

TRADE FINANCE – AN INSTRUMENT FOR EFFECTIVE TRADE DELIVERY

Introduction

“Trade can be a powerful force for growth or poverty reduction. Countries that have increased their share of trade in their GDP have grown faster and reduced poverty more rapidly.”¹

The need for developing and transitional economies to take a very critical look at their trade policies with a view to facilitating their trade has become more imperative in this era of globalization than ever before. Developed economies have through trade facilitation succeeded in developing their firms and industries and equipping them with the ability to trade in almost all parts of the world to their advantage. This global competition challenges the competitive edge of domestic firms even in their home markets and Ghana is no exception to this development.

Similarly, if firms in developing economies are to be sustained and their long-term viability guaranteed, then they are left with no choice but to also seek markets other than their own in which they can trade with some competitive edge. However for these firms and industries to be able to achieve such objective, they would have to be properly equipped to be able to control the international competitiveness of their offers. This can only happen if the companies have all the necessary skills and resources available to them.

In response to this global competition and to improve upon its terms of trade account which has perennially been in deficit, Ghana has come out with a “Trade Sector Support Programme” document as part of the country’s Trade Policy. This document recognizes the need for the country to *“move away from heavy dependence on exports of a limited number of primary commodities to create competitive advantage on a more diversified range of products with higher levels of value-addition.”*²

In a paper entitled *“Trade Facilitation from a Developing Country Perspective”*, the Swedish Board of Trade writes: *“Experience shows that it is imperative that four key elements are present for a Successful Trade Facilitation process:*

- 1. A strong political will*
- 2. A clear strategic plan*
- 3. A close cooperation with the business community, and*
- 4. A well funded and long term technical assistance programme.”*³

This paper discusses the issue of trade finance as a tool for effective trade facilitation. It will first attempt to provide a definition and an overview of the subject matter; it will then

¹ Nicholas Stem – World Bank Chief Economist & Snr. Vice President for Development Economics.

² Trade Sector Support Programme: Government of Ghana – Executive Summary – Introduction.

³ Trade Facilitation from a Developing Country Perspective: National Board of Trade, Sweden – Page 4.

proceed to show how trade finance has been organized in selected countries. It will further examine how trade finance has been organized in Ghana until now and propose a way forward for trade finance in Ghana if it is to be able to facilitate the country's trade.

The question however remains as to whether the government, in its objective of obtaining middle-income status for Ghana will have the political will to implement the decisions that will be arrived at (in these trade policy discussions). This remains to be seen but as is contained in the Swedish document quoted above, without a strong political will from government the way forward will only be a mirage.

Trade Finance

Trade finance refers to innovative, custom-engineered financial products and services that meet a country's import and export needs. Trade finance is completely different from regular commercial bank lending, mortgage lending or insurance. The words, "*innovation and custom-engineered*" are very vital to the development of any successful trade finance products.

Importers and exporters are looking for any competitive advantage that would help them to increase their sales. For example flexible payment terms make a product more competitive. Given a similar product form different countries, product financing can make the difference as to whether a sale will be made or lost. Similarly, the cost of finance (interest rate and other fees) has a strong effect on price and can make a product very uncompetitive in the international market. These factors are therefore to be adjusted to reflect the country's trade objectives. However left to market forces, their movements could be in the reverse direction and render the country's products uncompetitive.

While international trade is a two-way traffic, countries in the development of their trade finance schemes have place a lot of emphasis on exports which generate earnings for the country and makes it possible for the country to purchase any imports of its choice. This paper will therefore be limited to the structures and schemes that are necessary for the implementation of a successful export financing scheme.

Schemes

Every successful export financing model must necessarily include the following schemes:

1. Export Finance
2. Export Credit Guarantee
3. Export Credit Insurance
4. Sector Level Financing
 - a. Research & Development
 - b. Promotion and Marketing

Classification

Export Financing has two main classifications:

1. Stage

- a. Pre-shipment
- b. Post-shipment
- c. Development

2. Duration

- a. Short-term
- b. Medium-term
- c. Long-term

Classification by Stage

Export Finance may be classified from two viewpoints, namely, the stage at which the financing is provided and its duration. Classification from the stage viewpoint is broken down into (a) Pre-shipment Finance and (b) Post-shipment Finance.

Pre-shipment Finance may be defined as any loan or advance granted, or any other credit provided by a financial institution to an exporter for financing the purchase, processing or packing of goods, on the basis of a confirmed export order received in the exporter's favour from an overseas importer.

Post-shipment financing refers to the provision of finance for export goods from the stage of shipment to the date of realisation of the export proceeds. Exporters who sell goods abroad usually have to wait for some time before payment is received from overseas buyers. The period of waiting will depend upon the terms of payment, and the need for post-shipment finance to strengthen the financial position of the exporter varies accordingly. Post-shipment finance can take different forms but principally involves factoring or forfaiting (discounting of receivables).

Development Finance refers to finance that is provided towards the development of exportable products and the addition of value to these products. This form of financing is long-term in nature.

Classification by Duration

With respect to duration, export financing can be defined in terms of short-term, medium-term and long-term.

Short-term facilities are credits that are extended with a maximum duration of up to one-year; usually such credits are given for specific periods of 90 days or 180 days to meet specific export durations. Both pre-shipment and post-shipment finance fall under short-term financing.

Medium-term facilities are given from 13 months to a period of up to three years. While the short-term facilities are usually specific in nature, the medium-term facilities are usually of a general nature and are mostly utilised for working capital purposes.

Long-term financing has to do with the provision of credit for development purposes. Such facilities are usually given with duration of more than three years. They are given for the setting up of factories, establishments of farms and such other long-term objectives that go to increase the production and processing of export commodities.

In all instances, whether long-term, medium-term or short-term, such facilities are given on very advantageous terms at the various stages of the export cycle. Specifically, concessionary access to credit is especially important in periods of high interest rates, and so is the timeliness of delivery, without which export contracts cannot be executed.

Other Schemes in Export Financing

Aside of the facilities mentioned above, there are other forms of export financing that should be mentioned in this paper. These include:

1. Export Credit Guarantee Schemes;
2. Export Insurance Schemes;
3. Export Refinance Schemes;

The provision of finance for the facilitation of exports in a developing economy is a very risky venture. Many banks with adequate financial resources shy away from the provision of such finance hence the setting up of specialised institutions to address this need. Of utmost importance therefore in the provision of a workable trade financing scheme are Credit Guarantee, Credit Insurance and Refinancing schemes.

Export Credit Guarantee

An Export Credit Guarantee is a commitment provided by an Export Credit Agency to reimburse a lender if the borrower fails to repay a loan. It is basically an indemnity against loss and not a security for a loan. It is meant to provide a cushion to financial institutions in times of business failures and credit default.

The objectives of an export credit guarantee scheme are:

- To encourage banks to extend facilities to borrowers who may have inadequate or no collateral.
- To enable industries (both LORGS and SMEs) get access to institutional credit.
- To assist exporters to expand into new markets.

Why the Need for an Export Credit Guarantee Scheme?

In most institutional lending, the lending bank providing finance to the exporter would have to consider whether to request for collateral from the borrower in accordance with normal banking principles and prudence. If a credit appraisal of the borrower's financial resources and viability fails to satisfy the bank, then the bank must seek to protect itself by asking for collateral. Such collateral may entail charging some or all of the

borrower's assets so that in the case of default, the banker would be in a position to put in a receivership to recover sufficient funds from the liquidation of assets to repay the debts.

With pre-shipment export credit, security can arise from the transaction itself and can be based on a firm order, a signed export contract, a letter of credit, an accepted bill of exchange, or a promissory note given by the buyer. *All these "securities", while validating the borrowing as being for exports, may fail to produce value at the end of the day.* Because of this possibility of failure, the bank must still have recourse to the exporter's financial resources. The natural result of this is that the bank, if more lucrative lending possibilities exist in other areas of its operations, will not be eager or willing to lend to small exporters with inadequate resources. *Following from this, most firms falling under SMEs will never be able to have access to institutional credit to pre-finance their exports. The country in the end will be the loser as many export orders coming to SMEs will remain unexecuted.*

Export Credit Guarantee Schemes have been put in place around the world to mitigate this risk and enhances the opportunities available to exporting companies in accessing credit if the lending institutions have confidence in the ability of the scheme to deliver. For this to happen the Guarantee scheme must have sovereign backing.

Export Credit Insurance Scheme

The purpose of Export Credit Insurance *is to mainly offer offshore protection to exporters of goods and services who sell their products on credit terms.* The exporter is insured against losses arising from a wide range of risks, which may be conveniently categorised into either commercial risks, or political risks.

Commercial Risks:

- The insolvency of the purchaser;
- The default on payment by a buyer following an unforeseeable event;
- Non-acceptance of goods delivered to the purchaser, where such goods comply with any contracts in existence.

Political Risks:

- Cancellation or non-renewal of an insured's export licence after a contract has been entered into;
- War and other such disturbances in the purchaser's country of domicile which affect the fulfillment of the contract;
- Transfer risks, where one country can freeze the assets and bank accounts of another country held locally.
- Any action of a foreign government which hinders the enactment of the contract; including, import/export restrictions, the confiscation or expropriation of goods, and the nationalisation of corporations and industries.

The presence of an Export Credit Insurance Scheme in a country, as can be seen, provides exporters of goods and services with a significant degree of financial security,

thus allowing companies to pursue bolder export policies by accepting new purchasers, and entering into new overseas markets, but with a smaller impact from the risks of non-payment and political instability.

Suppliers' Credit

A good Trade Finance Policy should also include schemes that will allow the exporter to offer Suppliers' credit, which is the norm in the world today. In this instance the seller of goods for export offers favourable credit terms to the buyer while the exporting company's credit is financed by the a financial institution.

Export Refinancing Schemes

Under the Export-Refinancing Scheme the government of a country sets out a fund for the development and promotion of exports. This fund is usually managed by an Export Credit Agency (ECA). Banks in the country are encouraged to lend to the export sector at concessionary interest rates, with other flexible conditions to the export sector, after which they apply for refinancing from the fund held by the ECA.

Financing for Sector Level Activity

Although not related directly to the financing of enterprise level activity financing of trade related research and development and export promotion activities should receive considerable support from governmental sources.

EXPORT CREDIT AGENCIES

Evidence available from the developed world indicate that financial institutions (especially commercial banks) are unwilling to assume the risks that are associated with the financing of exports, consequently Special Purpose Vehicles (SPV), named Export Credit Agencies (ECA) have evolved over time to take over the functions of providing finance for exporters and assuming the associated risks that come with the provision of export financing.

Examples of such ECAs around the world are the US Exim Bank, ECGD of UK, Nexim of Nigeria, Koexim of Korea.

EXPORT FINANCING – EXPERIENCE FROM SELECTED COUNTRIES

This section briefly examines what structures have been put in place by selected developed and developing countries to support the financing of their exports trade.

BRITAIN⁴

The Export Credit Guarantee Department (ECGD), is the UK's official Export Credit Agency. It is a separate government department, reporting to the Secretary of State for Trade and Industry. ECGD derives its powers from the 1991 Export and Investments Guarantees Act. It supports British exporters of projects, capital goods and services in two main ways. *Firstly, it insures exporters and banks against the risks of non-payment by overseas buyers. Secondly, it gives interest rate support to banks, allowing exporters' access to finance at fixed, often favourable, rates of interest.*

ECGD has been in business for over 80 years and its facilities have evolved considerably to take account of changing customer requirements. Its policies enjoy the security provided by the FULL BACKING of the Government's resources in the shape of the Consolidated Fund. ECGD made strategic losses for many decades until about ten years ago when it was requested to operate against a robust breakeven policy.

In answer to a question as to whether ECGD should be privatized or not, it was decided as follows: *“It is important that UK firms and investors should have this support since the private sector is not able to offer the insurance they require on the consistent basis provided by ECGD. Also, UK firms need to be able to compete effectively against exporters and investors supported by government-backed ECAs in other countries”.*

This conclusion is supported by the findings of an independent report commissioned by ECGD from National Economic Research Associates (NERA). In answer to the Economic Rationale (if any) for the Public Provision of Export Credit Insurance by ECGD, NERA said: *“We consider that ECGD should continue to provide cover for medium- to long-term capital goods exports. We do not consider there to be a strong case for privatizing ECGD's current portfolio of medium- to long-term export credit guarantees or for ceasing to underwrite new business”.* The conclusion, therefore, is that there is a strong business case for retaining ECGD. *Abolition and privatisation should not be pursued.* ECGD's core aim should continue to be to benefit the UK economy by fulfilling its statutory purpose of facilitating trade. UK exporters would be adversely affected if ECGD did not provide appropriate support.⁵

USA⁶

The Export-Import Bank of the United States (Ex-Im Bank) is the official export credit agency of the United States. Ex-Im Bank's mission is to assist in financing the export of

⁴ www.ecgd.gov.uk

⁵ ECGD – Mission and Status Review 1999 – 2000 Page 8

⁶ www.exim.gov

U.S. goods and services to international markets. Ex-Im Bank enables U.S. companies — large and small — to turn export opportunities into real sales that helps to maintain and create U.S. jobs and contribute to a stronger national economy.

Ex-Im Bank does not compete with private sector lenders but provides export financing products that fill gaps in trade financing. *The bank assumes credit and country risks that the private sector is unable or unwilling to accept. It also helps to level the playing field for U.S. exporters by matching the financing that other governments provide to their exporters.* Ex-Im Bank provides working capital guarantees (pre-export financing); export credit insurance; and loan guarantees and direct loans (buyer financing). No transaction is too large or too small. On average, 85% of our transactions directly benefit U.S. small businesses.

With more than 70 years of experience, Ex-Im Bank has supported more than \$400 billion of U.S. exports, primarily to developing markets worldwide. Since its operating charter was renewed in 1986. *Since its inception the US Eximbank declared its first profit in 1996.* At the direction of congress Eximbank has instituted the most significant overhaul of its programmes since 1960 to make them as accessible, affordable and competitive as possible for US exporters.

COTE D'IVOIRE⁷

The Republic of Cote d'Ivoire has maintained a consistent policy in providing state support for the development of that country's export sector. This policy has helped the country achieve a comparative advantage in the development of their traditional and non-traditional export commodities compared to Ghana. In Cote d'Ivoire the Export Promotion Agency known as APEX-CI manages the country's Export Development Fund known as FADEX (Fonds d' Appui au Development des Exportations) which fund is used both for direct financing and for investment and promotional purposes. APEX-CI also has another fund for exports that it manages called FAMEX. These funds are literally interest free since they are given out as reimbursable grants of up to 85% of export expenditures incurred by exporters and other companies and institutions providing export related services.

Comparative Statistics between Ghana and Cote d'Ivoire

1. Cote d'Ivoire has overtaken Ghana in the production of Cocoa
2. Pineapples CI – 260,000 MT Ghana 26,000 MT
3. Cashew CI – 200,000 MT Ghana 10,000 MT
4. Coffee CI – 160,000 MT Ghana 6,000 MT

⁷ www.apexci.org

NIGERIA – NEXIM⁸

The Nigerian Export-Import Bank (NEXIM) was established by [Act 38 of 1991](#) as an Export Credit Agency (ECA) with a share capital of N500, 000,000 (Five Hundred Million Naira) *held equally by the Federal Government of Nigeria and the Central Bank of Nigeria*. The Bank which replaced the Nigerian Export Credit Guarantee & Insurance Corporation earlier set up under [Act 15 of 1988](#), has the following main statutory functions: -

- Provision of export credit guarantee and export credit insurance facilities to its clients.
- Provision of credit in local currency to its clients in support of exports.
- Establishment and management of funds connected with exports.
- Maintenance of a foreign exchange revolving fund for lending to exporters who need to import foreign inputs to facilitate export production.
- Maintenance of a trade information system in support of export business.
- Provision of domestic credit insurance where such a facility is likely to assist exports.

The Bank presently provides short and medium term loans to Nigerian exporters. It also provides guarantees for loans granted by Nigerian Banks to exporters as well as credit insurance against political and commercial risks in the event of non-payment by foreign buyers. The Bank is also the government's National Guarantor under the ECOWAS Inter-state Road Transit programme.

In all cases, the funds are given out at concessionary interest rates with flexible terms of payment. In all instances quoted, export finance support is given by statutory public corporations owned by government and not the private sector.

EXPORT FINANCING – THE CASE OF GHANA

Export Finance Company Ltd.

In August 1989, the Bank of Ghana with the active support of the Ministry of Trade and Industries (MOTI) promoted the establishment of the Export Finance Company Ltd. to provide financial support to exporters of non-traditional products. The Export Finance Company Ltd. was established to carry out the following functions:

1. To grant loans and/or provide other forms of credit to exporters;
2. To carry out business as a finance house and to issue and deal in commercial paper;
3. To raise loans for the purpose of financing exports;
4. To offer and accept guarantees in respect of export finance, and
5. To carry out all functions and duties incidental or ancillary to the production of export commodities and export of non-traditional exports.

⁸ www.neximbank.com.ng

The company was to achieve the above objectives by operating the following financing schemes:

- a) Pre and Post-shipment Credit Scheme;
- b) Export Credit Guarantee Scheme
- c) Export Insurance Scheme;
- d) Export Refinance Scheme;

The company was expected to commence business with an initial capital of US\$18.1million. Of this amount only €120 million was raised, which amounted at the time to a meager 0.09% of the initial capital expected. It is worth mentioning that although the company was sponsored by the Bank of Ghana and the Ministry of Trade and Industry both institutions of Government did not put any capital into the company. Interestingly, private insurance companies (which are known to be risk averse) were requested to contribute towards the company's initial capital.

The company was restructured during the governorship of Dr. Duffour with the Bank of Ghana assuming 58 percent, and Ghana Export Promotion Council 21 percent ownership respectively, the remaining 21 percent shares are held by the initial seven insurance companies. Unfortunately however due to delays in the restructuring process, Dr. Duffour was unable to recapitalize the company before his term expired.

The Bank of Ghana under the incumbent governor did not continue with the restructuring exercise pursued by the former administration. To the contrary, Export Finance Co. Ltd., the only Export Credit Agency in the country providing exporters with primary export financing facilities, has received a letter from the Bank of Ghana (its majority shareholder)⁹ requesting the company to either recapitalize to the new mandatory level of €10 billion or close down by December 2005; a very interesting phenomenon at this time in the development of the country's trade policy.

EXIMGUARANTY COMPANY (GHANA) LIMITED

In 1994 the Bank of Ghana promoted and established the Exim guaranty Company (Ghana) Ltd. Exim guaranty was set up purposely to provide the banking sector with guarantees and insurance cover for the export sector. The shareholders of the company are:

Bank of Ghana ¹⁰	98%
Trust Bank	1%
National Investment Bank	1%

Specifically Exim guaranty Co. Ltd. was to operate the following schemes:

1. Export Credit Guarantee Scheme
2. Export Credit Insurance Scheme

⁹ The shares of the Central Bank in the company are now held in trust for the Bank by the Financial Investment Trust (FIT).

¹⁰ Shares now held in trust for the Bank of Ghana by Financial Investment Trust (FIT).

3. Export Refinance Scheme

As with the Export Finance Company Ltd., structural deficiencies during the setup of Exim Guaranty Co. Ltd. (*i.e. inadequate funding and absence of recourse to reinsurance*) have been largely responsible for the company not having done too well on the market since it commenced business. The company last year received €5 billion budgetary support from the government, and another €5 billion as a grant from the Export Development and Investment Fund (EDIF). This injection has allowed the company to succeed in recapitalizing and has therefore not received a recapitalization or closure notice from the Central Bank. In spite of the injection this company's capital is still woefully inadequate for its operations.

LINES OF CREDIT FROM DONOR INSTITUTIONS

There have been various other interventions in the provision of trade finance in the Ghana from the country's bilateral and multilateral partners. These include:

1. Private Enterprise and Export Development Project (PEED)
2. Trade and Investment Program (TIP)
3. Trade and Investment Reform Program (TIRP)
4. Funds for Small and Medium Enterprise Development (FUSMED)
5. Trade and Investment Program (TIPCEE)

These interventions have all proved either too expensive for industry participants to access, or too short in duration to make any meaningful impact. Indeed it is ironic to expect another country to bring their tax payers funds to come and support another country's export sector so the supported country's goods and services can go and compete with the donors' own goods in the international market.

EXPORT DEVELOPMENT AND INVESTMENT FUND (EDIF)

- Promoted by the Ghana Export Promotion Council
- Set up under Ministry of Trade and Industry
- Commenced operations in 2002
- Funded by 0.5% of all imports and percentage of divestiture funds
- Funds divided into Credit and Development Accounts
- Provides financing to Designated Financial Institutions (DFIs) for on-lending to non-traditional exporters
- Currently has 16 Designated Financial Institutions (DFIs) – 14 Banks and 2 Non-bank Financial Institutions
- Cannot lend directly to customers
- Only companies with majority Ghanaian shareholding can apply for assistance
- Customers seeking development funds from EDIF should apply directly to the fund Secretariat.
- Interest rate: 12% - 2% to EDIF and 10% to DFIs

The present structure of the Export Development and Investment Fund (EDIF) does not assist exporters efficiently and effectively. The Fund has become another credit institution and literally replicating all the work that the Designated Financial Institutions (DFIs) are doing while bearing no risk. The timeliness that is needed in the efficient delivery of credit facilities to support the export sector is completely lost on them.

TRADE FINANCE – THE WAY FORWARD

The arguments raised in this paper suggest that almost every country that has successfully traveled the path of export-led growth placed a lot of priority on ensuring that appropriate structures and schemes that would enable them to provide specialized and custom-designed financial services for exporters were properly put in place. In almost all instances Export Credit Agencies and/or Export Import Banks were established as development institutions with 100 percent government shareholding to provide the needed support to the trade sector. In the light of the above I make the following recommendations.

1. As in the case of Nigeria, EDIF should be converted into EximBank Ghana. The funds presently received by EDIF will serve as a continuous source of injection into this bank, which may make losses but should be encouraged to endeavour to cover its costs. The Bank will have at least two divisions: Export Credit Division and Export Guarantee and Insurance Division.
2. The Export Finance and Eximguaranty Companies should be liquidated and absorbed into this new bank. Export Finance Company will be the Export Credit Division of the Bank while Eximguaranty will continue with its functions as the Export Guarantee Division with an additional Insurance function. The benefits of the expertise gained by the staff of these two companies should NOT be lost to the Ghanaian economy.

The EDIF is owned by government, the Financial and Investment Trust (FIT) of the Bank of Ghana owns majority shares in both the Export Finance and Eximguaranty Companies.

3. The use of Designated Financial Institutions should be abolished with the establishment of the Eximbank. The bank through its Credit Guarantee Division should encourage other banks in the country to provide financing to the export sector in designated products and services and at agreed rates of interest and then apply to the Eximbank for refinancing.
4. The new Eximbank should aim at providing Ghanaian companies with Suppliers Credit support to enable them penetrate into the West African market with their products. Where possible Buyers' financing (direct loans) should also be considered to importers from the West African region.

5. Care must be taken to ensure that in the implementation of this recommendation very qualified and experienced hands are recruited to manage the bank, given the very special nature of trade financing. The purpose of this critical institution (Eximbank Ghana) will be defeated if in the recruitment process, unqualified persons or qualified but inexperienced persons are given the task of managing the bank.

CONCLUSION

Available evidence indicate that commercial banks in developing economies would rather invest their funds in less risky ventures than to place such funds in the development of the export sector which is seen as being very risky.

As part of its mission the U.S. Eximbank states “.....*We assume credit and country risks that the private sector is unable or unwilling to accept. We also help to level the playing field for U.S. exporters by matching the financing that other governments provide to their exporters.*” Again in the UK NERA’s research on the future of ECGD concluded that ECGD’s core aim should continue to benefit the UK economy by fulfilling its statutory purpose of facilitating trade. *UK exporters would be adversely affected if ECGD did not provide appropriate support*”¹¹

Nigeria has also converted its Export Credit & Insurance Corporation into the Nigerian Export and Import Bank (NEXIM) and is providing appropriate relieves to exporters in that country through this bank.

Cote d’Ivoire is literally giving interest free credit and grants to its exporters hence the results that country is achieving.

The case may be clear and strong and the needed institutions are all in place to assist with the conversion process, but will our government have the political will to implement? This remains to be seen.

¹¹ ECGD – Mission and Status Review Report 1999 -2000 Page 8