BII's current approach to investments (2022-2026)

Through its investments BII aims to support development that is:

Productive – helping the productivity of an economy to ensure a decent standard of living for all.

Sustainable – helping to transform the economy, reducing emissions, and protecting the environment while allowing for adaptation to climate change.

Inclusive – allowing the gains from productivity and sustainability to be shared with poor, marginalised sections of society.

This framework allows BII and FCDO to ensure that investments remain aligned to strategic priorities. Each of the above strands contributes to an overarching impact score for each investment. Within each strand, BII focuses on a number of underlying sub-criteria. These are detailed in its latest Investment Policy for 2022 to 2026.[69]

This study has three main objectives. Firstly, it seeks to understand the impact of BII's trade finance programme on confirming FIs that hold an MRPA with BII and confirm trade finance transactions on behalf of issuing banks drawing on the MRPA. Secondly, the study aims to understand the effects of the programme on issuing banks whose trade finance is confirmed by the confirming banks through BII's MRPA. And lastly, the study aims to analyse the impact of the trade finance programme on importers and exporters, who are users of trade finance products provided by issuing banks.

The adopted assessment methodology follows BII's TSCF Impact Framework, shown in Figure 7. The TSCF Impact Framework analyses how BII achieves impact through its trade finance investments. This encompasses short-term outputs and medium-term outcomes. It also includes the direct effect of BII's investments on beneficiaries, the indirect impact via economic enablers, and the impact of BII's investments on shaping and catalysing markets.

69 BII, 2021, Investment Policy for the period from 1 January 2022 to 31 December 2026

Figure 7: BII's TSCF Impact Framework

Our contribution
CONTRIBUTION

Allocating and managing capital

Mobilising capital

Adding value beyond capital

How we achieve Impact
HOW

TSCF investments

Banks
Corporates
Funds & non-bank channels

Increase volume of risk capital
Ease risk limits
Access to working capital for firms
Reduce counterparty risks for firms

Narrow trade finance gap
Increase trade volumes
Promote inclusive & sustainable value chains
Productivity & competition
Technology & skills transfer
Economic growth

Ultimate Impact
WHAT WHO HOW MUCH

Economic Opportunity
Employment
Poverty reduction
Inclusion
Resilience

Access to goods & services
Availability
Affordability
Quality

Risks and how they are managed
RISK

Source: BII, 2021

The study also explores how BII's response during crisis situations affects confirming banks, issuing banks and importers and exporters, and whether this response affects trade activity in target countries. Trade finance seems likely to play a role in cushioning the impact of such crises, and this study provides more clarity on how effective support from TSCF has been during such crises. This includes considering factors such as timeliness, and the impact in terms of the availability of essential goods and services.

This study is therefore structured around answering six research questions, presented in the table below.

Table 2: Research questions

No.	Questions
1	What is the impact of trade finance on confirming financial institutions?
2	What types of issuing banks are BII's risk-sharing facilities being extended to, and how has BII's risk-sharing facility affected these banks' risk appetite, their ability to extend trade finance to the market, and serve new client segments?
3	What type of businesses are being reached by issuing banks, what is their composition (size, ownership structure/gender of business owner etc.), what products do they offer, what are the sectors they operate in, and what is the financial performance of the businesses receiving trade finance?
4	To what extent has BII's risk-sharing facilities impacted the trade finance value chain and users of trade finance (importers/exporters)?
5	During crises, such as the COVID-19 pandemic and the Ukraine-Russia conflict, what are the effects and impacts that can be attributed to trade finance at the confirming FIs, issuing FIs, and importer and exporter levels?
6	What lessons can be learned from the trade finance programme that could be replicated or built upon in other BII engagements?

The evaluation used a combination of quantitative and qualitative research methods to answer these questions:

1. Desk research on the global trade finance landscape and the macroeconomic and regulatory environments in the risk countries of BII's MRPAs;
2. Analysis of BII's internal monitoring data as well as internal data submitted by confirming banks, issuing banks and importers and exporters to understand how the MRPAs were utilised; and
3. Key informant interviews with BII's trade finance team, the two confirming banks, 11 issuing banks whose trade transactions benefit from confirmation by banks supported through BII's MRPAs, and 18 importer and exporter clients that receive trade finance from these issuing banks.

The evaluation team conducted interviews with the two confirming banks and purposively sampled interviewees from issuing banks and importers. The study focused on countries with the highest risk exposure under each MRPA. In each focus country, issuing banks with the highest exposure to BII's trade facilitation were selected for interviews.[70] Thereafter, importers and exporters were selected from a pool of business clients of the selected issuing banks and/or from enterprises in BII's network of importing/exporting businesses that access trade finance products.

Limitations

Some limitations were encountered in conducting this study:

1. To avoid moral hazard, confirming banks refrain from informing issuing banks of BII's MRPAs when providing them with partial guarantees.[71] As a result, issuing banks were identified without the support of those banks confirming their trade finance transactions under BII's risk-sharing agreements. This prevented the evaluation team from thoroughly exploring the relationship between confirming banks and their issuing bank partners.
2. It follows from the above that, although the evaluation team explored the impact of the approaches taken by individual DFIs during interviews with issuing banks, the team was unable to isolate the impact of BII's MRPAs from that of similar programmes provided by other DFIs to issuing banks and their clients (i.e. importers/exporters).
3. The self-reported nature of the qualitative data captured during interviews raises concerns about potential bias in reporting by importers and exporters, as well as by issuing banks who might have incentives to provide positive reports about trade financing This was more likely in those cases where businesses were part of BII's network of importing/exporting businesses, and for those FIs that had a pre-existing relationship/financing arrangement with BII.

To mitigate these limitations, the team used and triangulated multiple sources of information (including desktop research, interviews and data shared by BII) whenever possible to ensure robust findings. While fully mitigating these limitations is not possible, they are unlikely to impact the validity of the study findings.

70 It is important to note that some of the selected issuing banks also had an existing direct relationship with BII (that is, they were investees of BII on other non-trade finance-related activity).

71 Moral hazard is the risk that a party has not entered into a contract in good faith and has incentive to unduly gain from a transaction. Issuing banks are not made aware of BII's service to confirming banks and thus do not know that the confirming banks they are dealing with are sharing risk with BII on their trade finance loans. The facility is drawn in this manner to avoid moral hazard on the part of the issuing banks, since knowing that their creditor is supported by an insurance or a guarantee product will likely influence their decision and might encourage them to default on their payments where the risk of their creditor, the confirming bank with a risk-sharing agreement with BII, is partly covered by insurance.

1.5 Context of the study

It is easier to identify impact on confirming banks than on stakeholders further down the trade finance value chain. When identifying the impact of trade facilitation by DFIs according to the assessment methodology as outlined above, it was to be expected that challenges would arise in finding sufficient evidence of the direct impact of trade finance on importers and exporters, or how trade finance in turn contributes to economic development and the welfare of firms and individuals. Below are insights from studies undertaken by AfDB and ADB regarding key issues in the trade finance ecosystem.

Box 7: Key findings from the AfDB and ADB trade finance surveys.[72]

ADB's surveys indicate a structural shortfall in trade finance. Despite greater assistance from national export credit agencies and multilateral development banks, barriers to narrowing the trade finance gap still limit firms' access to trade finance, especially micro, small, and medium-sized enterprises (MSMEs).

While Asia and the Pacific has the highest share of trade finance applications, the region also reports the highest level of rejections compared to other regions, suggesting significant lost opportunities for trade and development.

The trade finance application rejection rate is also high in Africa. A recent study conducted by AfDB found that SMEs in Africa are more self-rationed in the trade finance market than large firms. Rather than have their applications rejected approximately 20 per cent of SMEs do not apply for trade finance, even though they need it, compared with 4 per cent of large firms.[73] Furthermore, over a quarter of SMEs have no alternative form of finance or are forced to use other sources of working capital to finance international trade.

The AfDB 2022 Trade Finance Survey for Tanzania and Kenya suggests that although participation in international trade is similar among women and men, gender bias is observed in accessing trade finance.[74] The survey revealed that women are less likely to apply for trade finance for reasons linked to the high cost of trade finance and not having sufficient collateral required by banks. Thus, the proportion of trade finance applications submitted by women and rejected by banks is higher.[75] Most women who apply for trade finance in Kenya and Tanzania have access to movable collateral (rather than immovable collateral), but movable collateral is often regarded as inadequate by banks.

It is important to note that while these surveys provide insights on the trade finance gap, they focus on applications for trade finance, and therefore most likely underestimate the actual trade finance gap (i.e., those potential applicants who are discouraged or refrain from applying).

Although several studies have been conducted to understand the relevance and additionality of trade finance support provided by DFIs, they provide limited evidence of the impact at the importer and exporter level. Research has mostly focused on investigating the additionality of trade finance programmes at the confirming and issuing bank levels, focusing primarily on whether trade finance programmes have enabled improved access to liquidity stimulating trade finance transactions. The European Bank for Reconstruction and Development (EBRD)'s Trade Facilitation Programme (TFP), mainly targets European and Western-Asia countries, relatively more sophisticated markets compared to BII's TSCF programme.[76] Key findings from a recent evaluation on TFP are summarised below.

72 ADB. (2022). Toward Inclusive Access to Trade Finance: Lessons from the Trade Finance Gaps, Growth, and Jobs Survey. | AfDB. (2020). Trade Finance in Africa: Trends Over the Past Decade and Opportunities Ahead - Policy Research Document 3.
73 AfDB. (2023). SMEs' Demand for Trade Finance in Africa: The Case of Kenya and Tanzania.
74 AfDB. (2023). Access to trade finance and gender: Survey evidence from Kenya and Tanzania.
75 Ibid.
76 Finlayson, B. (2021). EBRD Trade Facilitation Programme: Special Study. EBRD.

Box 8: Key findings of the EBRD Trade Facilitation Programme Study[77]

The objective of the review of EBRD's Trade Facilitation Programme (TFP), conducted in 2020, was to identify how the TFP contributes to EBRD's transition objectives. A finding from the evaluation was that while the TFP provides risk mitigation and liquidity products to local banks that they then pass on to importers to access the necessary liquidity, most trade does not appear to be directed to the banks' SME clients.

Overall, the review shows that there is no direct evidence of the TFP's impact on trade flows in countries of operation. The trade finance markets in these countries are relatively mature (high levels of liquidity and readily available trade finance) and most commercial banks have trade finance capacity, however, there remains a gap between demand and availability of trade finance. Key constraints on availability of trade finance include the lack of a credit rating by issuing banks, the fact that their customers are unrated, transactions are too small, or the perception of customer risk is too high. In addition, the review shows that while TFP has capacity to provide long tenors, and finance large transactions, in practice this capacity is not valued by clients as most transactions have short term tenor of less than nine months. Given high levels of competition and liquidity in these countries of operation, and ready availability of commercial trade finance training for banks, it is not clear that the TFP network and its outputs is a unique source of value to local importers and exporters.

While a relatively outdated evaluation (conducted in 2013), **the World Bank's Independent Evaluation Group found IFC's GTFP highly additional among high-risk countries and banks,** where the supply of trade finance and availability of alternate risk-mitigation instruments are lower.[78] The evaluation noted that the programme has been largely effective in helping expand the supply of trade finance by mitigating risks that would otherwise inhibit the activity of commercial banks.

This trade finance study will add to the body of literature on the impact of trade finance programmes. It analyses the full value-chain associated with BII's TSCF programme, and investigates its impact on importers/exporters, thus providing supplementary insights to existing evaluations.

77 Ibid.

78 World Bank. (2013). Evaluation of the International Finance Corporation's Global Trade Finance Program, 2006–12.

2. Outcomes at financial institutions level

2.1 Confirming banks

The risk-sharing agreements under BII's TSCF programme provided financial support to confirming banks, allowing them to expand their trade finance offerings in BII's focus countries.[79] BII's TSCF programme is designed to assume 50 per cent or more of the confirming banks' exposure on each approved trade finance transaction.[80] The two interviewed confirming banks noted that the risk-sharing agreements with BII enabled them to confirm an increasing number of trade finance transactions and extend their trade finance limits in countries where they had reached their maximum limits.[81] BII's guarantee reduces confirming banks' risk exposures and their need to set aside capital, allowing them to expand their trade finance portfolios beyond their country limits in those countries which have reached their designated limits but where demand for trade finance remains high.

Data confirms that BII's trade facilitation programme has a positive influence on confirming banks, enabling them to increase the volume of trade transactions. The figures below illustrate an overall increase in the total value of trade finance transactions confirmed through the two sample MRPAs, particularly MRPA A. Between 2018 and 2021, the total value of both the amount of trade finance transactions funded by the confirming bank through MRPA A and BII's exposure to the confirming bank have increased, growing at 22 per cent CAGR and 18 per cent CAGR, respectively. A 30 per cent decrease in the total value of trade supported is observed in 2022, from the previous year. Under MRPA B, after reaching a peak of $761 million in trade finance transactions in 2019, with BII's exposure being $190 million, the total value of both the amount of trade finance transactions and BII's exposure under MRPA B has been on a downward trajectory, as shown in **Figure 9**.

The differing trend observed in the two MRPAs (i.e. an upward trend with MRPA A and a downward trend with MRPA B) is likely due to the contrast in approaches adopted by BII to providing trade finance support during the pandemic to the two confirming banks (discussed in Section 4). In addition, factors such as the banks' risk aversion and the high cost of trade finance to importers and exporters in the different geographies supported also influence the trend observed. The declining trend observed in 2022 across the two MRPAs is likely due to a combination of factors including the end of COVID-19 lockdown restrictions stifled by global macroeconomic uncertainties, rising interest rates and global inflationary pressures. This report explores some of the factors affecting the demand for trade finance by interviewed businesses in a later section.

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79 BII stipulates the countries confirming banks are allowed to reach through each MRPA with BII. The evaluation found that the confirming banks did indeed support BII's focus countries.

80 Although the amount of risk BII takes on each transaction varies, BII can take up to 80 per cent of the risk on each transaction confirmed through MRPA A, and up to 70 per cent on each transaction confirmed through MRPA B.

81 In managing their risk, confirming banks set country limits for their aggregate exposure (their loans and other banking activities) in a given country to diversify geographic risk. If a significant share of a bank's loan portfolio is concentrated in just a few foreign countries, the bank may be unduly exposed to political, economic, and currency risks associated with those countries.

Figure 8: Total value of trade finance transactions confirmed and BII's risk exposure under MRPA A, split by BII's country classification (USD million, 2018–2022)[82]

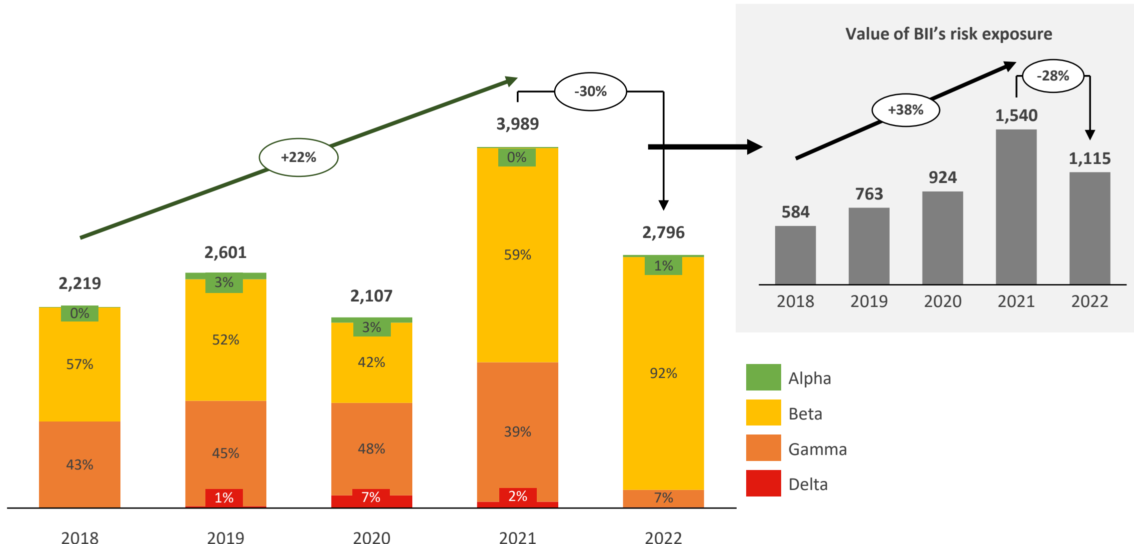
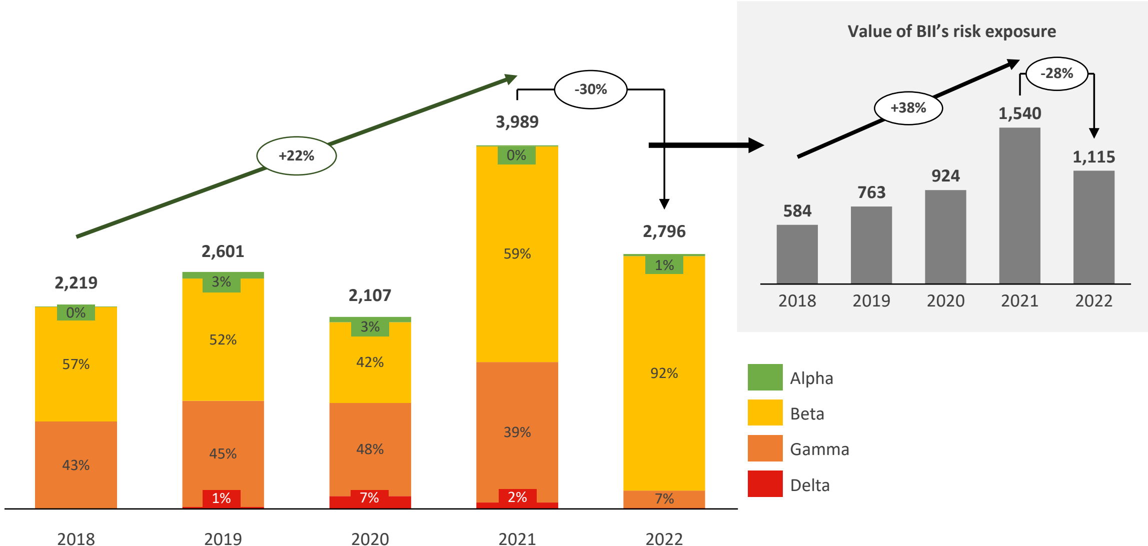


Figure 9: Total value of trade finance transactions confirmed and BII's risk exposure under MRPA B, split by BII's country classification (USD million, 2018–2022)[83]



Source: BII's Internal Database.

Note: The total value of trade finance transactions includes both outstanding and matured trades.

82 BII. (2023). Internal Monitoring Database

83 Ibid.

BII also enabled confirming banks to overcome challenges associated with entering new markets that they would otherwise find difficult to serve. One of the key challenges for confirming banks operating in fragile and risky countries is the higher level of credit and political risk associated with these countries. Risk-sharing agreements provide an additional layer of risk mitigation, reducing the risk exposure borne by confirming banks and boosting their confidence in conducting trade finance transactions in such challenging environments.

Data confirms this observation: BII's MRPAs pivoted towards supporting Beta countries, and banks in these countries generally find it difficult to get confirmations at an affordable price. The proportions of the total value of trade finance confirmations through MRPA A in low-income countries increased to 92 per cent in 2022, compared to 57 per cent in 2018. Similarly, with MRPA B, confirmations in Beta countries increased from 73 per cent in 2018 to 89 per cent in 2022. This coincides with BII's increasing focus on targeting a growing number of low-income countries.

To accommodate the growing demand for trade finance and better meet the needs of confirming banks, BII made several adjustments to their MRPAs. These adjustments included increasing the risk-share BII was willing to take, expanding the size of the MRPAs, and introducing funded participation.[84] BII increased its risk-share from 60 per cent to 80 per cent of the risk on each transaction confirmed through MRPA A in June 2018, and from 50 per cent up to 70 per cent on each transaction confirmed through MRPA B in April 2019.

Confirming banks found BII's MRPAs to be user-friendly and operationally superior to those provided by other DFIs, mainly due to BII's flexibility in adjusting the scope of their risk-sharing agreements. Internal monitoring data shows that confirming banks were able to increase their trade finance confirmations, in part due to the adjustments made by BII. For instance, under MRPA B, the inclusion of a funded participation and an increase in BII's risk-share in early 2019 coincided with a sharp increase in the total value of trade confirmations under the MRPA and BII's risk exposure, as shown in **Figure 9**. Confirming banks also highlighted that BII was more responsive to their requests and exhibited faster turnaround times for term extension requests compared to other DFIs. Notably, one of the interviewed confirming banks stated that BII was able to address term extension requests within a few hours, whereas other DFIs typically take several weeks to handle such requests.

On the other hand, while BII's MRPAs have enabled confirming banks to increase their funding of trade transactions, the overall impact on trade flows of the targeted countries appears to be limited. This reflects the fact that, as noted earlier, BII's trade finance support constitutes a small proportion of total trade value (i.e. imports and exports) in target countries. It is therefore unlikely that BII's facilitation will markedly impact the trade financing gaps experienced by target countries. While BII's trade facilitation would need to increase significantly to meet demand for confirmed transactions, as explained in Section 2.2, expansion of available trade finance would not address the binding constraint facing importers in target countries due to lack of access to foreign exchange.

84 Funded participation refers to risk participation whereby BII provides the confirming bank with funds based on the risk-sharing arrangement should clients of issuing banks be unable to fulfil their trade finance obligations.

Table 3: Findings and lessons learnt from the changes experienced by confirming banks

<table>
<tr><td rowspan="3">QUESTION 1:
What are the benefits and impacts of trade finance on confirming financial institutions?</td><td>Finding 1.1: BII's trade finance programme allows confirming banks to expand their trade finance offerings in countries where they have reached the ceiling for their exposure. With BII's TSCF programme designed to assume 50 per cent or more of the confirming banks' exposure on each approved trade finance transaction, the evaluation found that BII's MRPAs enabled FIs to confirm an increasing number of trade finance transactions.

Lesson 1.1: Risk-sharing agreements result in the expansion of trade finance limits in geographies supported by DFIs in the MRPA agreement(s). Confirming banks operate with limits on their trade finance exposure to clients in specific countries or regions. These limits are put in place to manage their risk exposure. When a DFI such as BII guarantees part of this exposure, the confirming bank can increase its trade finance limits, and thus support an increasing number of trade transactions.</td></tr>
<tr><td>Finding 1.2: Confirming banks reported an increase in trade finance confirmations coinciding with the improvements in the support provided by BII's MRPAs. BII made several adjustments to the two MRPAs to accommodate the growing demand for trade finance and to better meet the needs of confirming banks. The support was in the form of increasing the size of the facility, increasing the risk-sharing ratio and the inclusion of a funded guarantee.

Lesson 1.2: Increasing the size of the facility and the extent of risk-sharing as well as the introduction of funded agreements all work to reduce the risk exposure of confirming banks. The ability of a DFI to be agile and responsive to the needs of confirming banks is crucial to accommodate changes in the demand for trade finance facilitation.</td></tr>
<tr><td>Finding 1.3: BII's MRPAs enabled confirming banks to overcome challenges associated with entering markets that would otherwise be difficult to serve. Confirming banks noted they have been able to reach 'riskier' countries due to their risk-sharing agreements with BII as they provide an additional layer of risk mitigation by reducing the risk exposure borne by confirming banks.

Lesson 1.3: By partnering with confirming banks, DFIs can encourage confirming banks to support the development objectives of DFIs in their target countries (which are mainly low-income countries). As a result of the DFIs' engagement, confirming banks have been able to increase their funding of trade flows in fragile and risky countries.</td></tr>
</table>

2.2 Issuing banks

BII's MRPAs increase the ability of issuing banks to access trade finance confirmations in countries that are perceived as risky due to their low sovereign credit rating. The majority of the issuing banks utilising the two MRPAs analysed by this study have low credit ratings (reflecting the credit ratings of their respective sovereigns): in 2022, 52 per cent of BII's trade finance participation under MRPA A supported issuing banks with a Moody's credit rating of B1, and under MRPA B, 61 per cent of BII's risk exposure was with B2 rated issuing banks.[85] Similarly, on the Standard and Poor's credit rating scale, the majority of the issuing banks under MRPA A are labelled speculative with a credit rating of b- making up 49 per cent of BII's risk exposure and 77 per cent under MRPA B.[86] Confirming banks generally consider issuing banks operating in these countries to be too vulnerable to adverse business, financial, and economic conditions. Under other circumstances, these issuing banks would struggle to acquire confirmations due to risk limits imposed by confirming banks.

Within these countries with lower credit ratings, BII's trade finance support primarily reaches commercial banks that serve larger enterprises. Across the five countries included in the analysis (Bangladesh, Kenya, Mozambique, Nigeria, and Pakistan), all the issuing banks interviewed are leading banks in their respective countries, usually with long-standing relationships (over 5 years) with confirming banks. These issuing banks have access to multiple confirming lines with different confirming banks available to them as they are large and well-capitalised and can thus generally choose to channel trade transactions to alternative confirming banks. In addition, these issuing banks tend to favour operating with "blue-chip", larger enterprises, whereas smaller banks and microfinance institutions tend to service a wider clientele of SME businesses. In general, to fulfil their trade finance demands of their clients, issuing banks need to have access to multiple confirming lines. This need arises due to the rating of the issuing banks. Rather than reflect the creditworthiness of the issuing banks, the limits imposed by the confirming banks are constrained by the sovereign rating of the country where the issuing bank has its operations.

In interviews, issuing banks stated that access to multiple confirmation lines from regional and international banks has allowed them to increase the volume and value of their trade finance portfolio. Therefore, while it is possible that BII's risk-sharing agreements had a positive influence on the issuing banks' capacity to confirm their customers' transactions, it was not possible to definitively attribute this increase to the risk-sharing facilities provided by BII or other DFIs. One factor compromising the impact of trade facilitation by BII and other DFIs is that trade finance is hampered due to lack of availability of foreign exchange, see further discussion in Section 3 below.

While interviewed issuing banks noted an increase in their trade finance transactions, this may have come about at the expense of trade transactions of other, perhaps smaller, domestic banks who do not have access to the facilitation provided by DFIs. This can occur when banks compete to provide their customers with LCs, but the availability of foreign exchange is constrained, which prevents the value of trade finance in the market as a whole from growing. Interviews with banks and importers in all five countries suggested that limited availability of foreign exchange rather than access to trade confirmations is the binding constraint to expansion of trade finance, i.e. the countries' inability to generate income in foreign currency limits their ability to finance larger trade volumes.

It is important to note that BII's MRPAs do not intend to influence the dynamic between issuing banks and their clients (i.e. pricing and tenor of trade finance products, risk appetite etc.). Due to the nature and structure of MRPAs, BII can only have direct effect on confirming banks, but cannot influence the pricing or structure of trade finance products offered by issuing banks as well as the type of customers receiving trade finance products. Below is a discussion on the challenges faced by interviewed issuing banks which use confirmations lines (BII's MRPA 'A' and 'B') from BII's confirming banks to service their clients.

The structure of MRPAs is such that BII does not influence issuing banks to increase their risk appetite, or to increase their willingness to service new customer segments in need of trade finance support. Consistent with the findings of the AfDB, interviews with issuing banks revealed that confirmations were primarily concentrated among repeat customers in all analysed countries.[87] The majority of approved trade confirmations belonged to

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85 Moody's. (2021). Rating Scale and Definition. | BII. (2022). Internal database.
86 BII. (2022). Internal database.
87 AfDB. (2017). Trade Finance in Africa: Overcoming Challenges.

customers with whom issuing banks had established long-term relationships (at least 2 years). This observation may be symptomatic of the constrained FX liquidity environment in which issuing banks operate, with banks preferring to serve long term clients with whom they have a track record to reduce their risk.

Administering trade finance to new customers is costly. Interviews revealed that engaging with repeat customers benefits issuing banks by reducing administrative work and due diligence costs. For instance, interviewed issuing banks in Kenya stated that dealing with repeat customers has enabled them to maintain a rejection rate on letters of credit of less than 1 per cent on average. However, this practice limits the ability of new, often smaller enterprises, to access trade finance, as they are unable to get their transactions approved and build a track record.

Across all countries analysed, MRPAs primarily targeted the risk appetite of confirming banks rather than the fee structures of trade finance products charged by issuing banks to their clients. Interviews conducted with importers and exporters revealed that the interest rates charged by different issuing banks on trade finance confirmations are quite similar within the industry (see further discussion in Section 3), suggesting that the market for trade finance products is highly competitive. This makes it difficult to discern the impact of BII's facilitation on the cost of financing of trade transactions.

Emerging countries generally experience higher confirmation costs compared to developed countries' banks. In Kenya, interviewed issuing banks stated that high confirmation fees charged by confirming banks impact product pricing. A study by the World Trade Organisation (WTO), found that the cost of an LC is significantly higher in emerging markets, with an average of 2 per cent of the transaction value, compared to between 0.25 per cent and 0.50 per cent in advanced countries.[88] Therefore, despite the availability of confirming lines, issuing banks and their customers in developing countries often need to absorb high confirmation fees. It is also worth noting that the institutional infrastructure in emerging markets is generally weaker (with less developed property registration and foreclosure procedures), and more macroeconomic volatility relative to developed markets. These factors increase the risk associated with operating in these markets and are reflected in the fees required by confirming banks.

Similarly, high fees were identified as an issue in Pakistan limiting the willingness of importers and exporters to engage in trade finance. Issuing banks attributed the high fees charged on confirmations to prevailing macroeconomic conditions in emerging markets. In early 2023, Pakistan's credit rating was downgraded to Caa3 (indicating poor quality and very high credit risk) by Moody's rating agency, primarily due to increased default risk on foreign debt. [89] According to interviewed issuing banks in Pakistan, this downgrade led to a significant increase in fees they were charged by confirming banks.

The tenor offered by issuing banks on LCs to their clients is determined by the risk assessment of confirming banks. Interviewed issuing banks in Bangladesh explained that macroeconomic challenges have made it difficult for them to secure longer term tenors on LCs. Bangladesh experienced foreign currency shortages due to higher prices on imported fuel and food as a result of Russia's invasion of Ukraine.[90] As a result, confirming banks were reluctant to provide confirmations with longer-term tenors. Monitoring data provided by BII confirms that the proportion of BII's participation in transactions with a tenor longer than 180 days in Bangladesh fell to 38 per cent in February 2023 from 58 per cent prior to January 2022. This reduction in tenors reflects the risk that issuing banks perceive of not being able to access the FX which is required when the importer has to settle on the letter of credit.

More broadly, limited availability of FX is a pervasive issue across the countries of analysis. Scarcity of FX constrains the ability of issuing banks to confirm transactions. Across Africa, access to trade finance is exacerbated by shortage of foreign exchange.[91] Discussions with issuing banks and importers revealed that FX shortages in Nigeria and Mozambique were critical barriers preventing issuing banks from providing trade finance to their clients. Similarly, recently FX shortages in Pakistan and Bangladesh have exacerbated the challenges faced by

88 WTO., IFC. (2022). Trade Finance in West Africa.

89 Moody's investor's service. (2023). Moody's downgrades Pakistan's rating to Caa3; changes outlook to stable from negative.

90 Paul, R. (2023). Bangladesh struggling to pay for fuel due to dollar shortage, letters show. Reuters

91 Li, G. (2020). Contemporary Issues in African Trade and Trade Finance. Afreximbank.

issuing banks in making trade finance available to importers.[92] During interviews with issuing banks in Bangladesh, Mozambique, Nigeria and Pakistan, it transpired that confirming banks were unable to maintain their exposure in terms of confirming LCs, due to uncertainty regarding the ability of issuing banks to fulfil their obligations to satisfy trade finance transactions given the limited availability of FX.

Box 9: Key factors causing FX shortages in the countries of analysis

Interviews with issuing banks, and importers and exporters in Bangladesh, Nigeria, Mozambique, and Pakistan highlighted that the shortage of FX, among other factors, is a key barrier affecting the ability of importers to finance their trade transactions using letters of credit. Some of the key reasons for FX shortages in these countries include:

Mozambique: FX shortages have been a common occurrence in the country over the past few years, influenced by political crisis, the insurgence of terrorism, and fewer buyers of hydrocarbons.

Pakistan and Bangladesh: FX issues are not a common occurrence, when compared to the rest of the countries of analysis. FX shortages recorded in 2023 have been, among other factors, a result of specific issues such as political instability, rising global interest rates, and floods weighing down economic performance.

Nigeria: FX shortages are a common occurrence in the country, however often cyclical, due to the factors affecting the macroenvironment. For instance, the devaluation of Naira in 2023 has exacerbated the situation, making it difficult for importers to make FX payments for their imports.

Kenya: Although Kenya experienced FX shortages in 2023, interviewed issuing banks in Kenya did not highlight this as a major concern.

Consequently, the overall ability of importers to finance trade transactions using LCs has been constrained by a shortage of FX. In Bangladesh, import growth declined during the first half of 2023 due to various measures adopted by the Central Bank of Bangladesh to ration access to foreign exchange, such as limiting commercial banks' access to issuing LCs.[93] Similarly due to import controls and the rationing of LCs, Pakistan experienced an 18 per cent decline in imports during the same period.[94] In key sub-Saharan Africa economies, including Kenya, Mozambique and Nigeria, persistent US dollar shortages have resulted in liquidity challenges, negatively impacting trade finance and growth in overall economic activity.[95]

Due to pressures on their exchange reserves, central banks in Bangladesh, Nigeria, Mozambique, and Pakistan have placed direct restrictions on importers' access to FX, in effect limiting the availability of LCs that issuing banks are able to confirm. In an effort to limit demand for FX, central banks in these countries excluded specific commodities entirely from being eligible for FX, while in Mozambique, FX is unavailable for 'non-priority' goods (that is, non-fuel products). Thus, the introduction of BII's Fossil Fuel Policy has put a dampener on the usage of BII's trade finance program, which is likely to be underutilised in countries such as Mozambique.

92 Messenger, J. (2023). Pakistan faces ongoing commodity shortages as dollar crisis and lack of LCs take effect. Global Trade Review. | World Bank. (2023). Bangladesh Development Update - Trade Reform: An Urgent Agenda.

93 World Bank. (2023). Bangladesh Development Update - Trade Reform: An Urgent Agenda.

94 World Bank. (2023). Pakistan Development Update - Recent Economic Developments, Outlook, and Risks.

95 Li, G. (2020). Contemporary Issues in African Trade and Trade Finance. Afreximbank. | Strobel, A. (2022). Foreign exchange shortages could prompt further debt restructuring trends in SSA. S&P Global Market Intelligence. | Business A.M Live. (2023). How sub-Saharan Africa can scale trade finance amid hard currency challenges.

MRPAs are not designed to influence the terms of trade finance offered to importers and exporters. Interviewed issuing banks noted that their clients would benefit from lower confirmations fees and longer tenors. Here, other DFIs, such as the IFC, have directly partnered with issuing banks to enhance the trade finance capabilities of issuing banks more directly and thereby support the import of essential goods and equipment.[96] One of the interviewed issuing banks noted that through this direct engagement, the bank has been able to access longer term LCs (for up to 37 months) at relatively low fees. Banks interviewed in South Asia also noted that confirmations performed directly with ADB had lower confirmation fees compared to confirmations with global and regional confirming banks. Another benefit from such direct engagement is that guarantees can target trade finance transactions of those FIs that service SMEs, given that SMEs generally struggle to access trade finance.

BII utilises other trade finance instruments to influence issuing banks, and consequently provide more favourable trade finance terms to importers and exporters. Were BII to engage directly with issuing banks, this would entail significant regulatory and operational challenges, not least in assessing and monitoring the creditworthiness of individual banks in less developed markets. This lies beyond BII's capacity and is reflected in BII not being a confirming bank operating on SWIFT. This precludes BII from providing confirmation lines directly to issuing banks through MRPAs. BII directly provides trade loans to issuing banks, as well as supply chain finance to businesses to boost their international trade activity. While an assessment of the impact of these products on issuing banks, and importers and exporters is beyond the scope of this study, the magnitude of BII's investment in trade loans and supply chain finance support remains relatively small – making up 6 per cent of BII's TSCF programme between January 2015 and September 2023.

While increased direct engagement with local issuing banks would lead to greater development impact, this does require DFIs to assume greater credit risk. Currently BII partners with confirming banks to take credit risk on issuing banks. While dealing to a greater extent with issuing banks directly (e.g. through the provision of trade loans) would require BII to evaluate the credit risks of each issuing bank and closely monitor such exposures, the benefits to importers and exporters would likely be substantial compared to the current approach.

96 IFC. (2022). IFC Boosts Trade Finance for Pakistan's Bank AL Habib Limited to Support Imports of Capital Goods.

Table 4: Findings and lessons learnt from the changes experienced by issuing banks

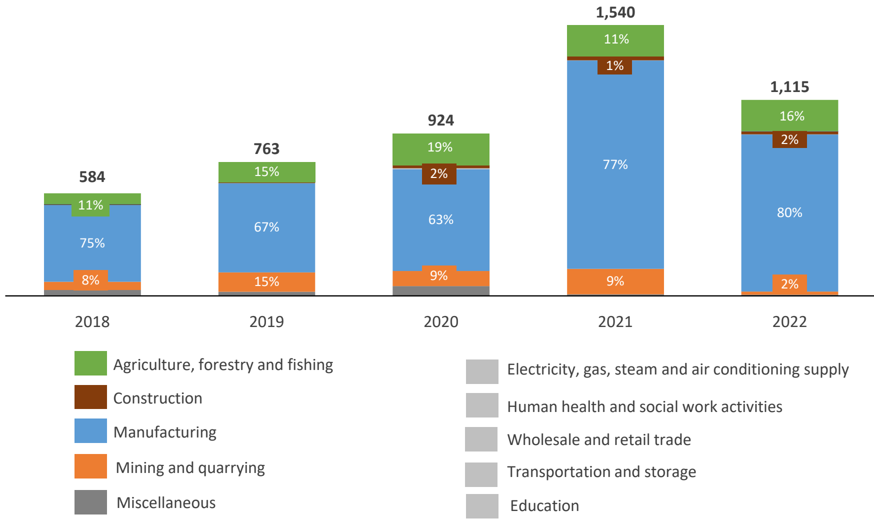
QUESTION 2: What types of issuing banks are BII's risk-sharing facilities being extended to, and how has BII's risk-sharing facility affected these banks' risk appetite, their ability to extend trade finance to the market, and serve new client segments?	**Finding 2.1:** BII's focus countries for trade finance support are composed mainly of economies facing challenging macroeconomic environments, such as those in Africa and South Asia, and thus have poor credit ratings. Most of the issuing banks utilising the two MRPAs have low credit ratings (reflecting the credit ratings of their respective sovereigns). Confirming banks generally consider these banks high risk, and therefore under other circumstances, these issuing banks would struggle to acquire confirmations due to risk limits imposed by confirming banks. **Lesson 2.1:** DFI's risk-sharing agreements can play a crucial role in enabling issuing banks that operate in challenging environments to secure trade finance confirmations. In sharing risk with confirming banks DFIs increase lines offered to issuing banks in countries with poor credit ratings.
	Finding 2.2: Limited availability of FX is a pervasive issue across the markets of analysis and limits the ability of issuing banks to confirm transactions. Central banks in analysed countries ration the availability of FX, restricting the total value of LCs confirmations. While BII's MRPAs are supportive of the volume of trade finance serviced by issuing banks, expansion in the overall market for trade finance is impeded by limited availability of FX. **Lesson 2.2:** While trade facilitation addresses the challenges faced by confirming banks in servicing more challenging markets, it cannot address the underlying causes of FX shortages which hamper growth in trade in less developed markets. Shortage of FX limits the provision of trade finance, as trade finance instruments such as LCs are typically invoiced in dollars. While addressing FX challenges is key to enable trade growth, the responsibility for resolving this dilemma lies predominantly with reform of macroeconomic policies as administered by the authorities in target countries.
	Finding 2.3: Benefits derived by issuing banks and consequently importers and exporters are compromised by the relatively long value chain in providing trade finance associated with MRPAs. Using MRPAs, BII supports the provision of trade finance by partially guaranteeing the exposures of confirming banks. While this guarantee increases the willingness of confirming banks to finance LCs in developing countries, the circumstance by which BII interacts with confirming banks rather than the issuing banks themselves curtails BII's ability to positively influence the clients being serviced (e.g. greater focus on SMEs) by issuing banks and the terms of trade finance products (e.g. lower confirmation fees, longer-term tenors) to the benefit of importers and exporters. Rather than interacting directly with issuing banks using the MRPA instrument, BII offers trade loans directly to issuing banks, and supply chain finance to businesses. These instruments allow BII to directly influence the pricing, tenor and targeting (e.g., to SMEs) of trade finance products. Nonetheless, trade loans to issuing banks and supply chain finance to business made up only 6 per cent of BII's exposure under the TSCF programme between January 2015 and September 2023. **Lesson 2.3:** DFIs could consider increasing trade finance support through direct engagement with issuing banks to deepen the impact and broaden the reach of trade finance support. While requiring BII to assess and monitor the credit risk of issuing banks, direct involvement with issuing banks would facilitate the provision of trade finance to new customer segments and encourage issuing banks to offer more affordable confirmation fees and longer tenors to importers and exporters.

3. Outcomes at importer and exporter level

3.1 Who are the users of trade finance products?

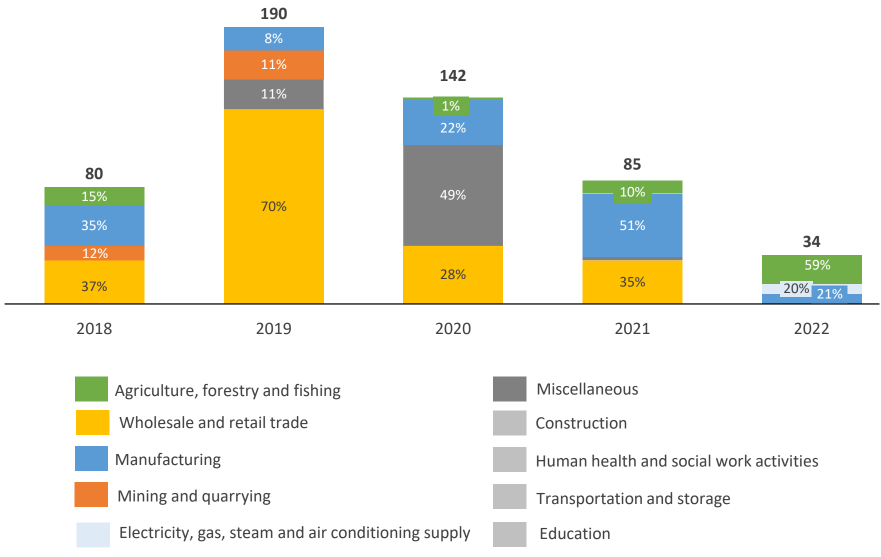
The importers and exporters acquiring trade finance products from issuing banks receiving confirmations through the two MRPAs considered in this study are mostly larger businesses. Under MRPA A, the businesses using trade finance products supported by BII predominantly operate in the manufacturing and agriculture sectors, as illustrated in Figure 10. Under MRPA B, businesses predominantly operate across the wholesale and retail trade sectors and the manufacturing sector.

Figure 10: The total value of BII's trade finance risk exposure under MRPA A, split by sector (USD million, % share of total value, 2018–2022)[97]



Source: BII's Internal Database

Figure 11: The total value of BII's trade finance risk exposure under MRPA B, split by sector (USD million, % share of total value, 2018–2022)[98]



Source: BII's Internal Database.

Note: The sharp increase in the share of BII's exposure in the electricity and gas industry noted in 2022 depicts a once-off rise in the number of approved trade finance transactions for the supply of electricity to Ghana.

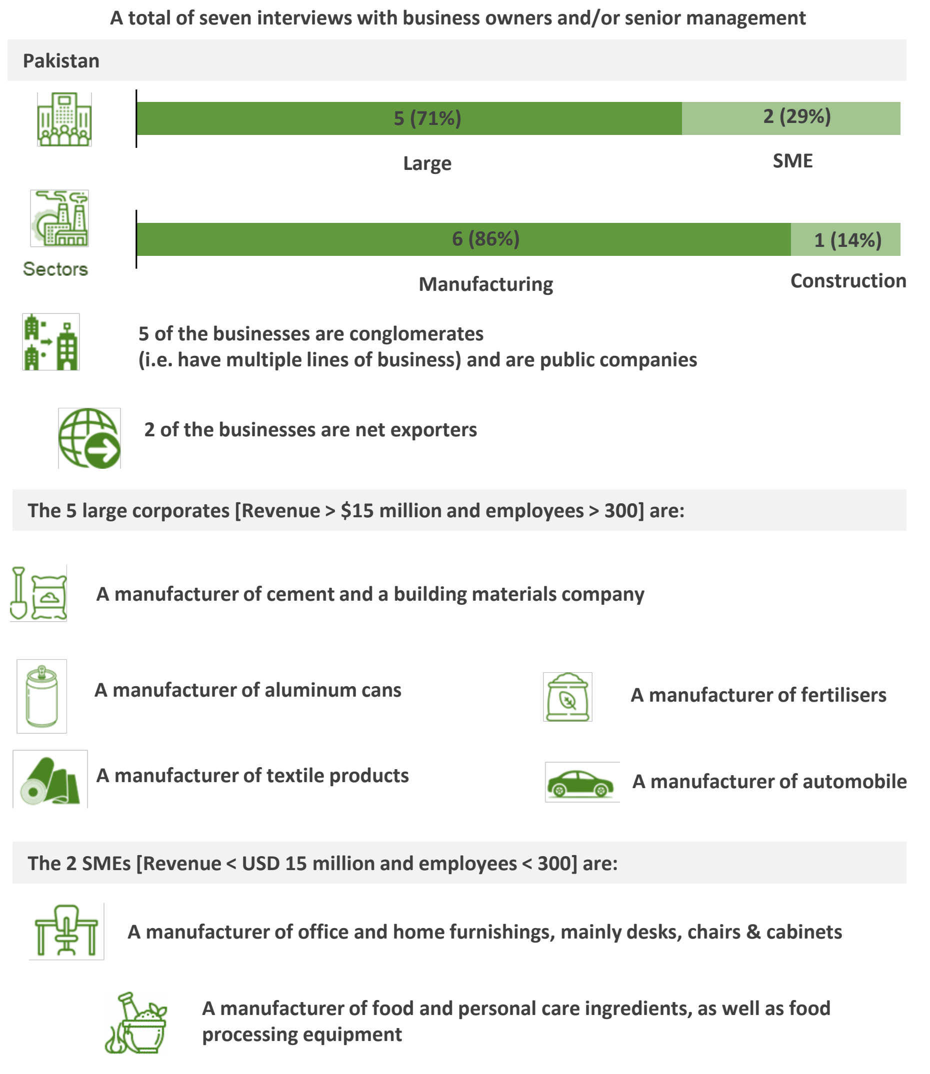
97 BII. (2023). Internal monitoring data

98 Ibid.

Despite the need for trade finance being greater among smaller businesses, access to trade finance remains concentrated in large businesses. Interviews with issuing banks in the sample highlighted that, using IFC's business size classification, large corporates constitute the largest share of their clientele base.[99] These businesses typically generate annual revenue exceeding $15 million and employ over 300 individuals. This highlights the need for more targeted trade finance instruments benefiting SMEs (see Section 3.3).

The following provides an overview of the qualitative research conducted with businesses utilising trade finance products from issuing banks that receive facilitation from confirming banks through risk-sharing agreements with BII. While interviews undertaken spanned four countries – Pakistan (7), Nigeria (5), Mozambique (5) and Kenya (1) – the results reported below focus on the case of Pakistan, as the insights derived from this specific set of interviews offer valuable heterogeneity, shedding light on diverse perspectives within this context.

Figure 12: Case Studies in Pakistan: Profile of the interviewed importers and exporters using trade finance in Pakistan[100]



Source: Interviews with importers and exporters in Pakistan.

The interviewed businesses have access to trade finance products offered by various leading commercial banks.

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99 According to IFC, an enterprise qualifies as a large corporation if it meets two out of three following criteria of the IFC MSME definition: employs more than 300 individuals; have total assets or annual total revenue of more than $15 million.

100 Note: the sample is selective and cannot be regarded as representative, as few clients of issuing banks using trade finance made themselves available to be interviewed. Therefore, it is possible that if a different group of clients (i.e. importers and exporters) were to be interviewed, the results could differ from those presented here. However, the outcomes of the interviews conducted in Pakistan were representative of the interviews conducted in other countries, suggesting the findings were meaningful.

Larger businesses, and those which are subsidiaries of corporate groups, have access to trade finance facilities from an average of 5-10 commercial banks, including banks that have received confirmation through the analysed MRPAs. The SME businesses interviewed consisted of private limited companies and partnerships employing fewer than 200 individuals and are primarily net importers with limited exporting activities.

3.2 What is the nature of the trade finance landscape for interviewed businesses?

Overall, larger businesses interviewed did not find it difficult to access trade finance, except during periods of FX shortages. During interviews with issuing banks and importers and exporters, it was observed that the majority of the clients are large corporations and some conglomerates operating across multiple business lines. Such large corporations have access to multiple confirmation lines offered by leading commercial banks in the concerned countries. For instance, in Pakistan, businesses with access to trade finance indicated that they had not faced significant challenges in accessing trade finance. This is because due to the size of their businesses they were able to establish relationships with five to ten leading commercial banks. Ideally, access to multiple trade finance lines enables businesses to have access to multiple banks when there is a FX shortage, as well as to work with multiple banks when one or more banks have exhausted their confirming lines with specific confirming banks. However, where there is foreign exchange scarcity, access to trade finance is significantly curtailed as issuing banks lack the foreign exchange required to close out trade finance instruments. In these circumstances central banks may also intervene directly by imposing limits on the total value of trade finance confirmations that can be approved. Thus, due to scarce availability of foreign exchange, businesses highlighted that unmet demand for trade finance has recently become a more pressing issue.

Large corporations have the advantage of negotiating favourable terms in trade finance. Large corporates interviewed in Pakistan reported that they were able to benefit from lower confirmation fees on their LCs than the market average, as they are considered low risk borrowers by banks due to the size of their businesses and the strength of their balance sheets. Therefore, while the trade finance market in Pakistan is competitive (meaning that there are multiple banks offering trade finance products), the cost of using these products varies significantly according to the size of the entity seeking to access them. Earlier studies have also noted that large corporations often face lower fees to access trade finance compared to small businesses.[101]

SMEs face costs for trade finance products that are almost twice as high as those charged to larger firms.[102] Secondary research, combined with interviews with SMEs, revealed that smaller businesses in the analysed countries typically encounter higher costs when accessing trade finance than large corporations. This is primarily because of the perceived high risks associated with the limited size of their business. Therefore, stringent collateral requirements are imposed by lenders, which SMEs find difficult to comply with. For most trade transactions, banks in Bangladesh, Kenya, Nigeria, Mozambique and Pakistan require importers to provide collateral exceeding 100 per cent of the transaction value, thereby restricting access to trade finance to those without the required collateral.[103] Although merchandise being imported normally provides adequate collateral in financing of international trade, banks often request additional collateral, particularly in the case of smaller enterprises, due to uncertainty regarding the enforcement of creditor rights, e.g., the banks' ability to seize and resell merchandise. This contributes to the difficulties encountered by small businesses in acquiring trade finance, as they generally struggle to provide sufficient collateral.[104]

101 WTO. (2022). Trade Finance in West Africa.
102 Ibid.
103 Stakeholder engagements. (2023). Interviews with issuing banks
104 Ibid.

Small businesses in Pakistan stated in interviews that having a direct contractual agreement with the seller (exporter) was less costly, and thus a preferred channel to facilitate trade compared to trade finance products. According to the small businesses interviewed, bilateral contractual agreements with the exporter typically incur a fee of 0.1 per cent of the total contract value, while banks charge approximately 0.4 per cent for LCs. However, under these contractual agreements, the FX risk (i.e., securing FX to pay the exporter) remains with the importer unlike under an LC. Due to difficulties in accessing the required FX, one SME importing business in Pakistan confirmed having substituted contractual agreements with LCs, as LCs provide assurance that the exporter will receive payment for the goods shipped at the exchange rate at the time of the initiation of the placement of the import order, when the LC was initiated.

Furthermore, small businesses prefer to use other sources of working capital to finance their imports, as opposed to acquiring trade finance products from banks. Similar to the AfDB study, findings of this study confirm that SMEs choose not to apply for trade finance due to the factors mentioned above, even though they need it.[105] Furthermore, to some extent low uptake of trade finance facilities by SMEs may be attributable to SMEs operating informally due to the associated advantages (such as tax evasion). Unregistered SMEs are often unbanked, and therefore are unable to access trade finance products. An estimated 91.3 per cent of SMEs in Pakistan operate as sole proprietorships and are not registered.[106] These businesses are unable to access trade finance products due to their informal status. At the same time, it is important to note that these businesses are also unlikely to engage in cross-border trade, and thus have little demand for trade finance. BII's TSCF programme aims to improve access to trade finance for businesses engaging in cross-border trade through formal financial institutions.

FX shortages appear to be a barrier to accessing trade finance, regardless of the size of the business. Despite having access to trade finance from multiple banks, large corporations stated that they find it difficult to meet their needs for trade finance due to ongoing FX issues in their respective countries. On average, they were only able to obtain confirmations for approximately 75 per cent of the total value of their trade needs. This is despite using multiple trade finance lines from various issuing banks. In the case of SMEs, such FX shortages are likely to be more acute, layered on top of other factors that severely limit their access to finance (as outlined above). Interviews with net importing large businesses in Pakistan highlighted their challenges in maintaining their production due to FX shortages.

In recent years, BII has taken a different approach to its TSCF investments, aimed at targeting SMEs through its trade finance programme. As noted above, BII's MRPAs have managed to provide liquidity to large and creditworthy corporations who are repeat clients with a track record of several years with issuing banks. Responding to the SME financing gap, BII places reliance on its trade loan product which provides liquidity to banks to be utilised in funding small businesses access to trade finance. In 2022, BII also introduced the Trade Access programme to provide trade finance to small businesses. The impact of BII's Trade Access programme, summarised in **Box 10**, in reaching SMEs is the topic of another in-depth study.

Box 10: BII SME trade finance support

SMEs in Africa are unable to access trade finance at an appropriate scale or volume. In Africa, only 28 per cent of the banks' total trade finance portfolios support SMEs.[107] Due to the limited appetite of traditional banking channels to provide credit to small businesses across Africa, the trade finance market is largely characterised by unmet demand for trade finance among SMEs. The COVID-19 pandemic brought about a further reduction in SMEs' access to trade finance, further hindering the growth prospects of these businesses.

To address the trade finance gap faced by SMEs in Africa, BII launched the Trade Access programme in 2022.[108] BII initially invested $25 million via a managed account with an investment manager and further increased its

105 AfDB. (2023). SMEs' Demand for Trade Finance in Africa: The Case of Kenya and Tanzania.
106 Daily Times. (2021). State of SMEs in Pakistan.
107 ADB. (2017). Trade Finance in Africa Survey Report.
108 BII. (2023). British International Investment and INOKS Capital announce first-of-its-kind Africa-focused trade access programme. | BII, (2023). Ancile Trade Access Program Sub-Fund.

commitment by an additional $25 million to support trade volumes in ensuring food security. The programme sought to increase the volume of SME trade finance in Africa by up to $40 million per year, with a view to support economic opportunities (creating jobs and increasing revenue) of approximately 75 SMEs over the period of the investment.

The programme allows BII to partner with alternative trade financiers to provide working capital and trade loans to SMEs directly. BII's target partners for trade access are fintechs & tradetechs, trade finance funds, non-bank financial institutions (NBFIs), merchant banks, and advisors. The programme has underlying transaction ticket sizes ranging from $250 to $500,000, and a wide range of underlying products with a maximum tenor of 12 months. Given that the programme was launched recently, it is too early to assess the impact of the programme on SMEs. However, by directly dealing with FIs that provide trade finance to importers and exporters (i.e. removing one layer in the trade finance value chain compared to when trade finance support is provided through an MRPA with confirming banks), it is expected that the impact of BII's intervention will be better targeted and more significant. This is because BII is able to reach the target market – SMEs – more readily by working with FIs that specifically finance SMEs.

3.3 What has been the impact of trade finance support on importers and exporters

In line with its objective, the TSCF programme improved the ability of importing businesses to access trade finance. Interviews conducted with businesses in Pakistan highlighted that access to LCs allows businesses to fund imports of raw materials of a superior quality and at lower price than those otherwise available on local markets, thereby increasing these businesses' competitiveness. These cost and quality advantages have effectively lowered production costs and led to increased profitability.

Accessing trade finance enables importers to free up working capital. By utilising LCs, importers can defer immediate payment for goods, particularly raw materials. This provides importers with working capital. This benefit is particularly relevant for smaller businesses, as they often have limited access to short-term financing, so access to trade finance has a significant impact on their working capital. On the other hand, large corporations, typically have better access to various sources of internal and external financing. As a result, they may not face the same challenges in accessing adequate working capital or managing cash flow.

Interviews also revealed that the benefits of trade finance in terms of freeing up working capital are hindered by the limited availability of longer tenors trade finance products. For instance, a small business owner in Kenya highlighted that due to the short-term tenors (less than 90 days) of LCs, the business often needs to fulfil its financial obligations to the exporter before the revenue cycle is complete, limiting the extent to which trade finance alleviates the working capital constraints faced by the business. It is worth noting that BII has recently signed an MRPA with ADB to offer up to 3-year tenors for goods that qualify as Green/Climate finance.[109] The BII-ADB partnership offers long term (>360 days) trade finance products to businesses with the aim of unlocking the trade of green goods needed to support Asia's sustainability goals.

While trade finance is not a source of longer-term working capital, other sources of working capital finance such as value chain finance or factoring, possibly organised on factoring platforms, could be beneficial to importing SME businesses that struggle to finance their working capital.[110] DFIs in Latin America, such as NAFIN (Nacional Financiera) in Mexico and Corporación Financiera de Desarrollo (COFIDE) in Peru, have had success in sponsoring the establishment of factoring platforms. Similarly, Corporación Financiera de Desarrollo (Cofina) in West Africa has demonstrated how securitisation of receivables can be used as a method for lessening working capital constraints faced by SMEs.

109 BII. (2024). BII and ADB Trade and Supply Chain Finance Program sign $100m risk-sharing agreement to promote green trade in Asia.

110 Factoring platforms allow small businesses to acquire cash advances based off their invoices (i.e. after delivering a product or service to its client, the small business is able to use the invoice provided by the purchaser for payment normally in 90 or 180 days as security for a loan). The factoring company pays the business immediately, using the invoice as collateral taking the risk on the larger enterprise purchasing from the small business. This is beneficial for SMEs, as factoring benefits their working capital and relieves them of having to meet collateral requirements otherwise required by commercial banks.

Table 5: **Findings and lessons learnt**

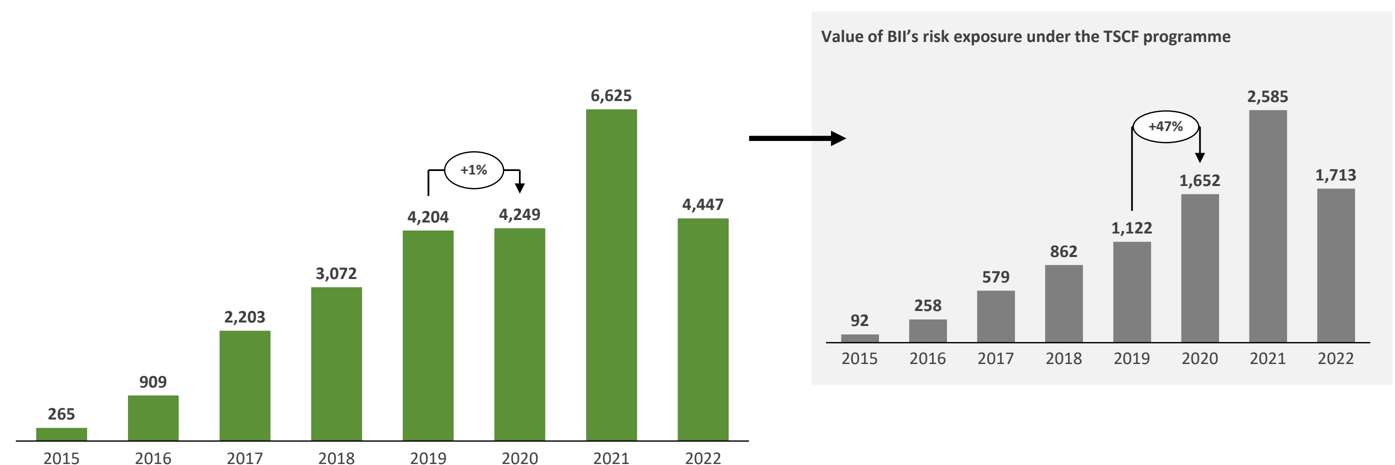
QUESTION 3: What type of businesses are being reached by issuing banks, what is their composition, what products do they offer, what are the sectors they operate in, and what is their financial performance?	**Finding 3.1:** Interviewed businesses utilising trade finance products are mainly large corporations, employing a large number of individuals that have access to trade finance from multiple banks. Interviews with issuing banks highlighted that trade finance remains concentrated among large businesses (employ over 300 individuals and earning revenue above $15 million). These businesses are often repeat customers of issuing banks, with multiple confirmation lines with various issuing banks in their country of operations. New businesses, often smaller enterprises, are less likely to be able to access trade finance. **Lesson 3.1:** DFI trade finance facilitation could more directly support SME clients of issuing banks. BII provides both trade loans to banks and directly to international commodity traders to support their import activity. While an evaluation of these products lies outside the scope of this study, their size remains relatively small (6 per cent of BII's exposure under the TSCF programme) compared to the guarantee coverage provided by the MRPAs. Therefore, DFIs should increase trade finance loans targeting SMEs.
QUESTION 4: To what extent has BII's risk-sharing facilities impacted the trade finance value chain and users of trade finance (importers/exporters)?	**Finding 4.1:** FX shortages have a negative impact on businesses' ability to access trade finance especially for net importing businesses and SMEs. Due to FX liquidity shortages in the analysed countries, trade finance needs of most businesses, especially SMEs and net importers, remain unmet. **Lesson 4.1:** A concerted effort by country authorities would be required to address the macroeconomic imbalances that give rise to foreign exchange shortages, including measures designed to (a) enhance the competitiveness of traded goods and services; (b) contain domestic demand for imported goods and services by managing fiscal expenditures; and (c) reduce reliance on foreign borrowing given that repayment of foreign currency loans absorbs scarce foreign currency. Although important in creating greater balance on the foreign exchange market, discussion of such measures lies beyond the scope of the current study.
	Finding 4.2: SMEs choose to not apply for trade finance, even though they need it. Small businesses face costs for trade finance products that are almost twice as high as those faced by larger firms. This is primarily due to perceived high risk of SME businesses. Therefore, issuing banks impose stringent collateral requirements, which SMEs find difficult to comply with. BII's MRPAs are not intended to influence the terms and conditions of trade finance offered by issuing banks, including the amount of collateral required or confirmation fees charged. In reaching out to SMEs under the TSCF programme, BII provides targeted trade finance support in the form of trade loans and supply chain finance. While an evaluation of the impact of these products lies beyond the scope of this study, their utilisation remains quite limited. **Lesson 4.2:** To have a positive impact in reducing the SME trade financing gap, DFIs should explore introducing innovative SME-targeted trade finance products which are affordable and have lower collateral requirements. DFIs can play a crucial role in providing financial products such as value chain finance or supporting the establishment of factoring platforms. An alternative approach being tested by BII is the Trade Access programme which uses digital assessment/scoring methodologies to facilitate SME access to short-term working capital loans.

4. Changes experienced during crises

As a result of the COVID-19 pandemic, the decline in international trade volumes in 2020 was among the largest since World War II.[111] Moreover, sovereign credit downgrades further exacerbated the pressure on trade finance availability in emerging markets. Between January 2020 and March 2021, three of the biggest credit rating agencies (S&P Global Ratings, Moody's Investors Service, and Fitch Ratings) issued a total of 99 sovereign rating downgrades on 48 countries, including several countries where banks utilising BII's TSCF programme were confirming trade finance transactions.[112] International banks responded to these actions by limiting their risk exposure in these countries. The African Trade Finance Survey Report highlighted a decrease in correspondent banking relationships and an increase in LC rejection rates across the African continent.[113]

In response to the liquidity crisis caused by the COVID-19 pandemic, BII increased the size of the MRPA facility with selected confirming FIs and entered new risk-sharing facilities. The aim was to provide additional support to African and South Asian countries during the COVID-19 pandemic and help mitigate the indirect economic impacts of the crisis. By increasing its trade finance risk exposure by 47 per cent in 2020, BII sought to assist confirming banks in continuing to provide trade financing. Despite increasing its exposure quite significantly during the pandemic, the total value of trade finance transactions only rose by 1 per cent (see Figure 13 below). Nonetheless, it is likely that without BII's intervention the overall volume of trade activity, rather than stabilising, would have been negatively impacted.

Figure 13: Value of trade transactions confirmed under BII's TSCF portfolio (USD million, 2015–2022)[114]



Source: BII

Increasing the size (both funded and unfunded) of MRPA A during the pandemic appears to have a stabilising impact on the overall trade in South Asia, although this appears not to have been the case in Africa. BII's increased its risk exposure under MRPA A by 67 per cent between 2019 and 2020. As a result, BII's confirming bank was able to continue to support trade finance transactions in fragile and poor economies, although the total value of trade finance transactions confirmed under MRPA A fell by 19 per cent. BII's additional support appears to have played a stabilising role during the pandemic, as without the additional support, it is likely that trade confirmations through MRPA A would have fallen considerably.

111 OECD. (2022). International trade during the COVID-19 pandemic: Big shifts and uncertainty.
112 Kramer et al. (2021). Sovereign credit ratings during the COVID-19 pandemic.
113 Afrexim bank. (2021). New report highlights Covid-19 impact on African trade finance.
114 BII. (2023). Internal monitoring data

MRPA B remained unchanged during the pandemic and monitoring data show a decline in confirmations and consequently BII's overall risk exposure. The overall value of trade finance confirmations through MRPA B fell by 41 per cent from $761 million in 2019 to $447 million in 2020, and as a result BII's overall risk exposure fell. However, the decrease in BII's exposure was lower (26 per cent from $190 million to $142 million), compared to the decrease in trade finance confirmation (41 per cent) under MRPA B. This suggests that BII took a greater risk on the confirmed trade finance transactions during the pandemic, compared to previous years. Overall, although both MRPAs (MRPA A and B) experienced a decline in confirmations during the pandemic (in line with the global trend), the decline in confirmations through MRPA A was less pronounced compared to MRPA B, most likely as a result of the accommodations made by BII to MRPA A.

The pandemic led to supply chain disruptions, resulting in delays in imports and factory closures. This had a direct impact on the demand for trade finance, with many interviewed businesses stating that they did not require trade finance confirmations, particularly in the first half of 2020 due to business closures following lockdown regulations.

Box 11: Impact of the COVID-19 pandemic on importers

Restrictions on access to FX, combined with delays in delivery of goods, meant that banks had to keep LCs open for longer periods than intended, and as a result importers incurred an increase in fees and interest charges.[115] Companies in Nigeria reported significant shipping delays and fivefold increase in freight costs at the peak of the pandemic. Importers within the manufacturing industry reported that they were unable to access raw materials/inputs during the pandemic, and as a result they had to switch from a 'just-in-time' supply-chain approach to stockpiling. Overall, the majority of importers experienced a decline in revenue, and issuing banks reported extending the maturities of their LCs in 2020. However, there was a recovery in financial performance in 2021, although not to 2019 levels.

Similar sentiments regarding the impact of COVID-19 on business activity were observed in Mozambique, including higher costs of importation during COVID-19.

In addition, interviews with issuing banks, particularly in Kenya, revealed that customers reduced the value of their trade finance applications (as they faced lower market demand) to mitigate pandemic-related risks. This led to a decline in the overall value of confirmations in 2020.

The Government of Pakistan imposed lockdowns during the pandemic. Therefore, demand for trade finance from the majority of interviewed businesses was relatively low during that period. Similar to the experience of businesses operating in Africa, interviewed businesses in Pakistan reported significant shipping delays which increased lead time when exporting/importing from approximately 30 days to 90 days. As a result, businesses requested extensions of their trade finance commitments from their issuing banks.

The COVID-19 pandemic also brought about a notable shift in the demand for trade finance instruments. Data regarding MRPA A shows an increase in demand for CBNs during and after the COVID-19 pandemic to 36 per cent and the level has remained relatively high, averaging 35 per cent between 2020 and 2022. Prior to the pandemic, CBNs represented only 11 per cent, while LCs accounted for 87 per cent of the total value of confirmations under MRPA A. The rise in demand for CBNs is driven by the need for businesses to be able to manage changes in their cash flows and more readily access liquidity during the pandemic. CBNs offer flexibility for both buyers and sellers in managing their cash flows, providing immediate liquidity for sellers, and allowing buyers additional time to make payments. This shift highlights the evolving nature of trade finance during the crisis and highlights the importance of financial institutions being able to respond to the changing demands and preferences of their business clients.

115 Note: The trend observed where LCs were open for longer periods than intended due to the restrictions on FX was prevalent in Nigeria prior to COVID-19. The FX challenges in addition to shipment delays due to the pandemic meant that LCs had to be open for even longer periods, compared to years prior to the pandemic.

Further disruption can be attributed to the Russia-Ukraine war. During the Ukraine-Russia conflict, confirming banks advised issuing banks against conducting transactions with Russia due to the trade risks associated with the conflict as well as the restrictions and sanctions imposed on Russia. Consequently, interviewed issuing banks stated that they were unable to facilitate transactions requiring trade finance support for importing raw materials from Russia.

Furthermore, interviews revealed that issuing banks faced difficulties increasing their confirming lines because of the significant elevation in commodity prices caused by the conflict. Interviews revealed that issuing banks struggled to increase their confirming lines to support the surge in the demand for trade finance because of higher global prices resulting from the conflict, thus exacerbating the existing trade finance gap. Although the impact of the Ukraine conflict on confirmation lines in Africa and South Asia was indirect, banks' inability to access confirmation lines of sufficient size disrupted the production and trade of crucial commodities, ultimately culminating in a global price hike and thus limiting the ability of importers to meet their payments.[116,117]

Table 6: Findings and lessons learnt from BII' investment during challenging times.

QUESTION 5: During crises, such as the COVID-19 pandemic and the Ukraine-Russia conflict, what are the impacts that can be attributed to trade finance at the confirming FIs, issuing FIs, and importer and exporter levels?	**Finding 5.1:** The COVID-19 pandemic demonstrated the critical importance of trade finance programmes in sustaining trade flows during crises. Although BII's increase in trade finance risk exposure was not matched by an equivalent increase in the total value of confirmation during the pandemic, it appears BII's additional trade finance support during the pandemic played a stabilising role, and without BII's intervention, the overall volume of trade activity as well as trade finance confirmations, rather than stabilising, would have been negatively impacted. **Lesson 5.1:** DFIs may be able to encourage confirming banks to maintain their commitments to target countries during challenging times by providing additional funding and guarantees to confirming banks. While it is difficult to disentangle supply and demand side factors, indicative results suggest that during the pandemic, BII increased its level of risk exposure to encourage confirming banks to maintain their trade finance commitments. The countercyclical support provided by BII appears to have played a stabilising role during the pandemic.

116 Baffes, J., Nagle. P. (2022). Commodity prices surge due to the war in Ukraine. World Bank.

117 BII has committed to the rebuilding of Ukraine. At the Ukraine Recovery Conference BII committed to allocate up to £250 million to support reconstruction of Ukraine. More importantly, BII intends to provide $25 million to the IFC's Global Trade Finance Program to help facilitate trade to support the Ukrainian economy while the conflict continues. This is expected to ease some of the disruptions to trade with Ukraine. Source: BII. (2023). British International Investment to support reconstruction in Ukraine.

Annex: BII’s country classification

Table 7: BII’s country classification based on the impact score, 2022–2026

Alpha	Beta	Gamma	Delta
South Sudan	Burkina Faso	Nepal	Morocco
Burundi	Uganda	India	Botswana
Somalia	Zimbabwe	Ghana	Bhutan
Central African Republic	Angola	Namibia	Tunisia
Congo, Dem. Rep	Nigeria	South Africa	Algeria
Congo, Rep.	Sao Tome and Principe	Egypt, Arab Rep.	Mauritius
Guinea-Bissau	Ethiopia	Cabo Verde	Sri Lanka
Liberia	Guinea	Philippines	Gabon
Eritrea	Kenya	Timor-Leste	Maldives
Niger	Senegal	Belize	Seychelles
Togo	Lesotho	Kiribati	Indonesia
Malawi	Cameroon	Tuvalu	Thailand
Sierra Leone	Cote d’Ivoire	Marshall Islands	Malaysia
Tanzania	Comoros	Samoa	Vietnam
Chad	Gambia,	Tonga	Fiji
Mali	Djibouti		Nauru
Benin	Mauritania		Palau
Sudan	Bangladesh		Dominica
Rwanda	Pakistan		Dominican
Zambia	Myanmar		Republic Grenada
Mozambique	Libya		Guyana
Madagascar	Equatorial Guinea		Jamaica
Afghanistan	Cambodia		St Lucia
Haiti	Lao PDR		St Vincent and the Grenadines
	Papua New Guinea		Suriname
	Solomon Islands		
	Micronesia		
	Vanuatu		
	eSwatini		

Table 8: BII's country classification based on the Development Impact Grid, 2017-2021

Alpha	Beta	Gamma	Delta
Afghanistan	Angola	Algeria	Mauritius
Benin	Côte d'Ivoire	Bangladesh	Morocco
Burkina Faso	Equatorial Guinea	Bhutan	South Africa
Burundi	Lao PDR	Botswana	Tunisia
Cameroon	Libya	Cambodia	Vietnam
Central African Republic	Mozambique	Cape Verde	
Chad	Nepal	Egypt, Arab Rep.	
Comoros	Nigeria	Gabon	
Congo, DR.	Pakistan	Ghana	
Congo, Rep.	Swaziland	Kenya	
Djibouti	Tanzania	Lesotho	
Eritrea		Namibia	
Ethiopia		Maldives	
Gambia		Rwanda	
Guinea		Seychelles	
Guinea-Bissau		Senegal	
Liberia		Sri Lanka	
Madagascar		Zambia	
Malawi			
Mali			
Mauritania			
Myanmar			
Niger			
São Tomé and Príncipe			
Sierra Leone			
Somalia			
South Sudan			
Sudan			
Togo			
Uganda			
Zimbabwe			

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