Are Exporters in Africa Facing Reduced Availability of Trade Finance

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1 Introduction

Over the past two decades, development policy has encouraged producers in developing countries to take advantage of the opportunities opened up by globalisation. In particular, exports of labour-intensive manufactures and non-traditional agricultural exports have been promoted as effective means of reducing poverty. Many jobs were created in sub-Saharan Africa by export-oriented garments production promoted by the African Growth and Opportunity Act (AGOA). High-value export horticulture has been one of the agricultural success stories of the region.

How will these industries fare in the face of a global crisis greater than any since decolonisation? Given the unprecedented financial nature of this crisis and its impact through the banking system, are exporters from low-income countries being hit by a lack of the finance needed for trade?

There is a certain amount of anecdotal evidence about shortages of trade credit in general, and concern has been expressed by policy makers from a wide range of international organisations, including the IMF, World Bank WTO and ITC, as well as from banking and trade specialists. What is less clear, however, is which types of firms and sectors might be facing credit restrictions that inhibit their ability to trade, and whether exporters from the poorest countries are facing restrictions in the availability of trade finance.

This paper refers to the literature on the impact of economic crises on trade finance and examines policymakers concerns about this issue. It then provides some evidence about whether or not firms in sub-Saharan Africa are experiencing problems in obtaining trade finance. This evidence is based on telephone interviews of companies exporting from Africa in the horticulture and garments sectors.

2 Trade finance and how firms use it for trade

Trade finance can take many forms. For simplification, we focus on three types, as shown in Table 1. Letters of credit (LCs) are specifically designed to facilitate trade. The function of this mechanism is both to provide finance and provide assurances about payment to the exporting company. If an irrevocable LC is issued, the exporter receives payment when it provides the specified documents to the advising/confirming bank. However, LCs require confidence and liquidity to be maintained at various points along the chain of payment from the importer, to the issuing bank, to the advising/confirming bank and to the exporter.
Table 1: Trade finance and potential impacts of a financial crisis

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<th>Type of trade finance</th>
<th>Potential impact of the crisis</th>
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| Letters of credit (LCs)                     | • The creditworthiness of the importer is undermined in the crisis and the issuing bank will not assume the risk.  
  Importers use LCs issued by their banks (the issuing bank) as a means of assuring exporters that they will be paid. If the exporter submits the required documentation (invoices, bills of lading, etc.) to its bank (the advising or confirming bank), payment is made to the exporter.  
  • The issuing bank does not have sufficient funds to extend credit to the importer.  
  • The advising/confirming bank does not have confidence in the issuing bank.  
  • Trade finance institutions reduce their overall exposure or exposure to particular countries during a financial crisis, reducing trade credit across the board to firms and banks in those countries. |
| Domestic bank lending                        | • Financial outflows reduce liquidity in the domestic banking system.  
  Domestic banks provide credit to exporters to cover pre-shipment or post-shipment costs. Such funding is similar to provision of working capital in general, although it may be less risky to the extent that it is loaned against specific purchases and assets.  
  • International banks operating in the domestic market reduce credit in order to cut the exposure of parent banks.  
  • Shortages of foreign currency prevent banks lending the foreign exchange needed for import of inputs or export freight charges. |
| Trade credit                                 | • General shortage of credit in domestic markets prevents importers and/or exporters extending credit to each other.  
  Companies extend credit to each other when buyers delay or advance payments to suppliers. This is called "trade credit", even within the domestic market. "Open account" trade involves importers paying invoices once goods are received. Equally, importers can extend credit to exporters if they pay for goods (all or in part) in advance.  
  • As credit become scarce, not only do banks reduce lending to their customers, but more creditworthy firms reduce lending to less creditworthy ones as their own access to finance is reduced (Love et al. 2007).  
  • Firms reduce credit extended to suppliers or buyers because of the increased risk of non-repayment by these firms as more companies get into financial difficulties. |

The other two forms of trade finance are extensions of credit facilities that operate in domestic economies. Companies may use domestic bank lending to finance both capital investment and working capital. Such lending can be used to facilitate trade. Similarly, inter-firm (trade) credit is widely used in the domestic economy. When contracts specify, for example, that buyers have a period in which to pay invoices for goods received, typically, 30, 60 or 90 days, the supplier is, in effect, extending credit for that period. Firms that have well-developed trading relationships may adopt the same practice. To the extent that sophisticated global value chains linking together firms in different countries often involve repeat transactions and long-term relationships, it is not uncommon for trade to be conducted on these terms.

These different forms of credit entail different allocations of risk between the trading partners, as shown in Figure 1. In the case of cash in advance, at one extreme, the importer bears all of the risks, relating not only to non-supply of the goods, but also exchange rate fluctuations and other
uncertainties. In contrast, an open account payment puts the risk on to the exporter. The importer only commits to paying at some point after the product has been received.

Figure 1: Risk allocation in payment methods

![Diagram showing risk allocation in payment methods]


3 Policymaker concerns

The issue of the possible impact of the global financial crisis on trade finance and the capacity of developing country exporters to finance their trade became salient in the final few months of 2008. Concerns were raised at a meeting in November held at the WTO, when the International Chamber of Commerce presented a report on the subject. This report stated that:

"Our members believe that in the weeks to come financial markets will continue to deteriorate due to continuing deleveraging, lack of liquidity, etc., especially towards the end of the year when banks close their books. The current environment is creating a risk-averse culture, both amongst banks and traders. With regard to the latter, banks report customers asking for confirmed letters of credit (LCs) where they previously dealt on CAD [commercial acceptance draft] or open account.... Our members have indicated this trend is accelerating and spreading to all continents" (International Chamber of Commerce 2008: 1-2).

This quotation highlights two aspects of the trade financing problem. On the one hand, firm-to-firm relationships may be undermined by uncertainties in global markets. It is suggested that firms that previously traded on the basis of open accounts, which place risk onto the seller (exporter), are becoming less willing to bear this risk. Sellers seek to transfer risk through devices such as LCs. and company demand for trade finance increases. On the other hand, the
international banking system may be reducing the supply of trade finance. First, because of the overall credit squeeze banks may be less willing to lend to companies in general. Second, there may be particular restrictions on availability of trade finance in developing countries, either because these countries are considered a particular risk,\(^1\) or because counterparty banks in developing countries are considered a greater risk than in the past, or because developed country investors are withdrawing funds from these markets. Marc Auboin at the WTO argues that the evidence for declining trade finance availability is clear:

"According to a survey conducted jointly by the IMF and the Banker's Association for Trade and Finance …flows of trade finance to developing countries seem to have fallen by some 6% or more year-on-year – significantly more than the reduction in trade flows. If such numbers were to be confirmed…that would mean that the market gap [for LCs] could be well over the $25 billion estimate mentioned above" (Auboin 2009).

These concerns were taken up by the WTO Secretary General, Pascal Lamy, who attended the November WTO meeting and announced immediately afterwards the formation of a task force to monitor how the financial crisis was affecting trade credit.

Further, data from the Institute of International Finance suggest that private financial flows to emerging markets are falling dramatically. Net private financial flows to emerging markets peaked in 2007 at $928bn, more than three times higher than in 2003. It is estimated that the net flow halved in 2008 and the forecast for 2009 is for these flows to reduce further, to $165bn. More important, the net commercial bank external lending portion of these flows is forecast to fall from an inflow of $410bn in 2007 to a net outflow of $61bn in 2009 (Institute of International Finance 2009). This might be expected to create a shortfall in trade finance both directly from international banks and through the impact of this reversal in flows on the capacity of domestic banking systems in emerging markets to sustain trade finance.

These same issues have been taken up by the International Trade Centre. The WorldTradeNet briefing quoted the following extract from the ICC report in November 2008:

"In recent months, banks have seen trade financing credit and liquidity capacity severely challenged. The effect of the squeezing credit markets is now amplified by the 'flight to quality', as investors withdraw capital from risky emerging markets. During a liquidity crisis, banks typically reduce their exposure as a defensive measure, which often results in a deep freeze in short-term trade lines" (International Trade Centre 2008).

Alongside these general concerns about trade finance, there is plenty of anecdotal evidence available on the Internet from businesses involved in trade about the likely drying up of trade credit, with reports of international banks becoming less willing to lend and the cost of trade finance rising (Reuters 2008a; London Banker 2008). Various bodies have responded to a perceived trade credit problem by extending new lines of finance for trade credit. These include Central Banks (Brazil in October 2008, the Reserve Bank of India in November 2008, South Korea, Indonesia, etc.), Export-Import Banks and international financial institutions (IFC, ADB, EBRD, etc.).

\(^1\) In the emerging market financial crises of the 1990s and earlier in the present decade, trade finance was withdrawn from crisis-affected economies as part of a more general reduction of exposure by lenders to these markets.
The developmental impact of such a trend, were it to be verified, would be serious. Companies that are otherwise solvent, going concerns may be undermined by restrictions in finance that are in no way connected to their own specific creditworthiness. Nevertheless, it is not clear whether traders, financial experts, national governments and international financial institutions are responding to an already-existing problem or anticipating that the problem will occur. Some of the anecdotal evidence refers to anticipated problems rather than actually occurring ones:

"In Chicago, one grain trader said his firm had been readying for the worst but so far the crisis did not appear to have stopped any grain shipments. 'We are loading stuff out and they are paying in a timely manner. (There has been) no hold up on sales because of letters of credit. They talked about it as a possibility but so far it is not an issue'" (Reuters 2008a).

"Angus Armour, Managing Director of Australia's Export Finance Insurance Corporation (EFIC), says that there are anecdotes of people having difficulties in obtaining trade finance, but EFIC is 'struggling' to find data to confirm these reports" (Asia Today International 2008).

Equally, Pascal Lamy noted, when announcing the formation of the WTO task force on trade credit, that "he was not aware of any shipments being stopped as a result of the crisis. 'No member has come to me saying we got stranded in this harbour because of the credit crunch'" (Reuters 2008b).

4 Evidence from past crises

What do we learn from past crises about how shortages of trade finance developed during financial crises and how they affected trade and businesses? There is ample evidence about trade finance during the crises that affected the emerging markets in the 1990s and early 2000s. In this period, trade financing emerged as a serious issue. According to Wang and Tedesse (2005: 1):

"During the financial crises in the late 1990s and the early years of the new century, trade financing to the crisis countries fell dramatically. Available data suggest that the emerging markets rely heavily on bank-financed trade credits to support exports at preshipment and postshipment stages, as well as imports. Such financing, provided by international commercial banks, tends to be channelled to local borrowers through leading domestic banks and is an important source of working capital for many emerging market companies. Bank financed trade credits declined by as much as 30 to 50 percent in Brazil and Argentina [in 2002], by about 50 percent in Korea in 1997-98, and from $6 billion to $1bn in Indonesia during the Asian crisis."

In these crises, short-term external debt fell sharply in emerging markets (Cline 2005 20-1), and the cost of credit rose substantially. In some cases, such as Indonesia, trade finance reduced so much and so sharply that:

"'Cross-border' international trade finance for imports became a particular problem at the peak of the crisis in Indonesia, where international banks reportedly refused to confirm or underwrite LCs opened by local banks because of a general loss of confidence in the local banking system. Given the high import content of exports (over 40 per cent in the manufacturing sector), Indonesia's growth of exports was seriously affected by the difficulty of financing imported raw materials, spare parts and capital equipment used in its export sectors" (Auboin and Meier-Ewert 2003: 4).
Trade finance is a low-risk, low-return activity where the credit is extended against assets that are being traded. It might be expected that this credit would be more resilient to economic crises than more risky forms of finance. However, during a succession of crises affecting these economies, shortages of trade finance appeared to be a substantial and direct consequence of broader economic problems. In fact, commentators seem to agree that the collapse in short-term trade finance was more substantial than might be expected, or possibly greater than had been the case during financial crises in the 1980s. Commentators point to the following factors:

- In situations of country- or regional-level financial crisis, financial institutions want to reduce the overall risk exposure, and this includes hits categories of lending, including low-risk lending. As bank leverage increases, this effect becomes greater.
- The consolidation of trade finance into fewer banks has led to an increasing correlation of financial institution behaviour (herd instinct).
- Short-term trade finance was no longer protected from country defaults to a greater extent than longer-term loans. In crises in the 1980s, London Club reschedulings often maintained payments on trade credit (Cline 2005: 21). Where losses on trade credit occurred they were very modest. Subsequently, this insulation of trade credit no longer operates and so risks associated with trade credit have increased.

It is not surprising, therefore, that during these crises a variety of financial institutions stepped in to sustain trade credit. These included regional development banks, the IFC, financial institutions in OECD countries, such as Japan Bank for International Cooperation, and EXIM Banks.

This evidence has focused on bank finance for trade. There is also evidence from the emerging markets in this period that inter-company lending (trade credit) fell. This issue is analysed by Love et al. (2007). They argue that trade credit acts as a form of redistribution of credit in the economy. Companies that are good credit risks are able to obtain credit from the financial system and then pass some of this credit on to other companies. These businesses are better able to assess the risks posed by at least some of their suppliers than the banks because they have established relationships with them. If credit in the economy as a whole dries up, then after a short period in which involuntary trade credit mounts up as debtors have difficulty repaying, trade credit declines. Therefore, we might expect this form of trade financing to decline in a crisis as well.

In spite of these findings, some unknowns remain:

- How relevant are these findings on emerging markets to the situation in Africa now? Emerging market may be particularly vulnerable to the crisis because capital inflows have been very substantial. It is frequently suggested that poorer countries in Africa still have small and relatively insulated banking sectors. Will the impact of the crisis be correspondingly smaller?
- Given that the current crisis is a global one, originating in the United States and Europe, the crisis will have a different dynamic. In the 1990s, banking crises were focused on particular countries or regions, albeit with spillovers from one emerging market to another. The impact on these regions was immediate and large. There was a general shortage of liquidity, although exporting firms benefited from currently devaluations. The latter problem is mitigated by the substantial exchange reserves held by the emerging market countries, but a global shortage of credit will play out in a different way. As global banks seek to repatriate assets or sharply cut back of lending and operations in developing countries, the banking sectors of developing countries may become short of capital. Exporters may suffer from restricted domestic credit and also the capacity of their
customers to obtain credit from their banks as lending seizes up. Similarly, deteriorating credit provision or company finances in developed countries could reduce the availability of inter-firm credit to developing country exporters.

- Even when trade financing availability is drastically reduced, it is not eliminated altogether. So which firms are more vulnerable to the credit crunch? Auboin and Meier-Ewert (2003: 10) note, "Small local suppliers, who sell specialised products to international importers on a one-off basis are much less likely to be able to obtain company financing, since they do not have an established relationship with their buyers." Conversely, companies that do have established relationships may continue to trade on pre-existing terms. The crisis will have highly differentiated impacts.

- The link between trade finance and the capacity to export remains unclear. Ronci notes that in previous financial crises substantial declines in short-term capital availability in crisis countries was very weakly associated with declines in exports. There was a positive correlation, but "the elasticity of export volume with respect to trade financing is estimated at between 0.02 and 0.04" (Ronci 2005: 34). Perhaps this is not unexpected. The risk with LCs is predominantly with the importer and the issuing bank. As was seen in Indonesia during the Asian financial crisis, it was imports that were hit hardest. So, to the extent that exports are not dependent on imported inputs, African exporters might not be greatly affected by falls in trade finance.

5 Trade financing the crisis: horticulture and garment firms in sub-Saharan Africa

In order to find out more about the impact of the financial crisis for exporting firms in Africa, IDS in Sussex arranged a small telephone survey in the first two months of 2009. The focus was on two sectors, horticulture and garments. These two sectors have been at the forefront of Africa's drive to increase exports of high-value agricultural products and manufactures. In the case of horticulture, export promotion activities have been extensive, with particular recent interest in ensuring that African producers and exporters meet increasingly stringent public and private standards in export markets (Humphrey 2008). In the case of garments, an export industry has been stimulated in the past decade by the African Growth and Opportunity Act, introduced by the United States in 2000. This led to a substantial expansion of garment factories in eastern and southern Africa. These produced garments for the US market, predominantly using inputs imported from Asia, taking advantage of duty-free access and absence of MFA quotas. Although the phase-out of the Multifibre Arrangement had a substantial impact on this sector (Kaplinsky and Morris 2006), there was still export activity in 2008.

Researchers in the UK and Kenya telephoned 30 firms in sub-Saharan Africa and asked them about how they financed their exports and imports and whether the availability of trade finance – from domestic banks, through LCs and from customers – had changed. Nineteen firms were interviewed in the garments industry in five countries in sub-Saharan Africa. Nine firms were interviewed in the horticulture sector, spread across six countries. Contact was made with a further three firms in Ghana and Uganda through another source. The uniformity of responses from these firms led to a broadening of the research focus. Two horticulture firms, in Guatemala and Thailand were interviewed to see the extent to which problems could be found in other parts of the world. This was followed up with contact with some UK importers and with the
International Trade Centre in Geneva. In addition, informants from two banks in Kenya provided a lender's perspective on trends in trade finance and the impact of the financial crisis.

The overall findings are clear. In both garments and horticulture, most of the African exporters interviewed had not (at least up to February-March 2009) experienced significant cutbacks in trade finance availability. The capacity of these firms to continue exporting was not being affected by cutbacks in credit, either from their customers, the international banking system (LCs) or domestic banks. The crisis had already had some negative impacts in both sectors, but these were not related to trade finance. This finding, which applies to well-established exporting firms in Africa, cannot be extended to other regions or to all types of firms, as will be discussed further below. The reasons for these findings differ in the two sectors.

In the case of garments, the exporters were a mixture of subsidiaries of Asian companies, US companies, domestic firms and some investments from the Middle East. The clear majority of these firms processed imported inputs for export to the United States under the AGOA regime, although some supplied Europe and/or African markets. Finance was required both for imports of raw materials and intermediates and to cover the time lag between exports of garments to customers and receipt of payment. For these firms, trade credit was, to some considerable extent, the responsibility of the parent companies, particularly for imported inputs. Some of the firms interviewed indicated that finance for either imports or exports had been affected in 2008, but none suggested this had affected their capacity export. These subsidiaries did rely to some extent on domestic bank credit for working capital. Even here, the availability of bank finance from within the host country had remained unchanged. Credit had generally been difficult to obtain and expensive, but this had always been the case. The domestic banking system was not used for trade finance.

For locally-owned firms, too, trade finance did not appear to be a problem. Firms in Ethiopia, Kenya and Tanzania either borrowed from banks to finance their imports and exports or relied on their own financial resources to bridge the gap between production and the receipt of payment from customers. These firms were still able to obtain credit from their locally-based banks. As long as these companies could show themselves to be a good risk and to provide collateral where necessary, trade finance was still available. In Ethiopia, firms difficulties in obtaining foreign exchange, but this is the consequence of government exchange rate policy rather than trade finance issues.

There were two exceptions to this picture. First, a company linked to a Middle East investor reported that the company's head office in the Middle East had experienced a credit squeeze in the international financial market. This has resulted a fall in the supply of finance from the parent company. Second, a garment company in South Africa reported shortages of credit as a result of the financial crisis. Garment firms are not considered good risks (it was suggested) and so they are affected by this problem.

Interviews with two banks in Kenya provided a complementary perspective on trade credit for garments firms. Both banks, one domestic and the other a subsidiary of an international bank, had garment companies on their loan books. Both confirmed that the financial crisis had not restricted their lending to companies. The international bank provided loans to garment firms in the export processing zone, and it was continuing as before. The bank financed imports through LCs and provided credit to facilitate exports. The main obstacle to lending was the creditworthiness of the

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2 The author is grateful to Ian Sayers at ITC for providing valuable information for this research.
firms. With increasing competition in global markets following the phase out of the Multifibre Arrangement, garment exporters had faced difficulties, and the main factor governing lending to these and other firms was the financial stability of the borrower. In the case of garments, export receipts often went directly to the parent company, and this made the bank especially wary of bad debts. The domestic bank also continued, in fact increased, lending to companies. The financial crisis had had a marked impact on overseas remittances used to buy property in Kenya, but this had not undermined the bank's capacity to lend.

In the case of horticulture, interviews were arranged with a variety of different firms. These included exporters in six African countries who exported to both the United Kingdom and a range of European markets. In order to include firms with potentially differentiated access to trade (inter-firm) credit, the sample included exporters supplying large retailers (supermarkets), which has a business model based on renewable one-year supply agreements and high levels of coordination between exporters and importers (Dolan and Humphrey 2000), as well as exporters supplying European wholesale markets, where business is more likely to be conducted through arms length trading relationships.\(^3\)

The reason cited by the interviewees for the absence of problems related to trade financing were the following:

- Established businesses remain good risks for domestic banks. The horticulture sector in sub-Saharan Africa has been successful in past years. It is considered a good risk by local banks, and lending continued. There is likely to be some risk that exports of high-value food will be more affected by the recession than exports of basic commodities, but one key informant from the Kenyan export horticulture sector reported in early 2009 that export volumes for fresh vegetables had not fallen.
- Firms are operating in well-established value chains. Even horticulture firms supplying wholesale markets in Europe had well-established relationships with their importers and establish lines of trade finance. Very often, these transactions are conducted without specific trade finance, involving open account trading. Unless the financial position of the creditor company in the relationship deteriorates, trade can be sustained. Where local banks did provide finance, they were continuing to lend, and the established patterns of trade finance had not been affected up to the time of the interviews.

These findings are confirmed by broader findings relating to trade in horticulture and agriculture. A variety of exporters of agricultural products are sustaining trade. For example, one major European importer of coffee and cocoa from West Africa reported that there were no problems with trade finance. Most transactions are performed between well-known parties who do not use LCs. Trust between the parties means that they rely on open account trading (payment following delivery) or documentary collections. As was seen in Figure 1, these require less external financing commitment and although they are at the end of the financing range that puts more risk on to the exporter, risk exposure is moderated by well-established trade ties.

5.1 Where the crisis is hitting the food trade

The fact that these particular types of exporters were not being affected by availability of trade finance does not mean that substantial impacts cannot be found in other types of firms and in other countries. In at least one West African country, for example, there is shortage of credit in

\(^3\) The horticulture sector into Africa predominantly supplies the European market, so no exporters supplying non-European markets were interviewed.
the domestic market, and as a result pre-financing of trade in cocoa is curtailed. This has an impact on local intermediaries that buy produce in rural areas and transport it to the docks. The big local buyers working with transnational companies are not affected as their customers provide finance, but smaller buyers are finding it difficult to borrow the cash they need to buy supplies at the farm gate or from cooperatives. This will have distribution and poverty consequences. Smaller producers and niche producers may find themselves marginalised as credit is only available for large buyers buying in large quantities. Given the unevenness of the impact of the financial crisis, there is a clear need to target any public provision of trade finance and domestic credit. This is a lesson from previous crises, as emphasised by Auboin and Meier-Ewert (2003: 10-11).

Second, there do appear to be substantial problems with trade finance in Central America, the Caribbean and parts of South America. This issue was emphasised by one large UK fruit importer. It has well-established, long-term relationships with fruit growers across this region. For some producers in Central America, it pre-finances production, paying up to half the purchase price in advance of shipping, or at the point of shipment. In late 2008, its growers in Costa Rica faced a crisis when the domestic banking system withdrew credit: the growers would have been unable to bring that year's crop to market without this finance. The UK importer was faced with a choice of extending further credit to its suppliers, or risk losing the advances that it had already made. Being cash rich, the importer was able to provide further advances and the crop was brought to market. Clearly, producers in a similar situation that did not have an established link with a cash-rich buyer would have been in much more serious difficulties.

This is not an isolated case. There are reports of significant problems for the banking industry in Central America and Caribbean, and this appears to be creating significant problems for SME producers, shippers and exporters. This not only reveals the potential impact of the global financial crisis working capital, but also suggests that the African banking system has so far escaped some of the impact of the crisis being felt in other parts of the developing world.

There are two ways of interpreting these results. One is to suggest that Africa is generally more isolated from the global financial crisis. Banks are still lending to companies and they still have money available, particularly for good credit risks. The second is that the financial crisis is merely delayed in Africa. The impacts of the global financial crisis merely take time to work through. At this point, it is not possible to say which is correct. However, it will be argued in the next section that firms are feeling the effects of the crisis in different ways, and these might eventually have an impact on trade finance.

5.2 Crisis impacts: exchange volatility and falling demand

Having established that most of the firms based in Africa in both sectors have not experienced difficulties with trade finance, it is important to recognise that the financial crisis is having clear and substantial impacts. These impacts are not uniform, but they have been reported by various respondents. Two major issues arise:

- Exchange rate volatility. In the garment industry, contracts are priced in dollars and companies have been largely insulated from exchange-rate fluctuations. In horticulture, in contrast, exchange-rate fluctuations are a major issue. In Kenya, the substantial devaluation of the UK pound against the dollar, amounting to a little over 25% in the
second half of 2008, created two problems. Exporters to the UK, which is a very important market for horticulture exporters in various parts of Africa, mostly have contracts priced in British pounds, but many inputs are priced in dollars. For companies that export CIF, airfreight (a substantial part of the landed price in the UK) is also priced in dollars. Furthermore, the appreciation of the Kenyan Shilling against the British pound by 12% between March 2008 and February 2009 (averages rates for both months) has meant that domestic costs have increased relative to export revenues. Firms are laying off workers, looking to increase exports to the Euro zone (easier for flowers than for fresh vegetables, as the latter are highly customised to the UK market) and holding back on new investments.

- Demand. Customers are ordering less. In garments, lead times for African producers are long; they are completing orders negotiated in mid-2008. But the companies reported that buyers were holding back new orders for the coming fashion season, and pushing for much lower prices. Almost all the garment companies reported falls in demand and poor prospects new orders. Fresh vegetable producers have not yet registered declines in demand for what is a premium product (fresh fruit and vegetables from Africa), but flower exporters do appear to be experiencing sharp falls in demand according to one well-placed local informant in Kenya.

Both of these effects could undermine company finances, leading to a deterioration in their creditworthiness and a decline in their access to trade finance. It was noted above that horticulture firms are considered good risks by the banks, while banks view firms in the garment industry with more wariness, in part because the garment sector has been declining in the face of intense competition in international markets. More difficult trading conditions and increased uncertainty about sales and profit could undermine access to trade finance.

6 Policy responses

The financial crisis works through to these companies in various ways. Dealing with the consequences has short- and long-term implications. In the short term:

- Overall, the mechanisms to sustain trade finance are well-established. In past financial crises, national governments, international financial institutions, regional development banks and parts of national banking systems have stepped into increase the supply of trade finance. There is ample evidence that the same bodies are taking action to improve the supply trade finance and the current crisis, with announcements from IFC, various national governments and regional development banks about finance for trade. In the emerging markets, governments are in a stronger position now than in the 1990s to take this action, but international financial institutions will need to step in to support those countries that are not so well placed.

- Trade finance needs to be targeted to be effective. We have noted regional variations in availability. There will also be sectoral variations and differences between firms that have differing assets and differing relationships to their customers. As the crisis unfolds it may begin to affect more businesses. Broadly-targeted support to increase lending capacity in the banking system – in both importing and exporting countries – will not necessarily reach the firms that are in most need. Firms with established exporting records that have repeat transactions with a range of established customers are more likely to obtain what bank finance is available and more likely to give and receive trade credit than other firms.

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4 From January to July 2008 the £:$ exchange rate stayed in the range of $1.94 to $2.03. In February 2009 it fluctuated between $1.42 and $1.48.
Difficulties in obtaining trade finance are more likely to affect small firms, and new entrants that do not have established relationships with their banks and with their customers. These will continue to be seen as worse risks than established companies. In particular, it was seen in West Africa that smaller exporters, producer groups and cooperatives might be particularly vulnerable. It is also the case that the financial crisis might impact more on new entrants to global markets that have been encouraged by recent development policy to venture into export markets rather than long-established companies that have both the financial resources and the business linkages to sustain the in this difficult period. Therefore, programmes should identify and target these companies.

In the longer term there are further implications for development policy. Firms that have done well from linking into dynamic global value chains, such as producers of fresh vegetables for UK supermarkets, are particularly vulnerable to adverse global conditions. Export-oriented production has linked these firms to powerful customers. In the crisis, the powerful customers are able to transfer the risks and consequences of turbulence and unpredictable markets to their suppliers. To the extent that exporters have investment in market- or customer-specific assets (such as sophisticated processing and packaging plants for supplying the UK market), customers can transfer the costs and risks of the crisis down the chain. Switching of suppliers is easier for UK importers and retailers than switching of customers is for their suppliers. UK supermarkets are trying to maintain the sterling price of imports irrespective of exchange-rate fluctuations. They will also vary purchase quantities according to short-term fluctuations in demand. As a result, all the risks and uncertainties fall on the supply chain. Large and powerful customers can be a benefit in times of expansion, but more difficult to deal with in difficult times.

References


