



**Mbuyu Capital**  
*Africa private markets*

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# Trade Finance in Frontier & Emerging Markets

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**Michiel Timmerman**  
**Ed Rushton**  
**Mbuyu Capital Partners**

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SARONA



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Mbuyu Capital has been asked by MEDA, in conjunction with Sarona Asset Management and Global Affairs Canada, to investigate the potential for trade finance to address the credit gap faced by SMEs in frontier and emerging markets in such a way that it creates positive impact.

We have examined supply and demand at an aggregate level as well as the financing needs of individual SMEs. Our consideration of both the bigger picture and individual SMEs echoes our approach to assessing impact and our conclusion that trade finance has the potential to create impact at both unit and system level.

Though trade finance is centuries-old, non-bank provision of trade finance – particularly by funds – is a nascent area of financial markets. There is considerable scope for new entrants to develop the sector ensuring impactful investment is firmly on the agenda.

Improving connectivity between SMEs and suppliers of trade finance; technology to reduce transaction costs; supply chain solutions; innovative financing; and risk mitigation solutions can contribute closing the credit gap. Creating investable products with identifiable impact outcomes and return/risk profiles are critical if investment capital is to be mobilised at scale.

There is therefore a crucial role for organisations focused on impact to shape the debate about how financially disenfranchised SMEs in frontier and emerging markets can access the capital needed to grow and support the communities in which they operate. MEDA and Sarona Asset Management are at the forefront of this debate.



MEDA is an international economic development organization whose mission is to create business solutions to poverty. Founded in 1953 by a group of Mennonite business professionals, the organisation partners with the poor to start or grow small medium-sized businesses in developing regions around the world.



Sarona Asset Management invests in private companies in frontier and emerging markets, targeting strong financial returns, and positive ethical, social and environmental impact. The firm, based in Canada and Netherlands, is a leader in innovative development finance, working with private and public partners to structure blended finance vehicles that achieve both financial goals and the Sustainable Development Goals. Sarona's mandates include direct and fund investment strategies focused on both debt and growth equity for private companies.



Mbuyu Capital opens up private markets in Africa to institutional investors by creating customised portfolios across private equity, real estate and credit. Both financial returns and impact are targeted using a research-driven, operationally-focused and disciplined approach, integrating primary, secondary and co-investments.



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## 1. Working Capital in Context

# 1. Working Capital in Context



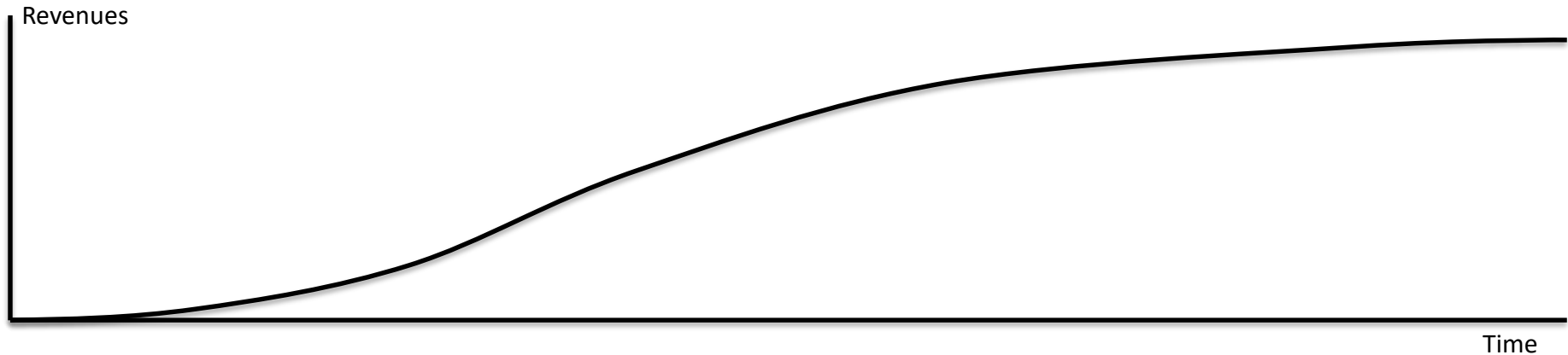
Trade finance is one way of improving SMEs' balance sheet position. This section considers:

- † The SME growth cycle and corresponding changing financing profile;
- † The effects of seasonality on SMEs' working capital needs;
- † Capital structure considerations for different types of SMEs;
- † Potential working capital needs for SMEs in different value chains.

# 1. Working Capital in Context



## Schematic SME growth cycle and financing profile



As the business becomes more established and less prone to shocks, there is increased scope to optimise long-term financing structure through appropriate use of leverage.

Family, friends, angel investors, microfinance, subsidies

Venture capital, bank loans, trade finance, leasing

Private equity, public equity, bond finance

Some working capital finance appropriate. Long-term assets and growth best funded through equity.

Working capital finance to be optimised. Conservative long-term debt finance increasingly appropriate.

Working capital finance to be fine-tuned. Whole balance sheet structure to be optimised.

Source: Mbuyu Capital, United Nations ESCAP.

# 1. Working Capital in Context



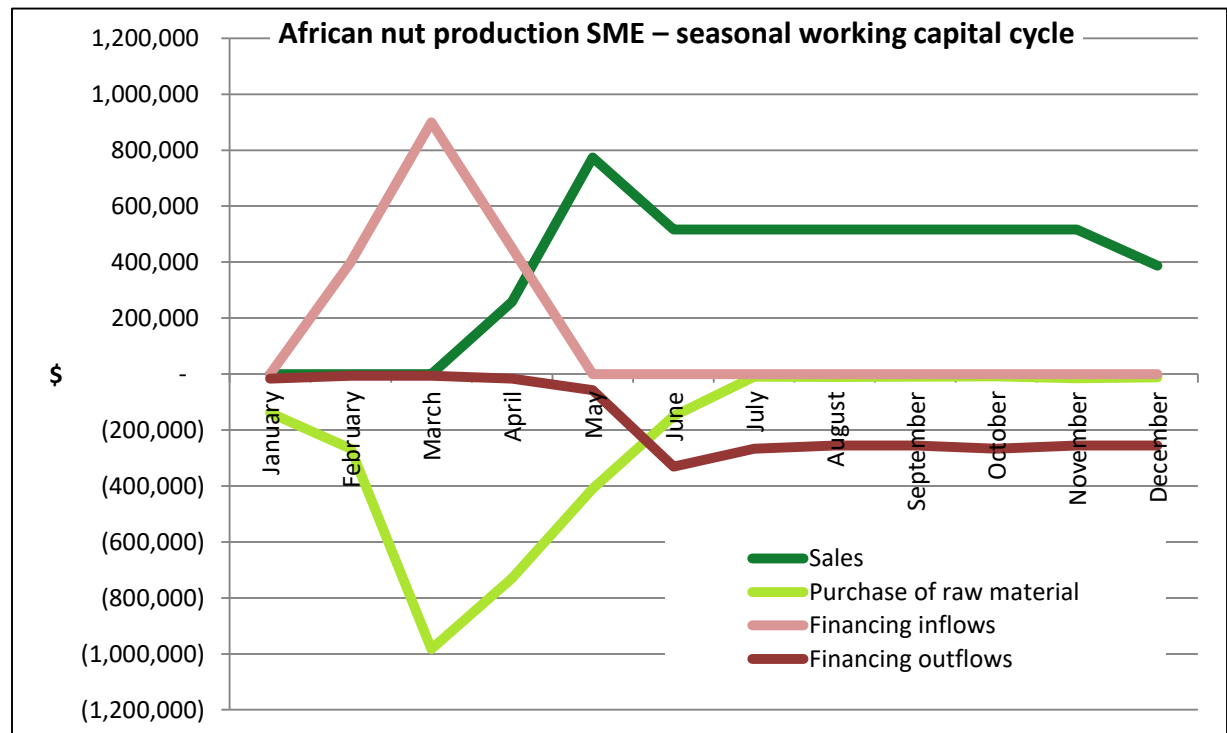
## Seasonality and working capital needs

† The working capital needs of SMEs vary by sector depending upon the nature of the purchasing and sales cycle. This is often most pronounced in agricultural SMEs where this is dictated by the seasonal cycles of growing and harvesting.

† The illustrative chart to the right shows this cycle for an African nut production SME.

† The cycle of financing inflows (borrowing) associated with buying the nuts, followed by sales and financing outflows (repayments) over a 12 month period is observable.

† It is this short term working capital cycle that trade finance is well placed to address in frontier and emerging markets.



Source: Illustrative data – Mbuyu Capital

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# 1. Working Capital in Context



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## *Seasonality and working capital needs (continued)*

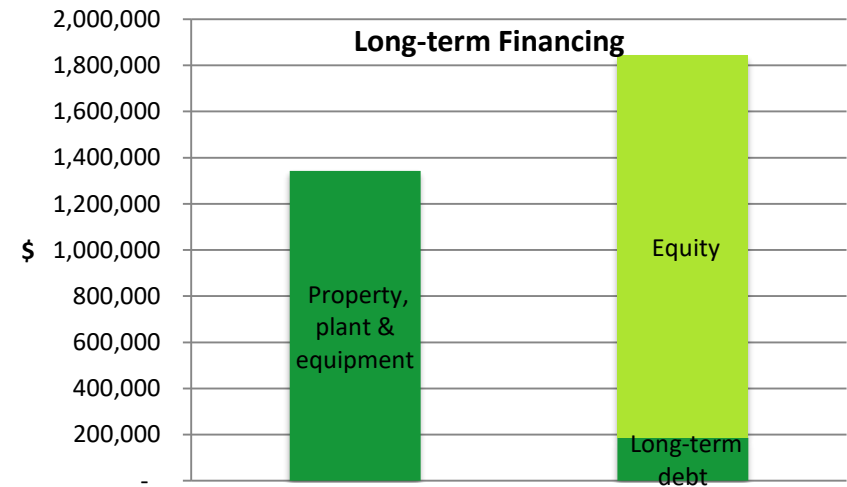
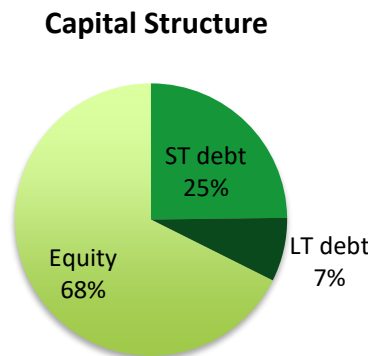
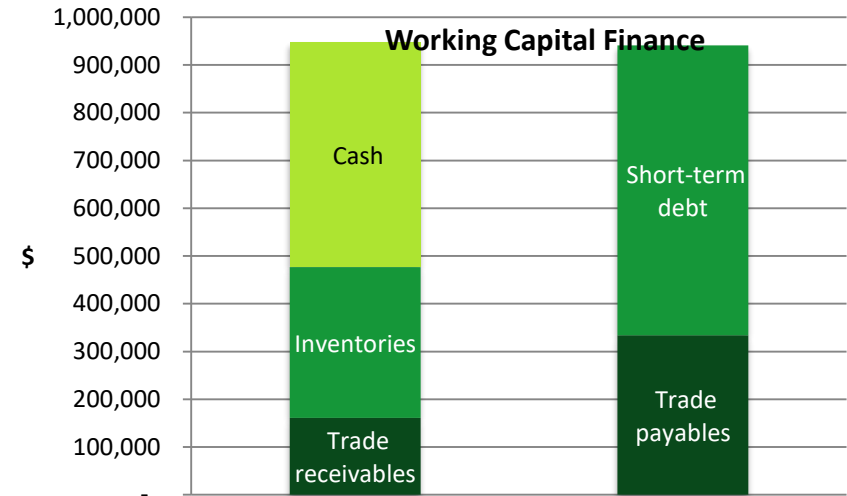
- † SMEs' working capital swings vary across sectors and within sectors depending upon the exact business model. We have considered the three sectors of agriculture, manufacturing and trading in a schematic sense in an attempt to bring a degree of clarity and simplicity to what is a complex and nuanced real world.
- † Trading businesses simply buy and sell goods for a margin. SMEs operating in this sector have a continuous need for working capital. These businesses need to optimise their procurement, distribution and financing in order to maximise the extent to which they can turnover their inventory given their operational capacity.
- † Agricultural SMEs have a far more seasonal requirement for working capital. In general and as in the foregoing example, there is a purchasing element to the cycle coincident with harvesting and sales element following processing. For agricultural SMES, the benefit of working capital is that enables participants to cope with significant swings in cashflow so that they can continue to pay fixed costs throughout the year.
- † Manufacturing SMEs are conceptually somewhere in the middle. They may not be driven by seasonality but must add value to their purchases (through processing, construction, assembly etc.) before distributing the end product. Working capital finance assists by covering any lag or shortfall in cash availability before it is replenished through sales receipts.

# 1. Working Capital in Context



## Capital structure considerations

- † Ideally, as with the SME in this example, long term assets such as machinery are financed with long term capital and short term inventory purchasing requirements with working capital.
- † This SME was founded less than five years ago and is therefore also appropriately heavily funded with equity rather than debt.



Source: Illustrative data – Mbuyu Capital; Photo – Wikipedia

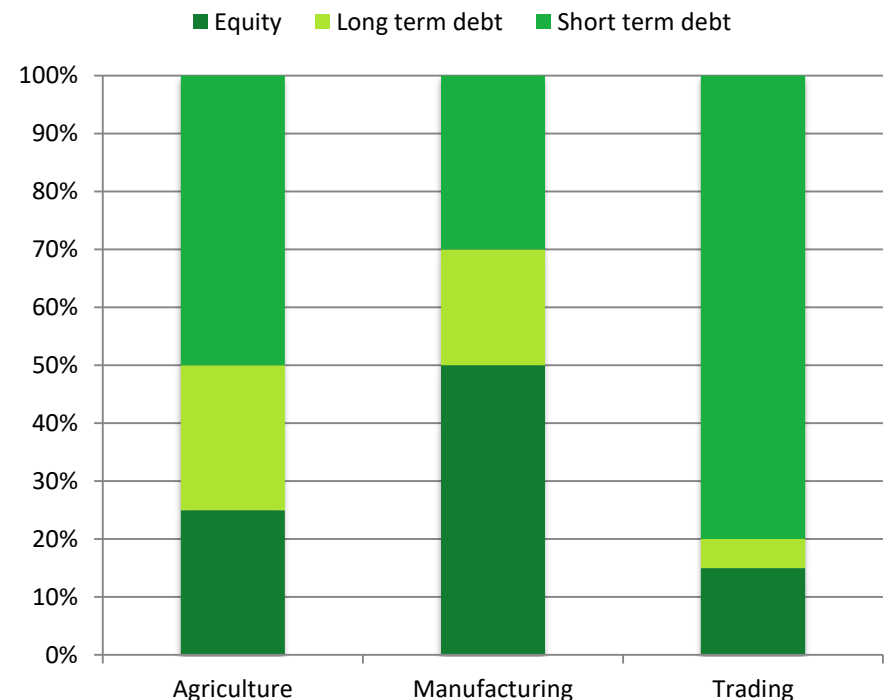
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# 1. Working Capital in Context



## Capital structure considerations (continued)

- As well as differing working capital needs, SMEs have varying optimal capital structures dependent not only maturity of the business (as illustrated above) but also depending upon the sector within which they operate. The chart below illustrates this schematically.
- Agriculture SMEs have a proportionately higher requirement for short term capital in the overall structure. Some long term debt may be needed for equipment, perhaps in the form of leasing. An equity cushion is needed to cope with longer climate cycles.
- Manufacturing SMEs typically have a larger fixed asset base to finance. Over time, funding may move from equity to debt as operations mature.
- Traders have few long term needs but some equity cushion is needed both for collateral and operational contingency purposes.



Source: Illustrative data – Mbuyu Capital; Photo – Wikipedia

# 1. Working Capital in Context



## *Capital structure considerations (continued)*

There are many factors to consider when deciding whether debt finance is appropriate at all and, if so, which product and how much should be used. Some of these factors can be controlled, some cannot.

### Controllable factors

- † Profitability
- † Equity position
- † Liquidity
- † Asset / liability matching
- † Term structure matching
- † Diversification of funding sources
- † Nature of the business
- † Are margins robust?
- † Is there a sufficient equity cushion, providing long-term funding?
- † Are interest and principal repayments manageable?  
e.g. leasing for PPE, trade finance for inventories
- † Do maturities match asset profile?  
Beneficial for pricing and security of funding
- † Cyclical or volatile businesses should use less debt

### Non-controllable factors

- † Cost of capital
- † Currency risk
- † Access to sources of finance
- † Counterparty risk
- † Debt finance is not always cheaper than equity
- † Currency should be matched to the extent possible
- † What financing options are available?
- † Are lenders good counterparties?

# 1. Working Capital in Context



## Working capital needs: Agriculture Sector Value Chain

Value Chain	Example Activities	Emerging Market Participants	SME Working Capital Needs
Inputs	Fertiliser, seed, animal feed, agricultural machinery supply	SMEs, large caps, MNCs <sup>1</sup>	Inventory financing, receivables financing
Production	Growing, farming	Smallholders, SMEs	Seasonal loans, receivables financing
Processing	Milling, refining, dairy operations, packaging	SMEs, large caps, MNCs	Inventory financing, receivables financing
Distribution	Warehousing & logistics, domestic trading, exporting	SMEs, large caps, MNCs	Inventory financing, receivables financing, pre-shipment, commodity trade finance

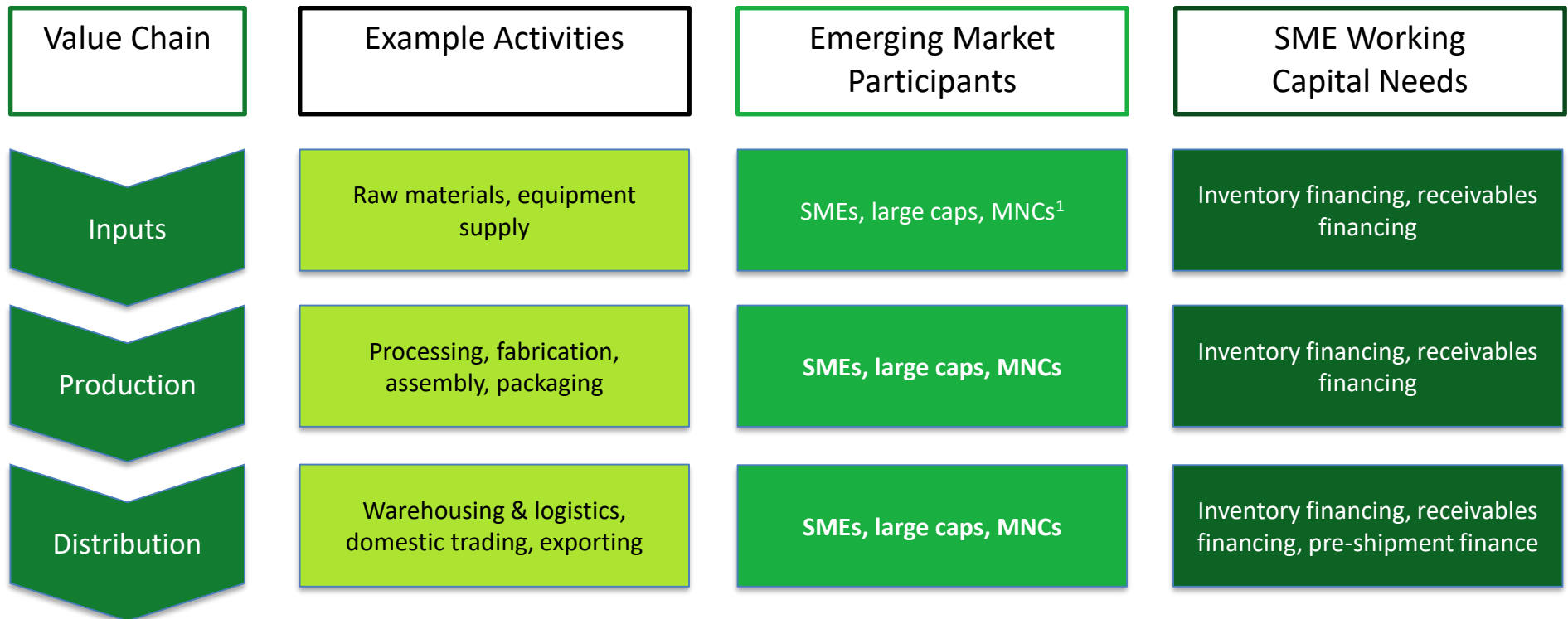
Note: (1) MNCs: Multi-national corporations

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# 1. Working Capital in Context



## Working capital needs: Manufacturing Sector Value Chain



Note: (1) MNCs: Multi-national corporations

# 1. Working Capital in Context



## Working capital needs: Trading Sector Value Chain

Value Chain	Example Activities	Emerging Market Participants	SME Working Capital Needs
Procurement	Consumer goods businesses, equipment distributors	SMEs, large caps	Inventory financing, receivables financing, distributor finance
Logistics	Warehousing & logistics	SMEs, large caps	Inventory financing, receivables financing
Distribution	Retail sales, wholesale distribution, exporting	SMEs, large caps, MNCs <sup>1</sup>	Inventory financing, receivables financing, pre-shipment finance

Note: (1) MNCs: Multi-national corporations

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## 2. Trade Finance Definitions



## 2. Trade Finance Definitions



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### *Introduction*

What is the objective in facilitating access to trade finance for frontier & emerging market SMEs?

¶ Improvement of cash flow position

- Frontier & emerging market SMEs report that inability to access to trade finance is a significant impediment to business growth.<sup>1</sup>
- Access to trade finance increases working capital capacity, allowing businesses to increase inventory turnover and therefore revenues.
- Other things equal, as a further benefit this in turn enables businesses to employ more people.

¶ Reduction of risk exposure

- Trade finance products can help mitigate the risk both that SMEs do not receive timely payment for merchandise sold.
- Where SMEs are part of a supply chain – especially in domestic markets - risk to the broader sector can also be reduced.

*Source: (1) World Trade Report: Levelling the Playing Field for SMEs.*

## 2. Trade Finance Definitions



*Propensity of trade finance products to benefit SMEs*

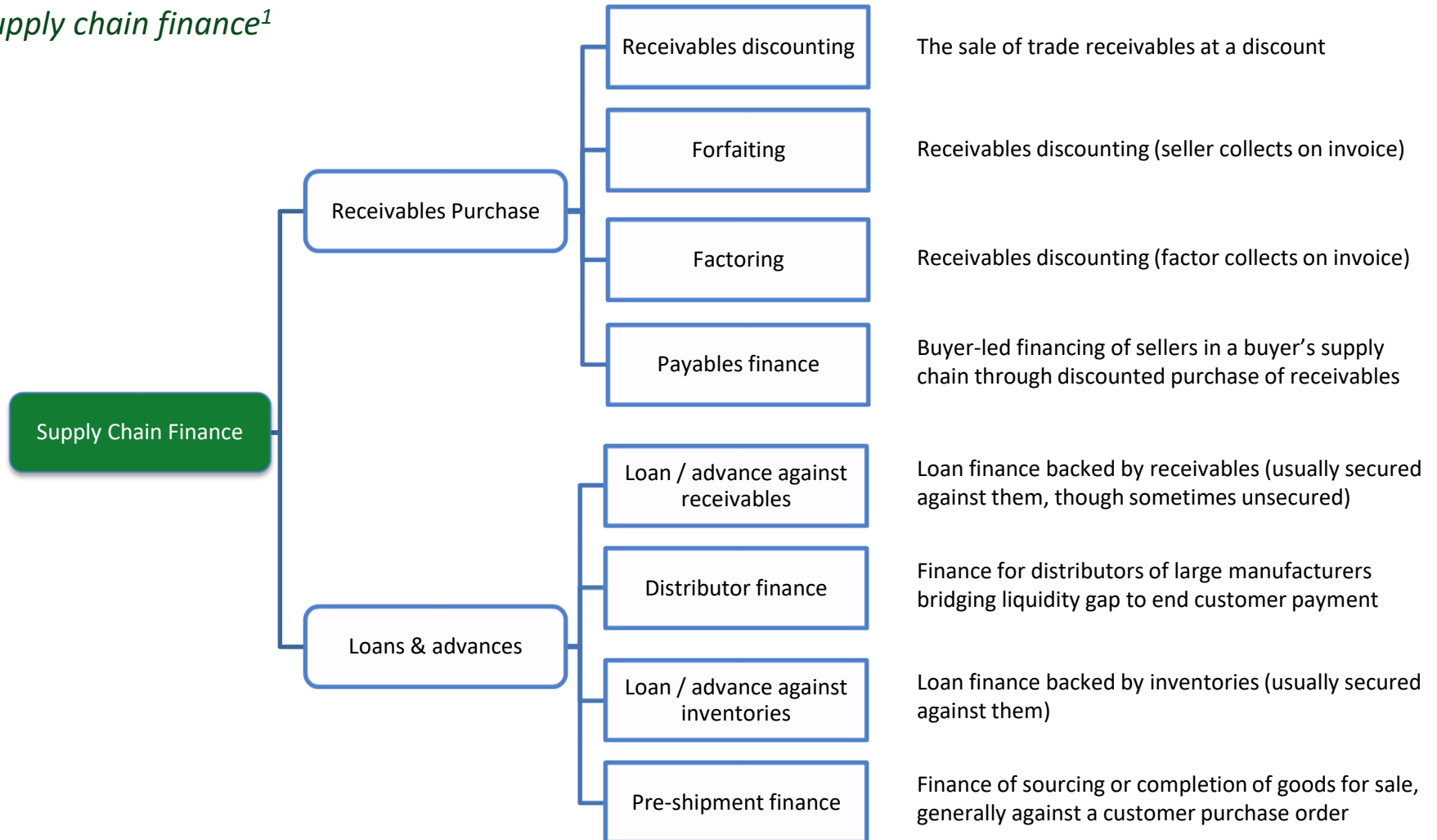
	Supply Chain Finance	Collections	Guarantees	Letters of Credit
Trade finance category	Finance	Payment facilitation	Risk mitigation	Payment facilitation
Product	Provision of working capital	Bank administered transaction	(Partial) guarantee of payment	Bank promise to pay on behalf of customer
Scope for direct cash flow impact:	High	Low	Low	Low
Scope for risk mitigation:	High	Medium	High	High

*Our focus is on supply chain finance as it encompasses the most impactful set of products to assist SMEs in frontier & emerging markets.*

## 2. Trade Finance Definitions



### *Supply chain finance<sup>1</sup>*



Note: (1) See Appendix A1 for detailed information on each category of supply chain finance.

Source: *Global Supply Chain Finance Forum*

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## 2. Trade Finance Definitions



### Impact on SMEs

	Cash flow impact to the SME	Risk impact for the SME
Receivables discounting	Cash from invoiced sales received earlier	Payment risk effectively eliminated
Forfaiting	Cash from invoiced sales received earlier	Payment risk effectively eliminated
Factoring	Cash from invoiced sales received earlier	Payment risk significantly reduced
Payables financing	Buyers suppliers receive cash earlier	Payment risk reduced
Loans / advance against receivables	Cash liquidity made available	No payment risk reduction
Distributor finance	Liquidity gap bridged for distributors	No payment risk reduction
Loans / advance against inventories	Cash liquidity made available	No payment risk reduction
Pre-shipment finance	Working capital position optimised	No payment risk reduction

Source: Global Supply Chain Finance Forum

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### 3. Demand Analysis

### 3. Demand Analysis



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#### *Summary Findings*

- ¶ We conclude that there is a \$150bn total gap in the provision of trade finance to frontier & emerging market SMEs globally.
- ¶ We further conclude that whilst the overall credit gap for frontier & emerging market SMEs is \$1.3 trillion, only certain types of SME and sectors can benefit from trade finance at all.
- ¶ Nonetheless, we also find that for those SMEs that are large enough and in the relevant sectors, trade finance could be highly relevant. This is because of its centuries-long development as a financing product specifically designed to tackle the risks associated with lending in higher-risk jurisdictions.
- ¶ Within the total \$150bn of unmet demand for trade finance, there is plentiful opportunity of a sufficient quality to constitute addressable demand. Two of these markets are over \$10bn (Brazil and Argentina), ten over \$1bn, and 21 over \$500m. The top 30 addressable markets of sufficient size and quality to merit individual investigation total about \$60bn.

### 3. Demand Analysis



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*SMEs say that inability to access business and trade finance is a major impediment to growth.*

- ¶ According to the WTO's 'World Trade Report 2016: Levelling the Playing Field<sup>2</sup> for SMEs', inability to access business and trade finance prevents SMEs from moving up sector value chains:
  - Lack of **access to business finance** is the factor most cited by agrifood sector SMEs (60%) when asked what prevents them from moving up agrifood value chains. Lack of **access to trade finance** is the fourth most cited factor (35%) after transportation costs (55%) and certification costs (47%).
  - Over 50% of apparel sector SMEs say that lack of **access to trade finance** prevents them from moving up apparel value chains, again the most cited factor.
  - When asked what factors affected bringing tourism suppliers from developing countries into their supply chain, respondents cited lack of **access to supplier finance** as the main factor (60%).
- ¶ The following analysis aims to quantify and qualify demand for trade finance from SMEs in all sectors in frontier & emerging markets.

Note: (1) See Appendix A2 for further detail.

### 3. Demand Analysis



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#### *Approach*

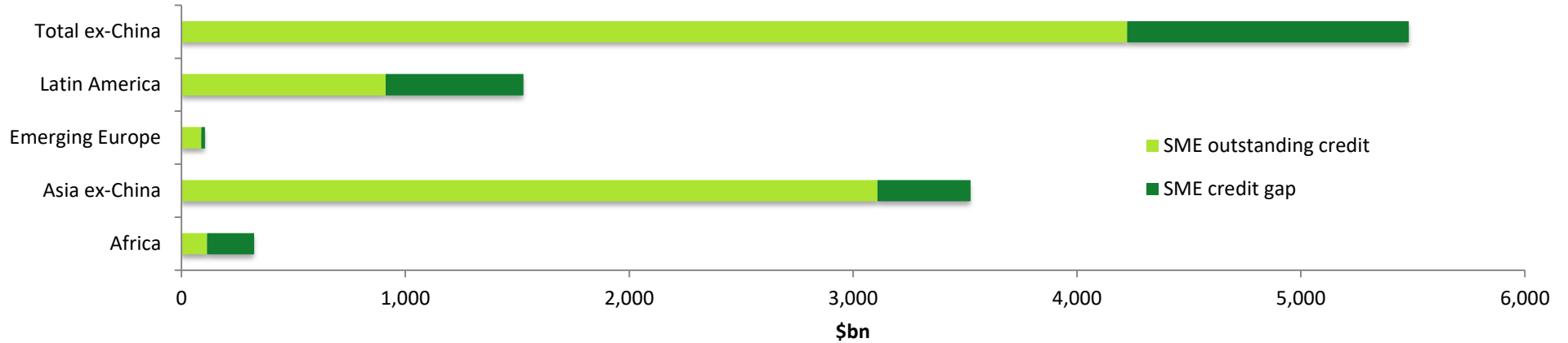
- † In seeking to understand the demand for trade finance for frontier and emerging market SMEs, we have used as our starting point estimates of the well-documented ‘credit gap’ faced by SMEs globally. In 2010, McKinsey and the IFC published the seminal report ‘Two trillion and counting’ which estimated the unmet need for credit for SMEs in the developing world at between \$2.1 and \$2.5 trillion.
- † Starting with updated data in the IFC’s SME Enterprise Finance Gap database estimating this ‘credit gap’ on a country-by-country basis, we then refine this overall number to reach a conclusion as to how much of it could usefully be addressed through trade finance.
- † In conducting this analysis, we have constructed a comprehensive data base including **22 different categories and indicators** for **125 countries**, creating **2,750 data points** in total. This database can then be used to create a nuanced picture of the demand for trade finance by SMEs in frontier and emerging markets.
- † We have also constructed an index that aims to quantify qualitative aspects of a country’s attractiveness as a market opportunity for trade finance with the objective of identifying where the unmet demand for trade finance can most credibly be serviced.



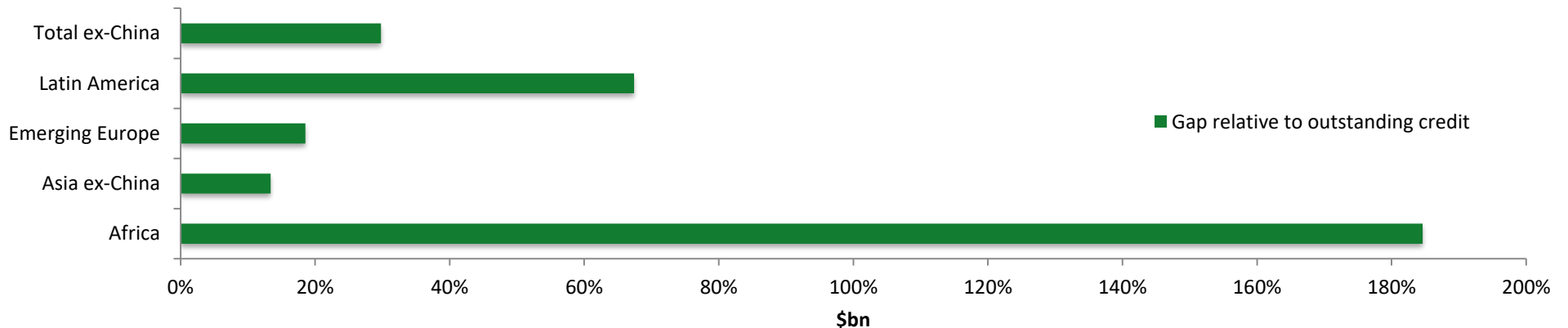
### 3. Demand Analysis



*Emerging market SMEs face a credit gap of \$1.3 trillion. The gap in \$ terms is greatest in Asia and Latin America...*



*...though relative to credit outstanding, Africa shows the most pronounced deficit in relative terms.*



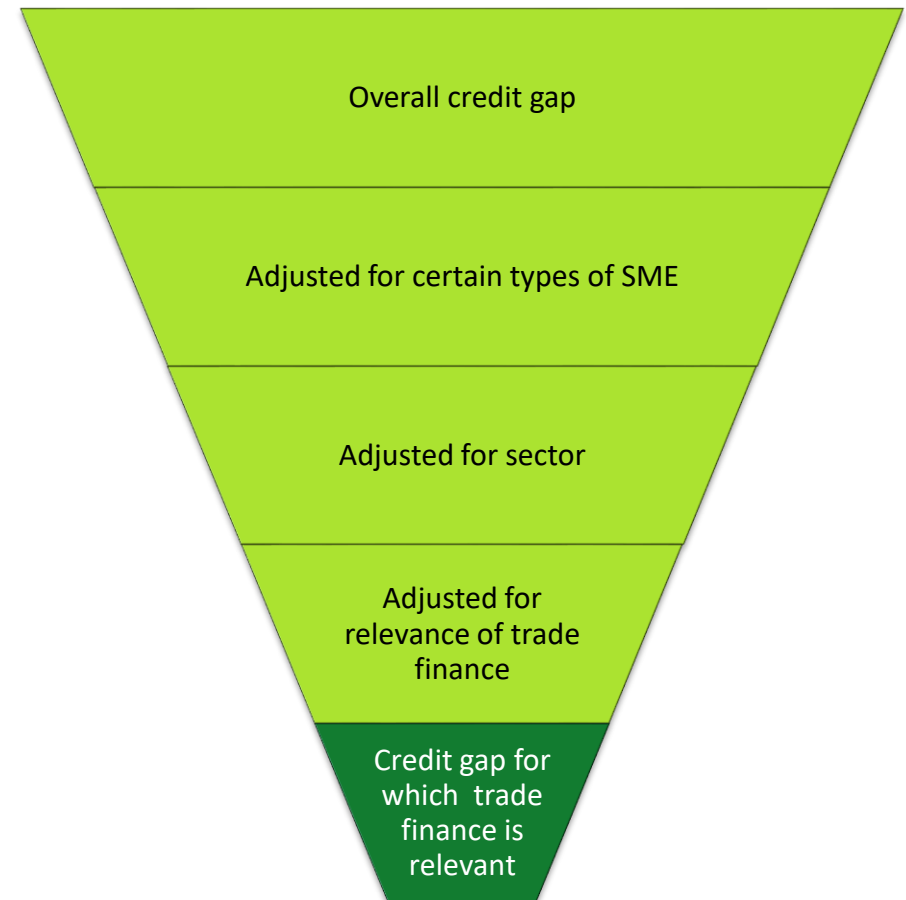
Source: Mbuyu Capital analysis, IFC SME Enterprise Finance Gap Database, McKinsey 'Two Trillion and Counting'

### 3. Demand Analysis



*Our analysis aims to determine how much of the gap could be addressed with trade finance.*

- ¶ In order to determine the unmet demand for trade finance from emerging market SMEs, we make several adjustments to the \$1.3 trillion overall credit gap.
- ¶ First, we refine the total gap by excluding certain categories of SME.
- ¶ Second, we exclude some SMEs based upon sector characteristics.
- ¶ Lastly, we recognise that SMEs will require different forms of credit finance depending upon a number of factors. We further adjust our analysis to reflect this.



### 3. Demand Analysis



*Informal, micro and very small SMEs are unlikely to be eligible for trade finance*

SME size	Definition	
Informal	All enterprises that are not registered with the municipality or tax authority and all the non-employer firms (independent of registration)	<p>Micro and very small enterprises are defined as having revenues of only c. \$100k p.a., meaning that a maximum borrowing level would be unlikely to exceed \$10k. This in turn would mean that trade finance products are not economic due to high transaction cost relative to loan size. Higher risk levels would also be a problem for trade finance providers. Microfinance and local bank credit provision are more appropriate products for this SME segment.</p>
Micro	1 – 4 employees, Annual sales <\$100,000 Loan sizes up to \$10k	
Very small	5 – 9 employees	
Small	10 – 49 employees Annual sales <\$3m Loan sizes up to \$100k	<p>Trade finance products are most likely to benefit larger enterprises in the SME spectrum.</p>
Medium	50 – 250 employees Annual sales <\$15m Loan sizes up to \$2m	

Source: IFC SME Enterprise Finance Gap Database definitions, IFC SME Banking Knowledge Guide.

### 3. Demand Analysis



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*SMEs operating in the services sector are unlikely to require trade finance products*

- † We analyse the unmet demand for trade finance using the sector categorisations adopted by the IFC MSME database: agriculture, manufacturing, trading and services.
- † SMEs in agricultural value chains require seasonal working capital in particular, often in the form of loans against inventory, and as such will benefit from trade finance<sup>1</sup>.
- † Manufacturing SMEs can benefit from trade finance, particularly in the form of receivables financing<sup>1</sup>.
- † Trading SMEs typically have significant trade finance needs as an integral element of their business model<sup>1</sup>.
- † However, services sector SMEs would not benefit in the same way. Typically, much of the cost base for services companies is fixed and therefore companies experience fewer swings in working capital or need for short term purchasing. Furthermore, services companies tend not to have inventories or the type of receivables against which lending can be secured. We therefore exclude services SMEs from the market that can be addressed through trade finance products.

Note: (1) Further discussed in Section 1 of this report.

### 3. Demand Analysis



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#### *Trade finance can address some of the SME credit gap but other credit products are also important*

- ¶ We have considered tenor and sector relevance in assessing the portion of the gap that trade finance can usefully address. Trade finance is a short-term credit product that has developed over centuries and across jurisdictions. It is specifically designed to cope with credit- and counterparty risk by focusing on security afforded by physical collateral and receivables. This is in contrast to bank lending where security is usually general collateral and is less actively monitored.
- ¶ For trading sector SMEs, the requirement for financing is short term in nature and trade finance is highly applicable. We assume trade finance is relevant in 100% of cases.
- ¶ For manufacturing SMEs, long term financing is required to finance fixed assets. Although equity is often more appropriate, we assume that up to 50% of the credit gap for manufacturers may be for tenors longer than one year and trade finance is relevant for the other 50%.
- ¶ For agricultural SMEs, there is generally a significant seasonal working capital requirement<sup>1</sup> and less emphasis on long term asset finance. We assume 75% of the credit gap for these SMEs can be addressed through trade finance.
- ¶ Excluding services SMEs, 17% of the remaining universe are agriculture SMEs, 35% manufacturing and 48% trading. We therefore make a further refinement to our addressable market size to reflect our view that 75% of the SME credit gap can be addressed using trade finance<sup>2</sup>.

Notes: (1) Further discussed in Section 1 of this report. (2) Calculated as  $([17\% \times 75\%] + [35\% \times 50\%] + [48\% \times 100\%]) = 78\%$ , rounded down to 75%



### 3. Demand Analysis

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#### *A note on the DAC list and China*

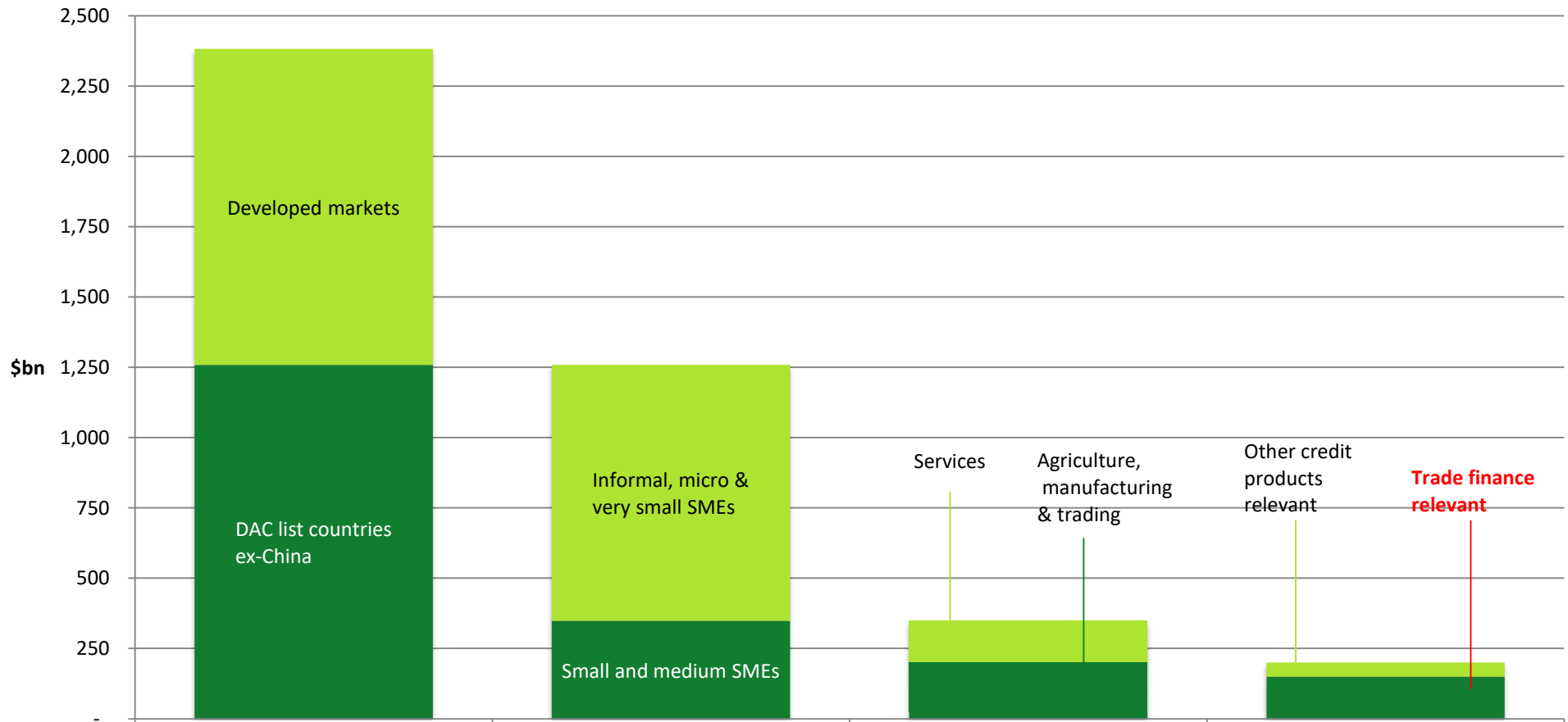
- † Our country universe comprises countries on the DAC list<sup>1</sup>. The DAC list is compiled every three years and uses per capita GNI data from the World Bank. The latest version is effective from 1<sup>st</sup> January 2015 and uses 2013 per capita GNI numbers.
- † The list includes four categories: 'Least Developed Countries', 'Other Low Income Countries', 'Lower Middle Income Countries' and 'Upper Middle Income Countries'. China is in the 'Upper Middle Income Countries' category which includes countries with per capita GNI of less than \$12,745 in 2013 and therefore qualifies for Official Development Assistance according to OECD rules.
- † We include China in our database but we exclude the country from our analysis. Were we to include China, it would heavily skew the results by increasing the market share of Asia.
- † China has developed a relatively sophisticated SME credit registry system. The country also has problems with corporate overleverage and NPLs. For these reasons, the realistic addressable market is likely much smaller than is indicated in our database.

Note: (1) The OECD's Development Assistance Committee (DAC) list (<http://www.oecd.org/dac/stats/daclist.htm>).

### 3. Demand Analysis



*Of the total \$1.3 trillion F&EM SME credit gap, \$150 billion can be addressed through trade finance*

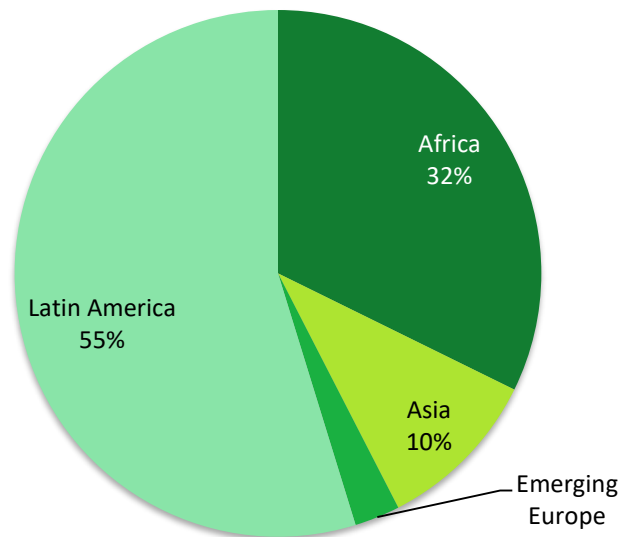


Source: Mbuyu Capital analysis, IFC SME Enterprise Finance Gap Database, McKinsey 'Two Trillion and Counting' 2010

### 3. Demand Analysis



*A \$150 billion addressable market globally...*



Source: Mbuyu Capital analysis, IFC SME Enterprise Finance Gap Database, McKinsey 'Two Trillion and Counting' 2010

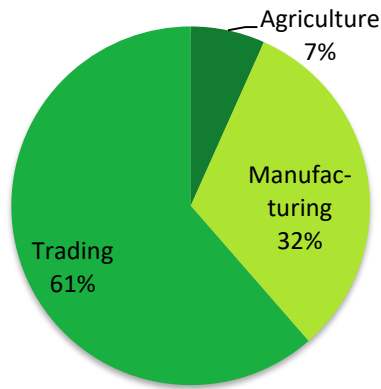
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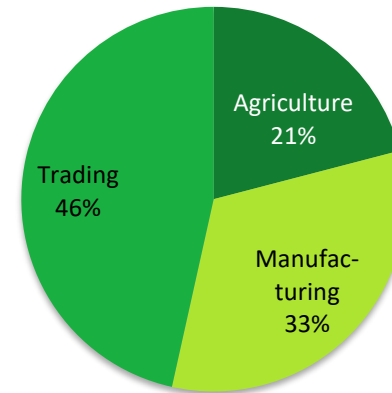
### 3. Demand Analysis



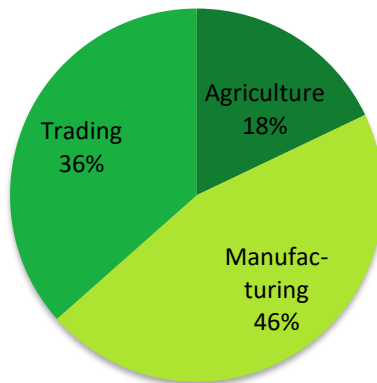
*...of which \$82 billion is in Latin America...*



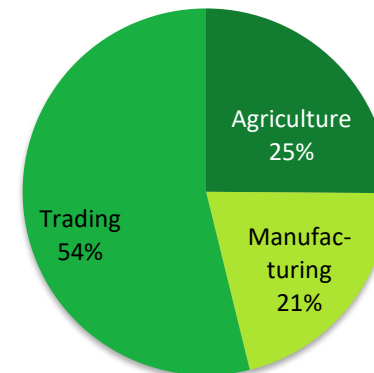
*...\$48 billion is in Africa...*



*...\$15 billion is in Asia...*



*...and \$4 billion is in Emerging Europe.*

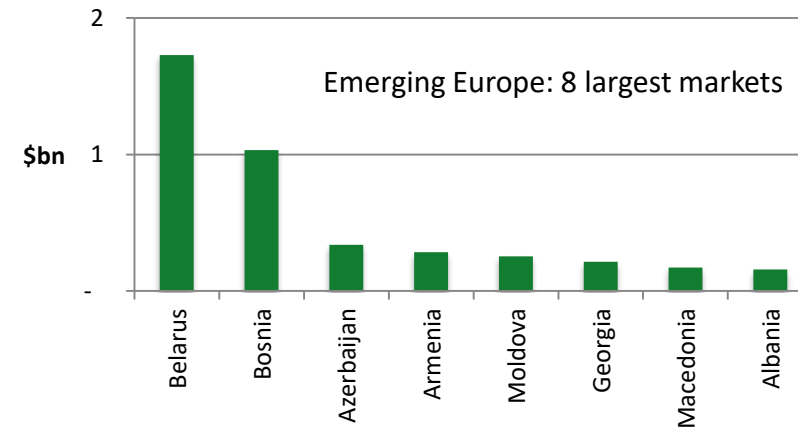
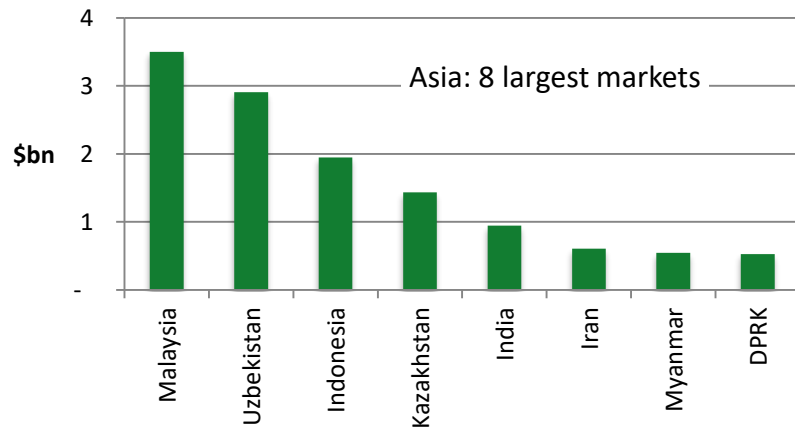
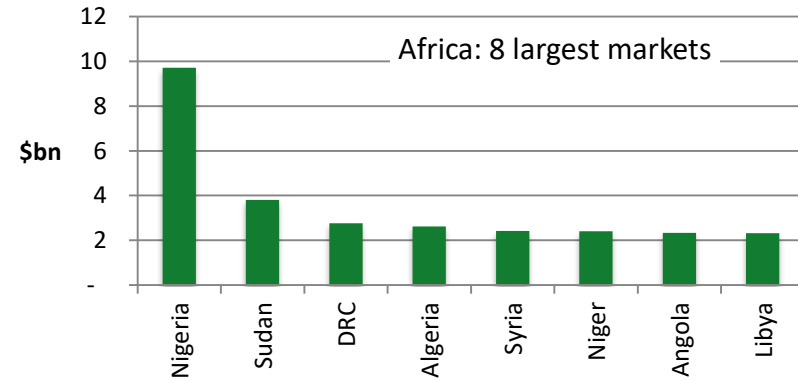
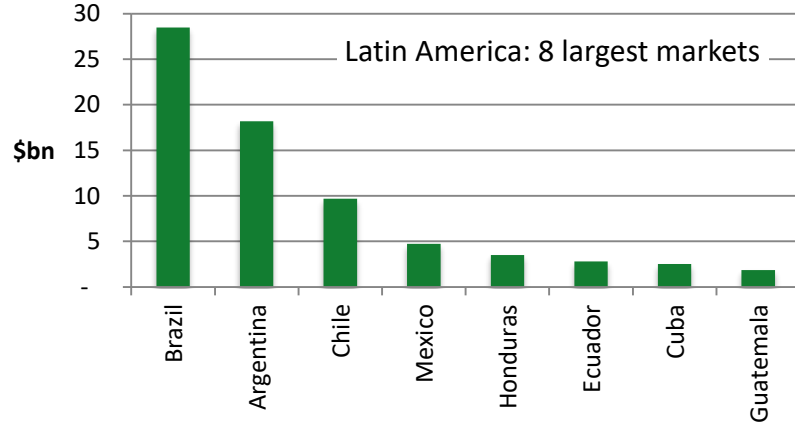


Source: Mbuyu Capital analysis, IFC SME Enterprise Finance Gap Database, McKinsey 'Two Trillion and

### 3. Demand Analysis



*Having considered addressable markets at a regional level, we now look at country-level markets.*

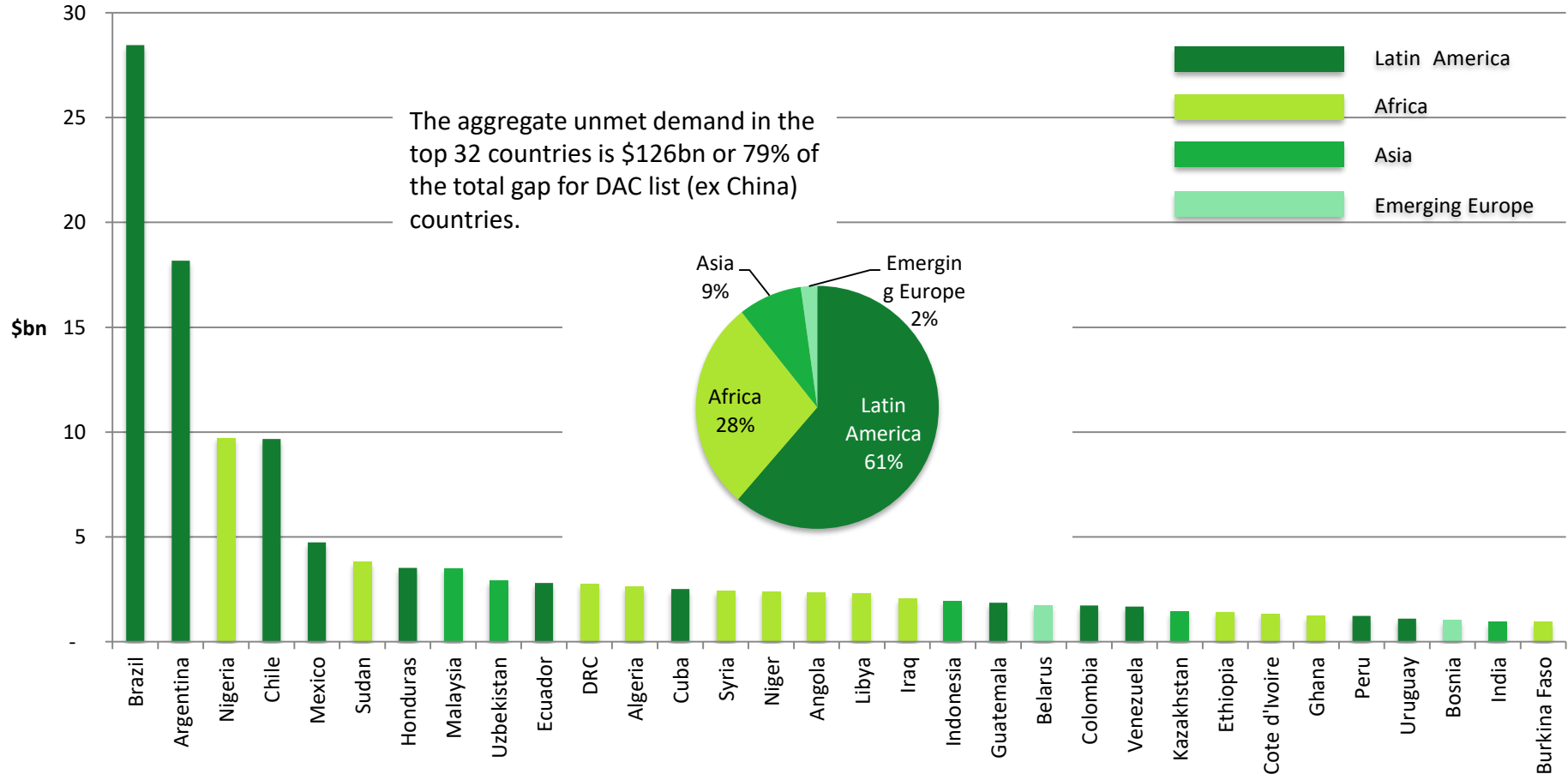


Source: Mbuyu Capital analysis, IFC SME Enterprise Finance Gap Database, McKinsey 'Two Trillion and Counting' 2010

### 3. Demand Analysis



*If we think about the top 32 DAC markets (ex China) anywhere in the world, the picture is slightly different again...*



Source: Mbuyu Capital analysis, IFC SME Enterprise Finance Gap Database, McKinsey 'Two Trillion and Counting' 2010

### 3. Demand Analysis



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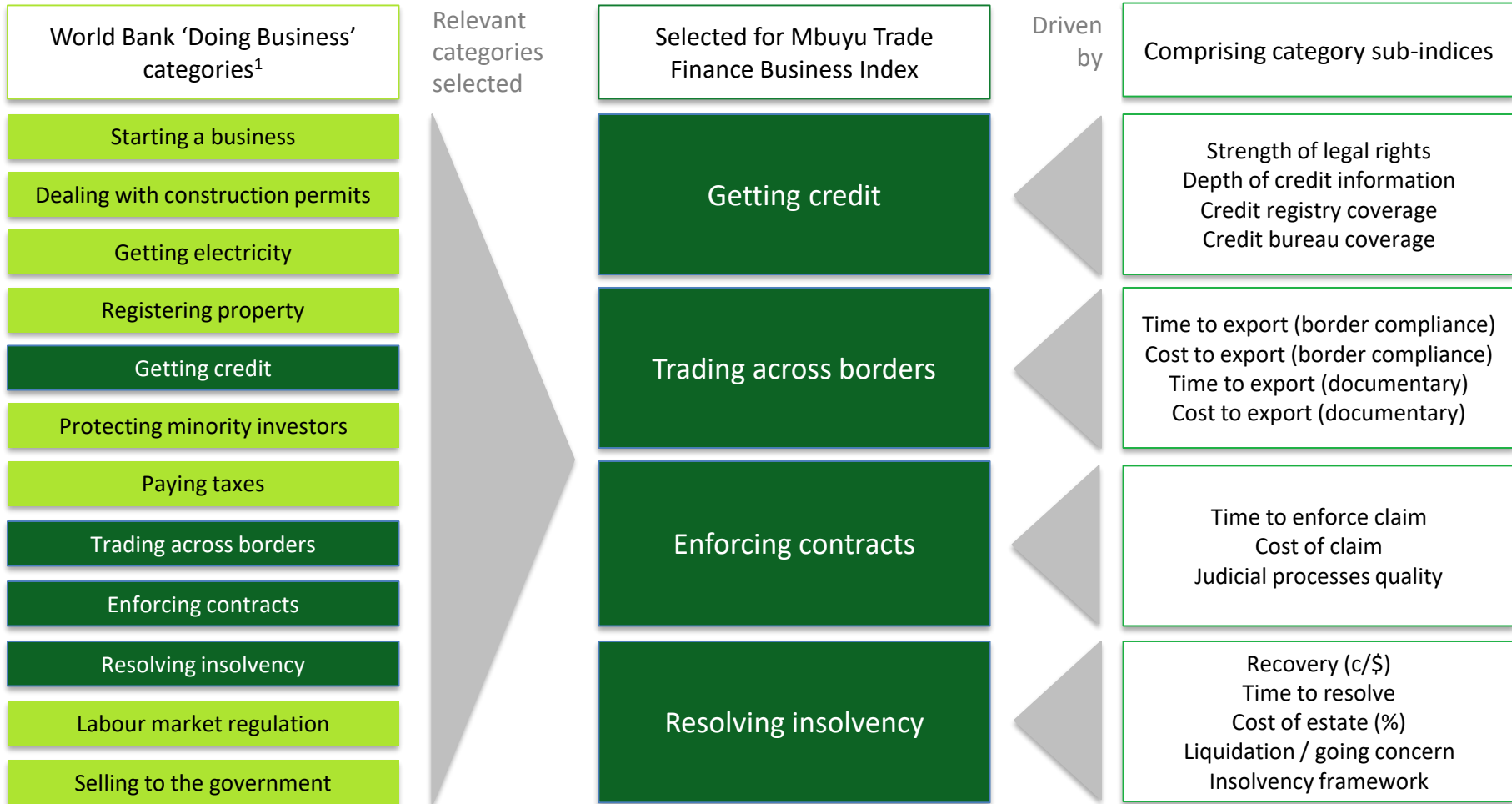
*...but it is not only the size of the market that is important. We have also considered business environment for sourcing and providing trade finance.*

- ¶ Mbuyu Capital has created a Trade Finance Business Index designed to score countries to reflect:
  - The environment for providing credit products
  - The ability to enforce contracts
  - The ability to recover money in the event of insolvency
  - The ease with which cross-border trade is conducted.
  
- ¶ We then use these scores to qualify and adjust the opportunity suggested by our initial country rankings.
  
- ¶ We then re-rank the countries in order to provide a list of market opportunities by country which reflects both the US Dollar size of the opportunity and the quality of the opportunity in terms of business attractiveness.
  
- ¶ For instance, Sudan shows a large opportunity in US Dollar terms (\$3.8bn) but its score of 0.14 in our Index (on a scale of 0.00 to 1.00) ranks it 182<sup>nd</sup> out of 190 countries, meaning we would not view Sudan as an appealing market opportunity.
  
- ¶ In contrast, Malaysia shows a good opportunity in both size (\$3.5bn) and quality (index score of 0.78).

### 3. Demand Analysis



#### Trade Finance Business Environment Index construction



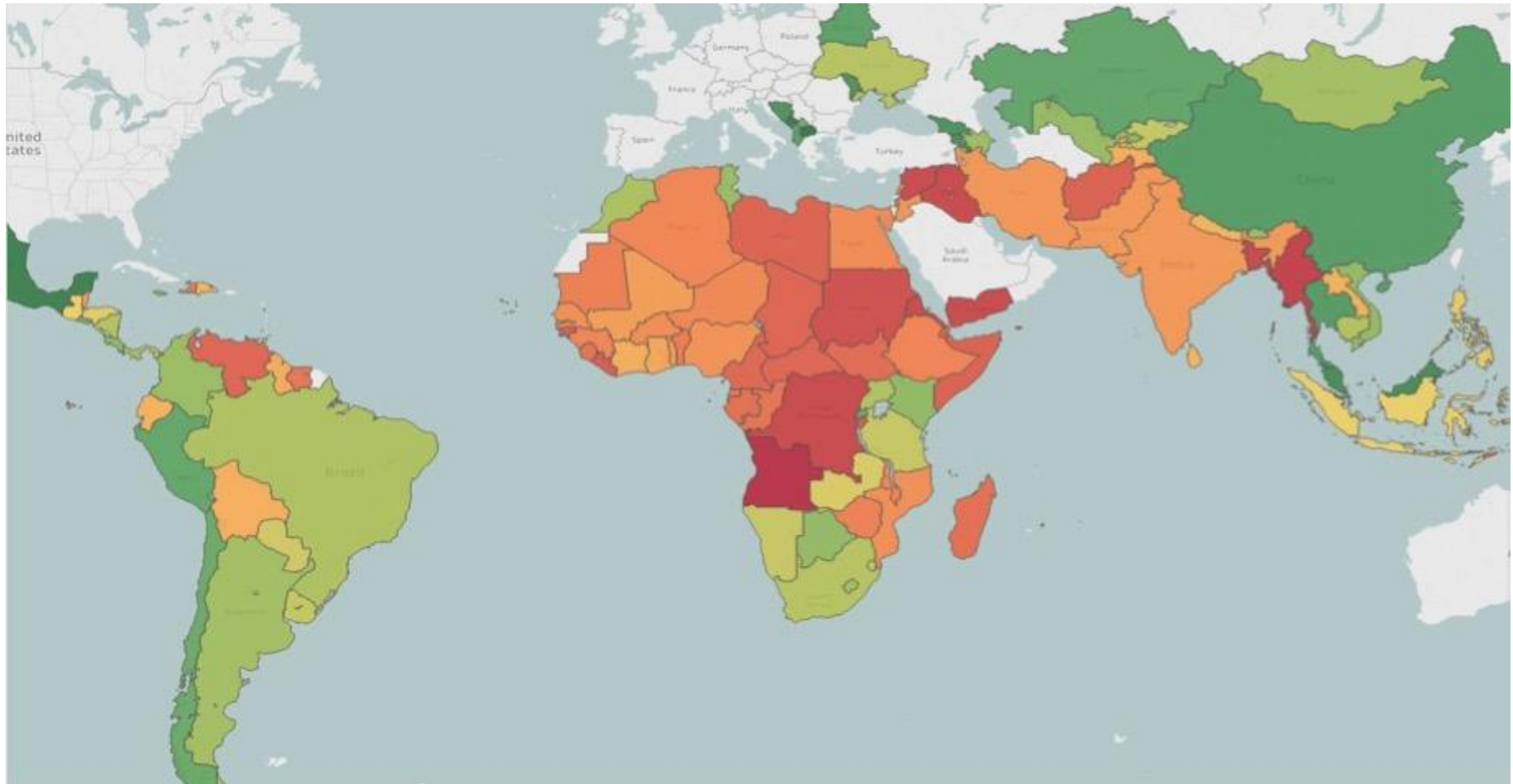
Note: (1) Refers to the World Bank Doing Business Index (<http://www.doingbusiness.org/rankings>)

### 3. Demand Analysis



#### *Mbuyu Trade Finance Business Index map*

*(Red: Worst business environment for trade finance; Green: Best business environment for trade finance)*



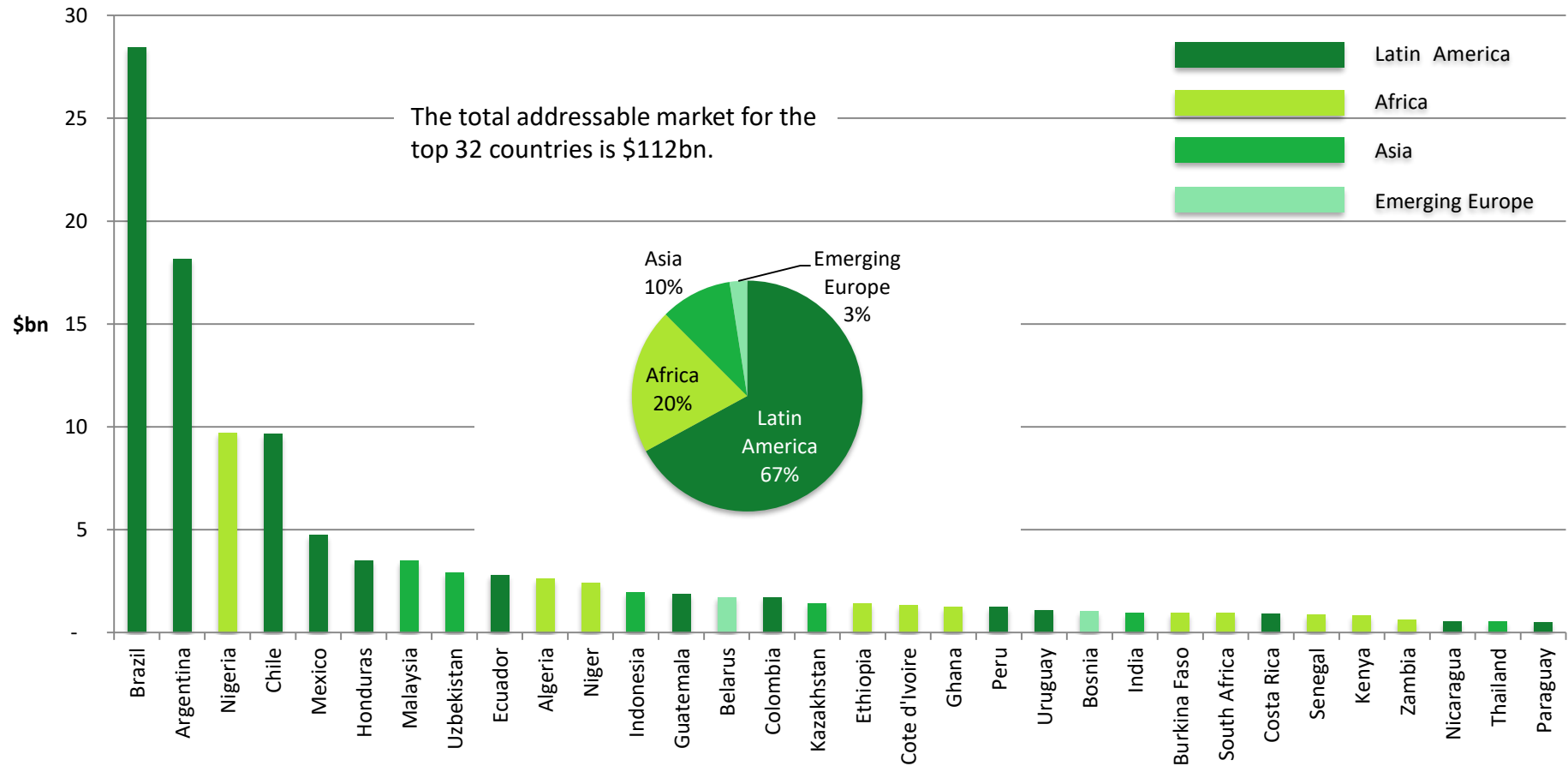
Source: Mbuyu Capital

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### 3. Demand Analysis



Top 32 markets after re-ranking by the Mbuyu Trade Finance Business Index.



Source: Mbuyu Capital analysis, IFC SME Enterprise Finance Gap Database, McKinsey 'Two Trillion and Counting' 2010

### 3. Demand Analysis



#### Top 30 opportunities

##### Top countries before applying the Index

- |              |                   |
|--------------|-------------------|
| 1. Brazil    | 17. Libya         |
| 2. Argentina | 18. Iraq          |
| 3. Nigeria   | 19. Indonesia     |
| 4. Chile     | 20. Guatemala     |
| 5. Mexico    | 21. Belarus       |
| 6. Sudan     | 22. Colombia      |
| 7. Honduras  | 23. Venezuela     |
| 8. Malaysia  | 24.               |
| 9.           | Kazakhstan        |
| Uzbekistan   | 25. Ethiopia      |
| 10. Ecuador  | 26. Cote d'Ivoire |
| 11. DRC      | 27. Ghana         |
| 12. Algeria  | 28. Peru          |
| 13. Cuba     | 29. Uruguay       |
| 14. Syria    | 30. Bosnia        |
| 15. Niger    |                   |
| 16. Angola   |                   |

##### OUT OF TOP 30

- |       |           |
|-------|-----------|
| Sudan | Angola    |
| Libya | DRC       |
| Iraq  | Cuba      |
| Syria | Venezuela |

##### INTO TOP 30

- |              |           |
|--------------|-----------|
| South Africa | Zambia    |
| Costa Rica   | Nicaragua |
| Senegal      | Thailand  |
| Kenya        | Paraguay  |

##### Top countries after applying the Index

- |               |                   |
|---------------|-------------------|
| 1. Brazil     | 17. Ethiopia      |
| 2. Argentina  | 18. Cote d'Ivoire |
| 3. Nigeria    | 19. Ghana         |
| 4. Chile      | 20. Peru          |
| 5. Mexico     | 21. Uruguay       |
| 6. Honduras   | 22. Bosnia        |
| 7. Malaysia   | 23. India         |
| 8. Uzbekistan | 24. Burkina Faso  |
| 9. Ecuador    | 25. South Africa  |
| 10. Algeria   | 26. Costa Rica    |
| 11. Niger     | 27. Senegal       |
| 12. Indonesia | 28. Kenya         |
| 13.           | 29. Zambia        |
| Guatemala     | 30. Nicaragua     |
| 14. Belarus   |                   |
| 15. Colombia  |                   |
| 16.           |                   |
| Kazakhstan    |                   |

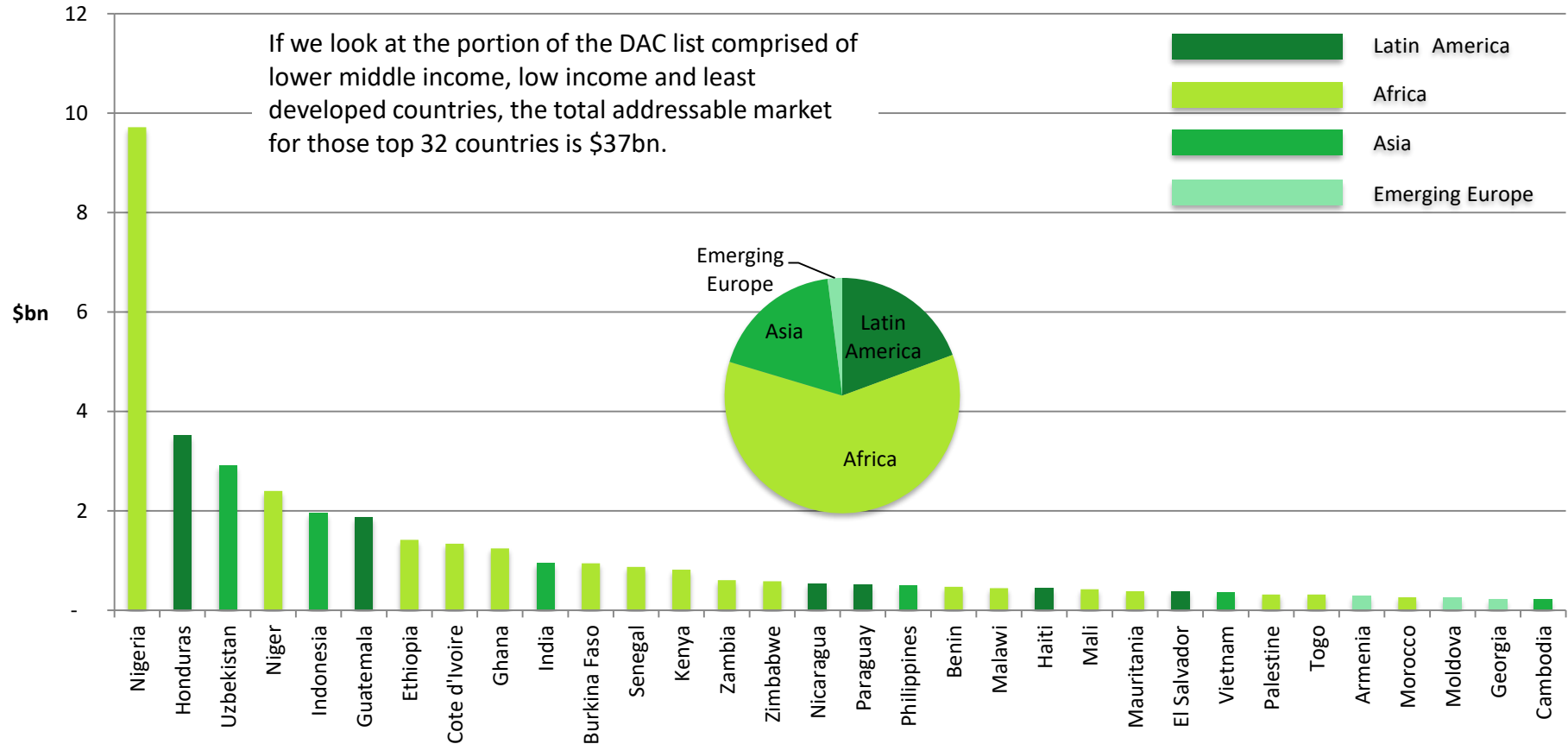
Source: Mbuyu Capital analysis



### 3. Demand Analysis



#### Top 32 markets after re-ranking by the Mbuyu Trade Finance Business Index (lower income countries)



Source: Mbuyu Capital analysis, IFC SME Enterprise Finance Gap Database, McKinsey 'Two Trillion and Counting' 2010

### 3. Demand Analysis



#### Top 30 opportunities (lower income countries)

##### Top countries before applying the Index

- |                   |                 |
|-------------------|-----------------|
| 1. Nigeria        | 16. Senegal     |
| 2. Sudan          | 17. Kenya       |
| 3. Honduras       | 18.             |
| 4. Uzbekistan     | Madagascar      |
| 5. DRC            | 19. Rep. Congo  |
| 6. Syria          | 20. Chad        |
| 7. Niger          | 21. Zambia      |
| 8. Angola         | 22. Zimbabwe    |
| 9. Indonesia      | 23. Somalia     |
| 10. Guatemala     | 24. Burma       |
| 11. Ethiopia      | 25. Nicaragua   |
| 12. Cote d'Ivoire | 26. DPRK        |
| 13. Ghana         | 27. Paraguay    |
| 14. India         | 28. Philippines |
| 15. Burkina Faso  | 29. Benin       |
|                   | 30. Malawi      |

##### OUT OF TOP 30

- |            |                 |
|------------|-----------------|
| Sudan      | Rep. Congo      |
| DRC        | Chad            |
| Syria      | Somalia         |
| Angola     | Burma (Myanmar) |
| Madagascar | DPRK            |

##### INTO TOP 30

- |          |          |
|----------|----------|
| Armenia  | Mali     |
| Vietnam  | Morocco  |
| Moldova  | Haiti    |
| Zimbabwe | Togo     |
| Georgia  | Cambodia |

##### Top countries after applying the Index

- |                  |                 |
|------------------|-----------------|
| 1. Nigeria       | 16. Paraguay    |
| 2. Honduras      | 17. El Salvador |
| 3. Uzbekistan    | 18. Philippines |
| 4. Indonesia     | 19. Armenia     |
| 5. Guatemala     | 20. Vietnam     |
| 6. Niger         | 21. Moldova     |
| 7. Cote d'Ivoire | 22. Zimbabwe    |
| 8. Ghana         | 23. Georgia     |
| 9. Kenya         | 24. Mali        |
| 10. Ethiopia     | 25. Morocco     |
| 11. India        | 26. Malawi      |
| 12. Burkina Faso | 27. Haiti       |
| 13. Zambia       | 28. Benin       |
| 14. Nicaragua    | 29. Togo        |
| 15. Senegal      | 30. Cambodia    |

Source: Mbuyu Capital analysis



## 4. Supply Analysis

## 4. Supply Analysis



### *Introduction*

- ¶ This section of the report considers the supply of trade finance products to SMEs in frontier and emerging markets. In particular, it examines the landscape of finance providers beyond the banks, which remain the largest suppliers overall.
  
- ¶ We have interviewed suppliers, built a database and analysed the data that we have gathered. This has enabled us to draw some conclusions about:
  - the state of the market
  
  - the depth of capital available to address the credit gap in frontier and emerging markets
  
  - the range of opportunities available through which private sector investors and DFIs are able to deploy capital to address this gap.



## 4. Supply Analysis



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### *Key conclusions*

- † The aggregate supply of trade finance from the vehicles in our universe is very small compared to the opportunity for deployment of capital suggested by our demand analysis.
- † The banks continue to dominate the market in terms of the volume of credit supplied. However, trade finance tends to be an adjunct to their main loan books. Banks therefore generally finance larger corporations and commodity traders, hence the credit gap.
- † The assets managed by alternative trade finance suppliers has grown significantly in recent years, a trend that looks set to continue. Some of these new entrants have impactful lending as an explicit part of their strategy. Many are focused on non-exchange traded commodities, lower volumes, niche routes or a combination in order to achieve higher margins.
- † Nonetheless, returns have come down in recent years. This can only partly explained by a low interest rate environment. A significant further factor seems to be the growth in AUM and the concomitant requirement to lend in larger ticket sizes that in turn do not command the higher rates associated with smaller transactions.
- † At the same time, origination of suitable deal flow also seems to be an issue suggesting an information gap that will need to be addressed before the credit gap for SMEs can be closed.

## 4. Supply Analysis



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### *Trade finance suppliers*

- ¶ Mbuyu Capital has interviewed 31 suppliers of trade finance, 25 of which make up our universe.
  - Six suppliers we have spoken to are not included in our universe because they are no longer providing trade finance products or because their focus is more on developed markets and / or large-scale commodity trading.
- ¶ Between these 25 suppliers, there are 40 vehicles through which trade finance is supplied to SMEs in frontier and emerging markets. Of the 25 suppliers, 17 are set up to manage funds and 8 are not – i.e. they are factors or limited liability companies that use their own balance sheet and are financed through their own equity and loans from banks and/or other lenders, including impact lenders.
- ¶ We believe we have captured all of the significant alternative trade finance suppliers that are structured as funds.
- ¶ There are a number of managers that are new entrants to trade finance currently in the process of raising funds and building teams. We have interviewed as many of these as we have been able to reach.

## 4. Supply Analysis



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### *Trade finance supplier database*

- † We have compiled a database of the 25 trade finance suppliers with 40 investable opportunities, accessible in order to target SMEs in frontier and emerging markets.
- † Data covers business operations, lending strategy, impact and other investor-relevant information across 44 categories, meaning that our database holds over 1,500 data points to help us analyse and understand the investible supplier landscape.
- † We have also spoken to suppliers that have provided us with valuable insights on the trade finance market but that are not directly relevant (e.g. because they do not focus on SMEs, an investment is not possible or practical etc.). We exclude these from our database.
- † We believe we have captured the significant players but not all suppliers were available or willing to be interviewed. These too are excluded.

## 4. Supply Analysis



### *Data gathered*

Categories	Data collected	Data points
Manager & vehicle	Manager & name of fund / vehicle	-
Regions targeted	Africa / Asia / Emerging Europe / Latin America	4
Sectors targeted	Agriculture / manufacturing / trading / services	4
Commodity trade financed	Energy / metals / softs / other / none	4
Excluded sector	Tobacco?	1
Product focus	Receivables discounting / factoring / forfaiting / payables finance / loans against receivables / distributor finance / loans against inventories / pre-shipment finance / other trade finance / other credit	10
SME focus	Some focus / exclusive focus	1
Impact	Impact targeted?, measured?, reported?, score from 0 to 3	4
Product	Ticket size, tenor, interest rate, currency	4
Investor information	Vehicle structure, target net return, management fee, carried interest, hurdle rate, liquidity, open / closed status, possibility of segregated accounts	8
Manager details	AUM, offices, staff, history	4
	Total	44



## 4. Supply Analysis



### Regional coverage



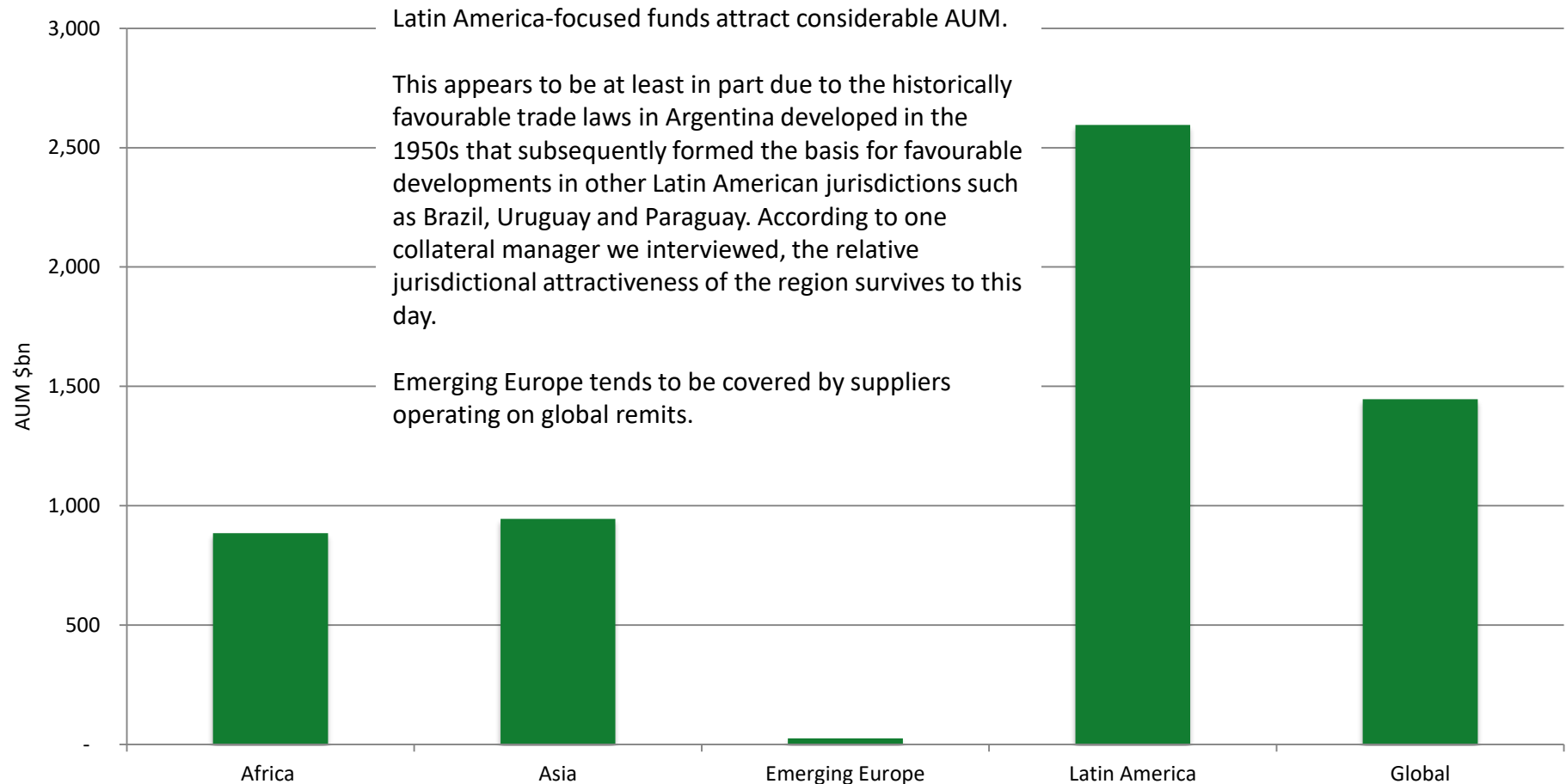
Source: Mbuyu Capital Trade Finance Supplier Database ('Mbuyu Data')

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## 4. Supply Analysis



### *Fund AUM by region*



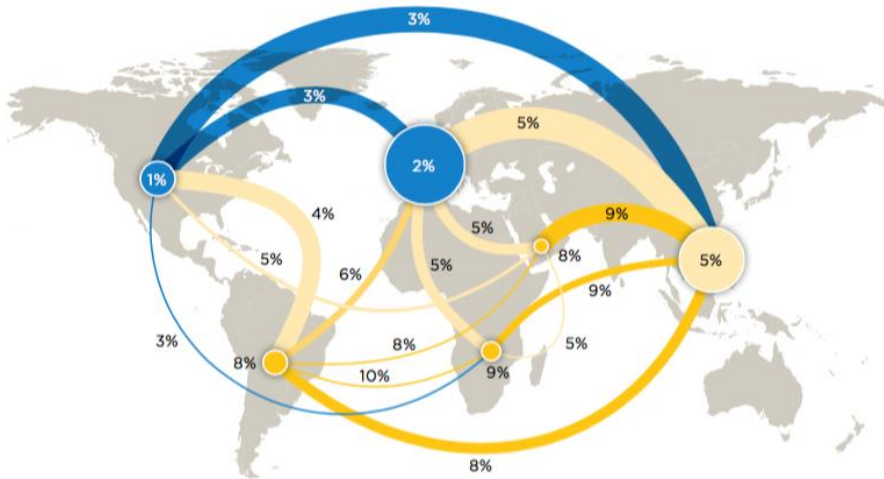
Source: Mbuyu Data

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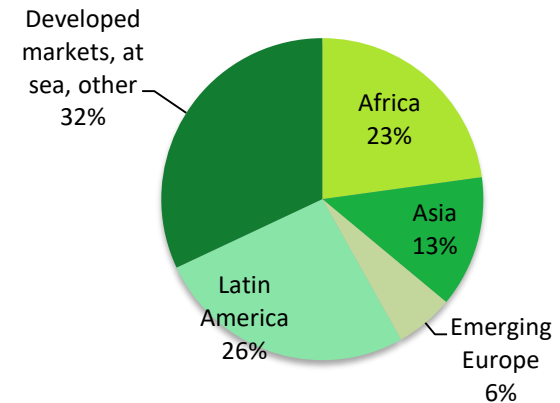
# 4. Supply Analysis



## Trade finance, regional focus and jurisdictional exposures



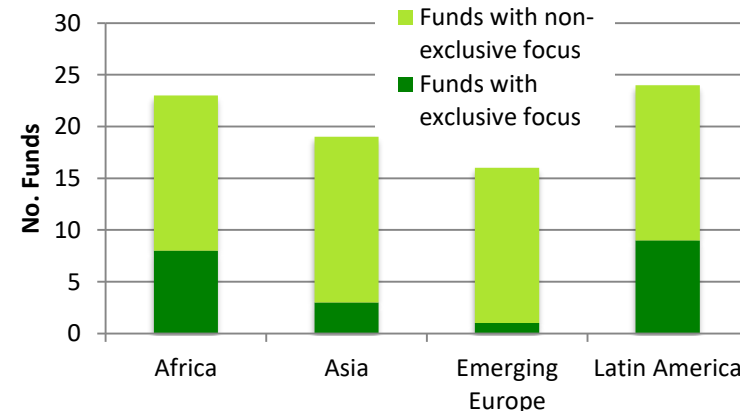
**Exposure to borrower jurisdictions of selected large funds**



Trade finance is an international business by nature. Inter-regional commodity flows mean that, even where a supplier may lend to trade borrowers in one jurisdiction, SMEs in another can still benefit. In fact, this is fairly typical.

This means that assessing relationships between supply and demand of trade finance in a particular market is unlikely to be meaningful.

**Regional strategy focus**



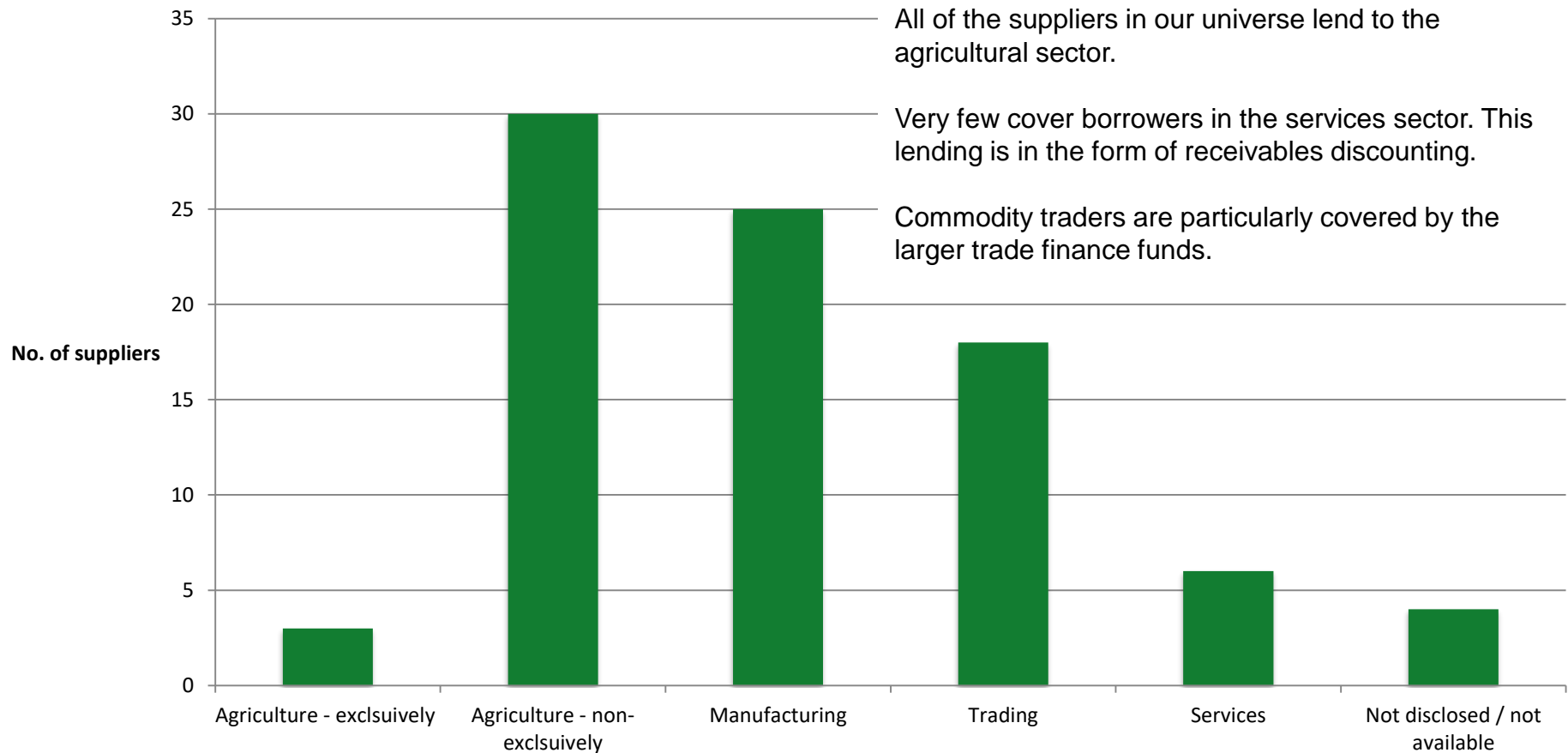
Source: IIC, Mbuyu Data

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## 4. Supply Analysis



### *Trade finance supply to major sector categories*



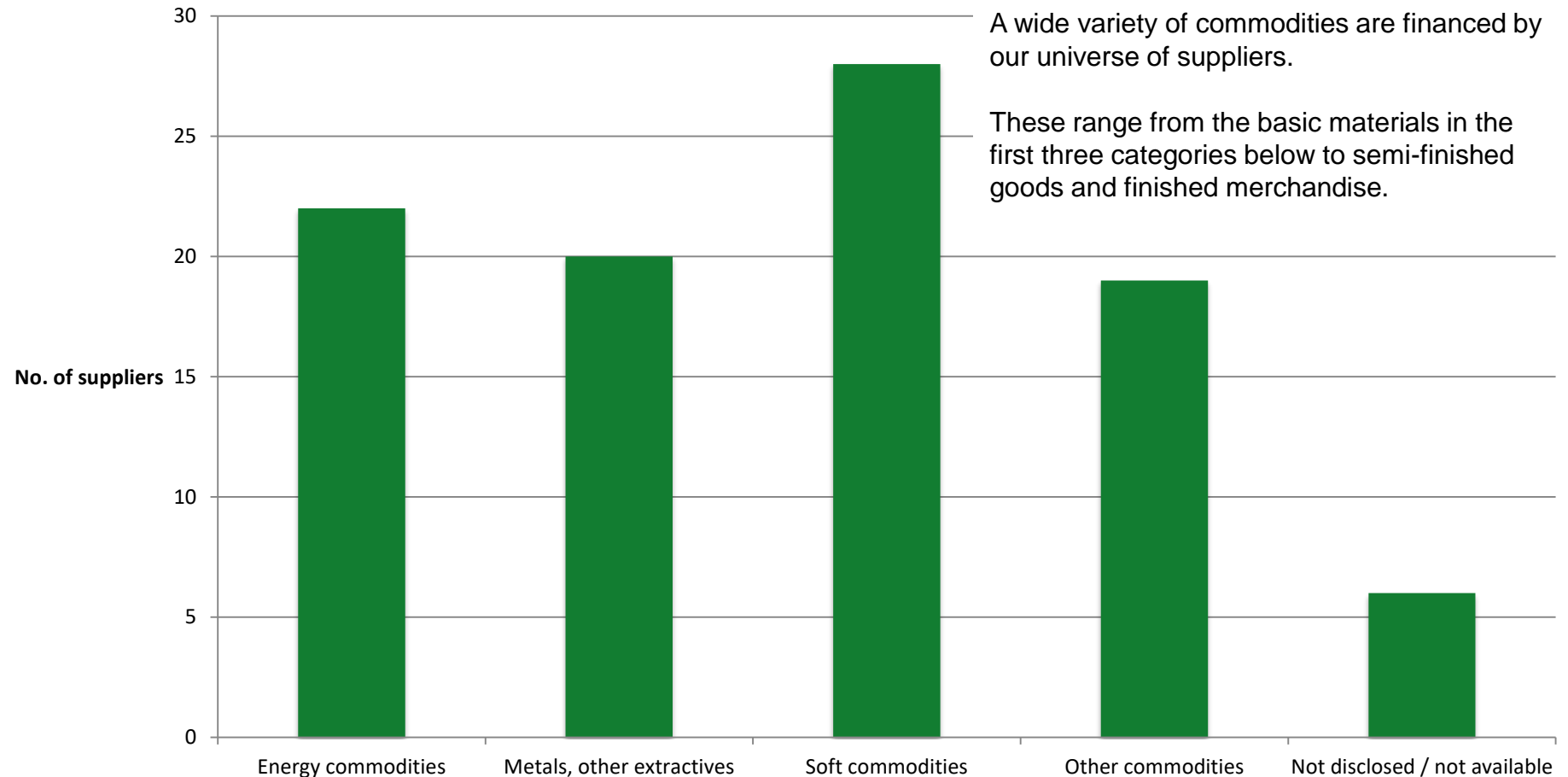
Source: Mbuyu Data

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## 4. Supply Analysis



### *Trade finance and commodities*



Source: Mbuyu Data

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## 4. Supply Analysis



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### *Alternative trade finance lenders and banks*

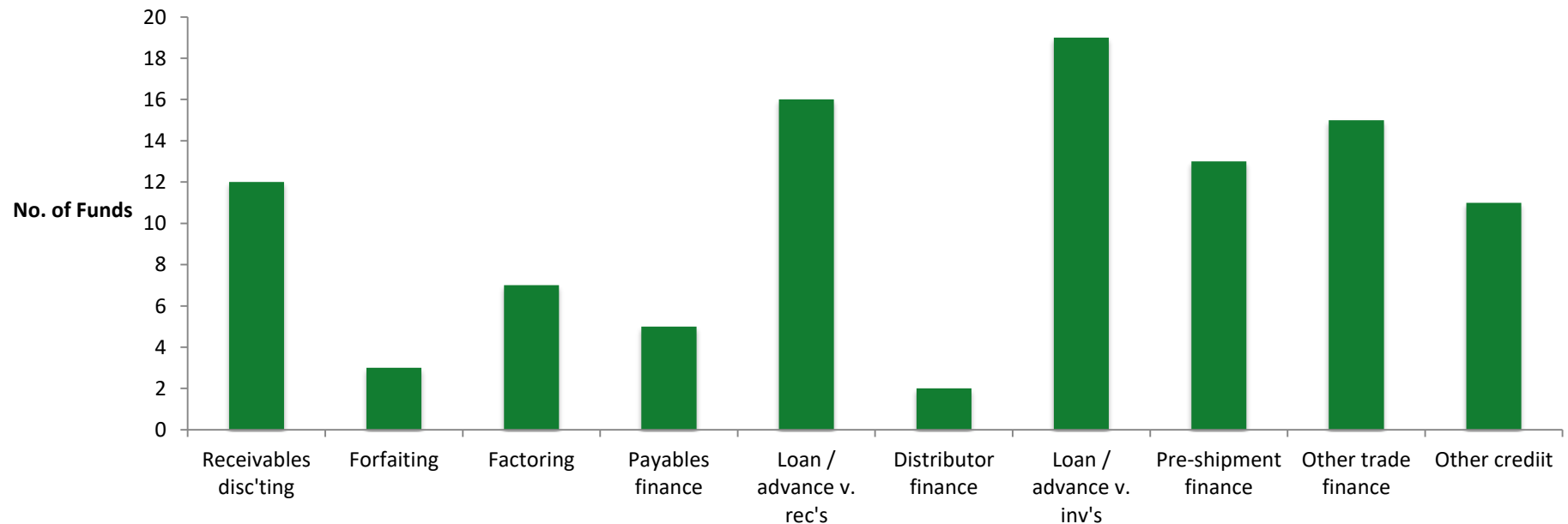
- ¶ Mbuyu estimates that, in aggregate, alternative managers of trade finance fund capital that addresses SMEs in frontier and emerging markets, is about \$6.4bn.
- ¶ Beyond capital managed through a fund structure, there is further supply of similarly targeted trade finance available from non-bank financial institutions (NBFIs) such as factor houses and those lending from e.g. limited liability company balance sheets of in excess of \$0.5bn per year.
- ¶ Banks are still the overwhelming provider of trade finance as a whole. The Bank for International Settlements (BIS) estimated in 2011 that global stocks of bank trade finance was \$1.6trn - \$2.1trn. However, trade finance is generally considered in terms of flows rather than in stocks (BIS estimates \$6.5trn - \$8.0trn in terms of flows). Letters of Credit, which are often accounted for off-balance sheet, and the short term, self-liquidating nature of other products means that facilities might be re-used several times each year.
- ¶ It is difficult to compare trade finance provided by banks, funds and other suppliers quantitatively and we are not aware of analyses that would be able to split out supply chain finance provided to SMEs in frontier and emerging markets from aggregate bank lending.
- ¶ What does seem clear is that alternative provision of trade finance to SMEs is a small, if growing, fraction of what is provided by banks.

## 4. Supply Analysis



### *Trade finance products*

- ¶ The universe of suppliers provide finance across each of the supply chain finance categories.
- ¶ Of particular note is the growing tendency of these suppliers to provide 'structured' and longer-term credit beyond the one year tenor associated with 'classic' trade finance.
- ¶ The distinction between the last two categories can be rather blurred on occasion, with some suppliers effectively extending term loans, albeit to finance the trade finance supply chain.



Source: Mbuyu Data

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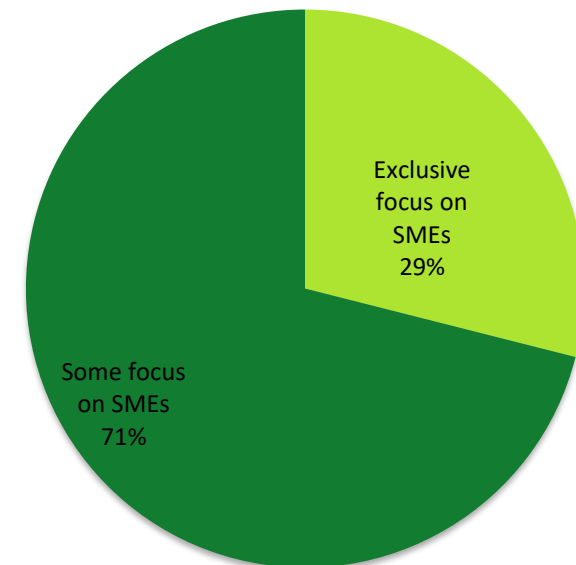
## 4. Supply Analysis



### *Trade finance and SME focus*

- † All the suppliers in our universe focus on SMEs to some extent.
- † However, there is a lot of variation and a large difference between what a small factor house does and the structured commodity finance provided by the big alternative funds.
- † It is also the case that there is considerable variance in definition. For some lenders who say that they lend to SMEs, a borrower with \$50m of annual turnover is judged 'small' in terms of their loan book.
- † A further nuance is that some suppliers think about reaching SMEs directly through their loans, whilst others consider the broader supply chain so that, for instance, they might lend \$10m to a commodity trader in Singapore that is in turn using that finance to purchase inventories from a range of SME growers in frontier markets.

**Supplier focus on SMEs**  
*(by # of suppliers)*



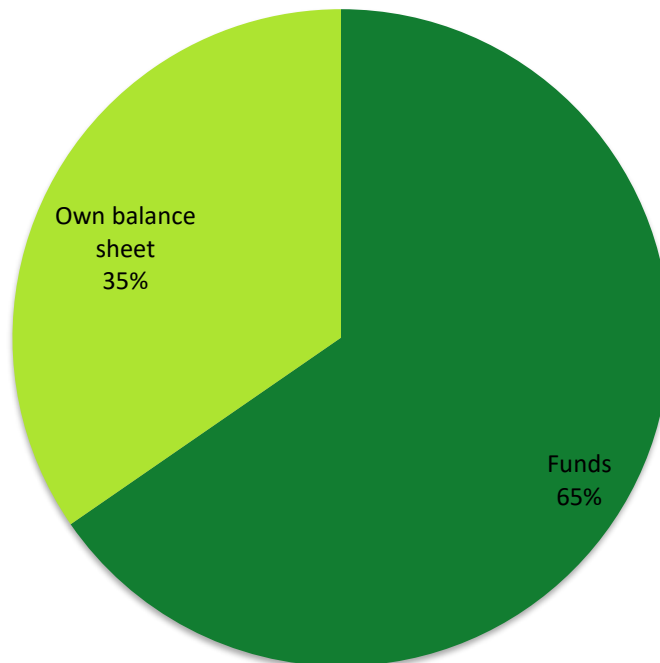


## 4. Supply Analysis



### *Trade finance supplier structure*

**Supplier structures**  
*(by # of suppliers)*



Source: Mbuyu Data

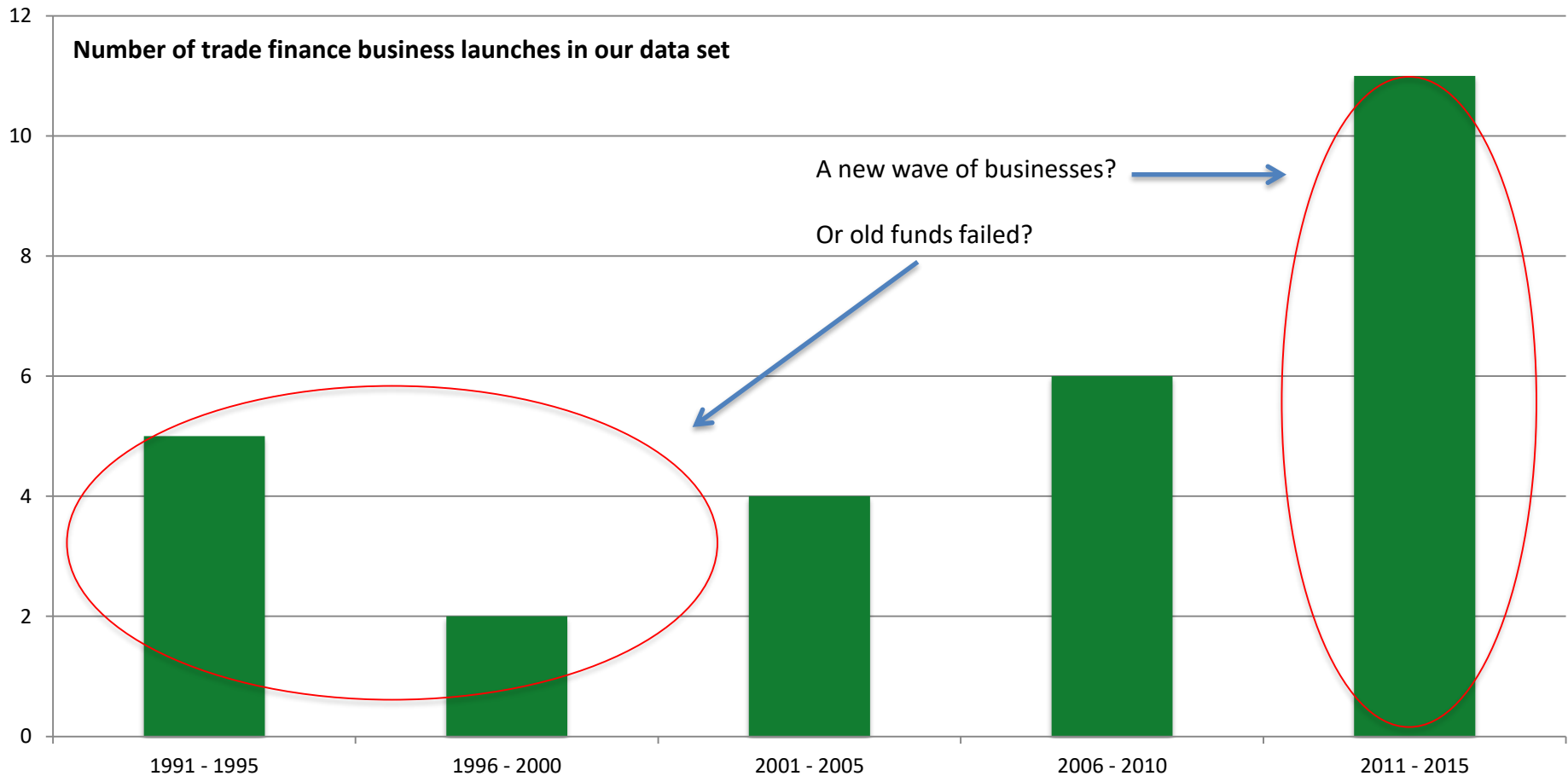
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- ¶ The suppliers in our universe are mostly funds but we also spoke to factoring companies and a number of suppliers that had specifically chosen not to structure themselves as funds.
- ¶ In one case this had to do with the investor base (retail versus institutional) but the inflexibility of a fund was also cited on a number of occasions.
- ¶ The problem of cash drag is an issue for trade finance suppliers that structure themselves as funds. This is the problem of not being able to deploy capital to the extent desired to generate an investment return because individual companies' drawdowns of working capital are variable.
- ¶ Vehicles that simply finance transactions on a deal-by-deal basis from their own balance sheet need not worry about this issue (in the same way).
- ¶ From an investor perspective, these vehicles are interesting as the opportunities for investing are more flexible, with debt, equity and co-investments / risk participations all possibilities.
- ¶ The variation in legal structures means capitalisation levels and structures in our universe are similarly various.

# 4. Supply Analysis



## *Alternative trade finance providers – a growing trend?*



Source: Mbuyu Data

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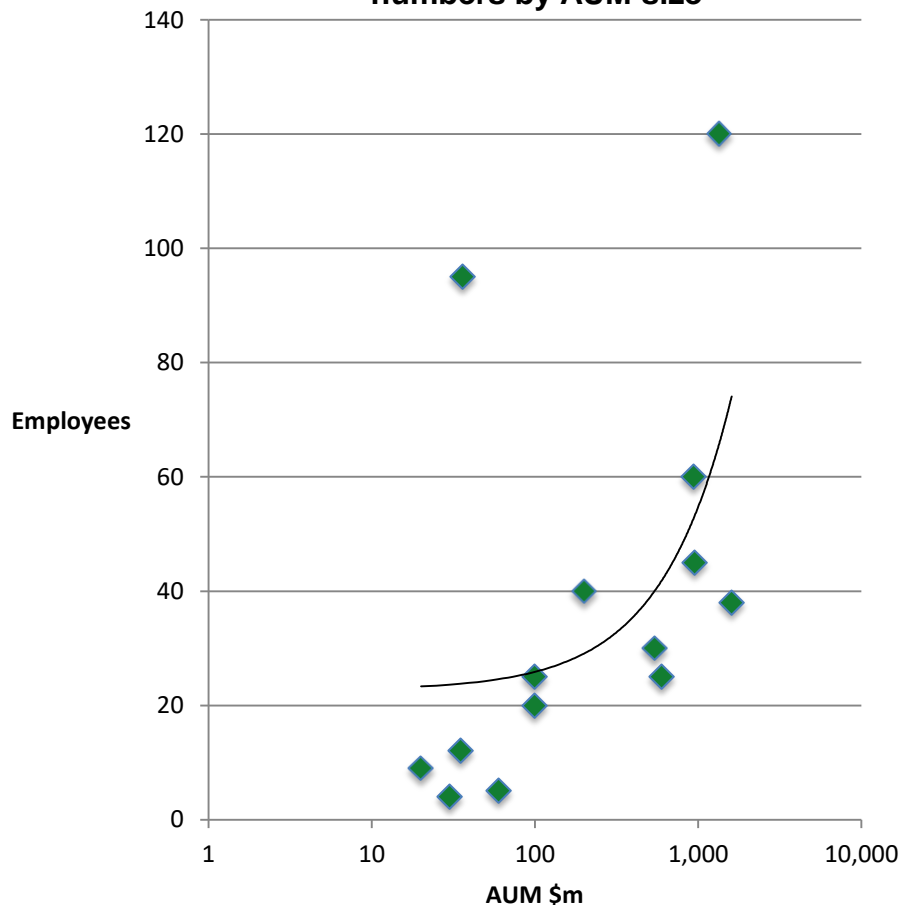
Source: Mbuyu Data

## 4. Supply Analysis



### Trade finance and human resources

**Trade finance provider employee numbers by AUM size**



- ¶ Trade finance is a human resource intensive business. Each of the suppliers we have spoken to have emphasised in particular the need to maintain adequate resources to ensure all documentation relating to collateral management is properly monitored at all times.
- ¶ Some managers also devote considerable resources to their origination capabilities. As AUMs grow, this need becomes disproportionately more important because a) managers may have used up capacity from existing ad hoc business relationships and b) existing relationships may not yield opportunities of an appropriate ticket size for expanded funds to deploy.
- ¶ Well managed operations are particularly conscious of this and plan their deal pipelines and capital calls in order to maximise opportunity whilst minimising 'cash drag' on portfolio performance.

Source: Mbuyu Data

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## 4. Supply Analysis

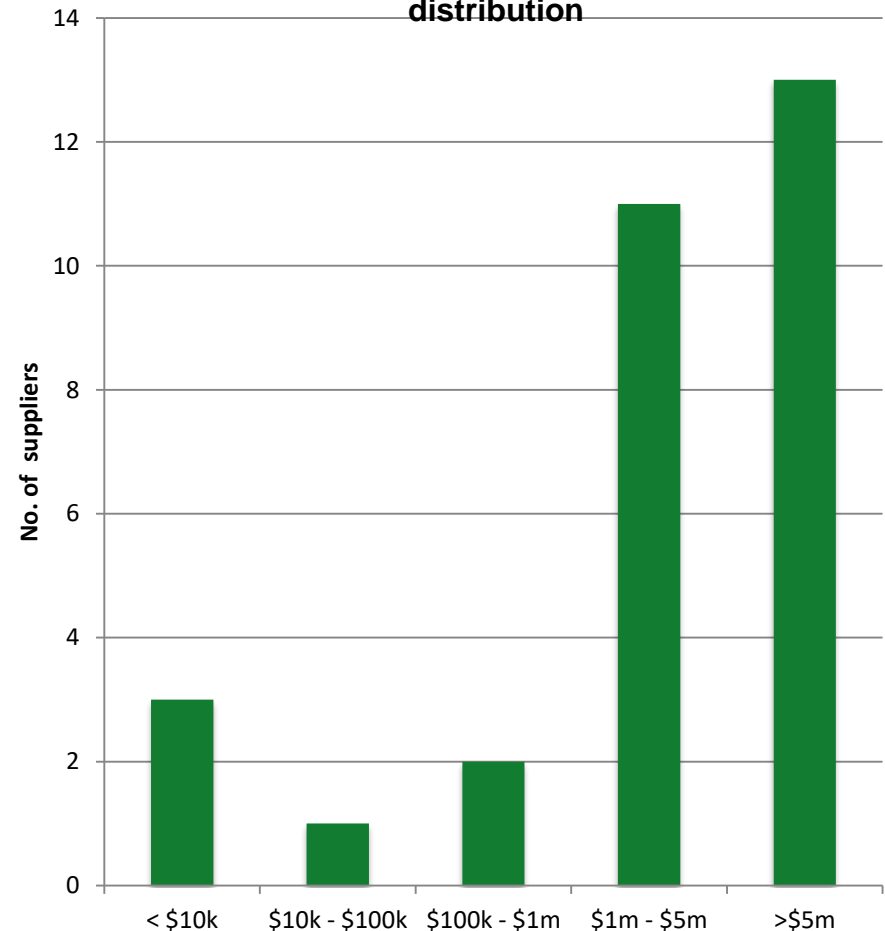


### *Trade finance lending size*

- † Most of the suppliers in our universe are focused on larger ticket sizes.
- † Ticket size is a difficult aspect to pin down in trade finance.
- † One reason is that within portfolios themselves, there is a often a large range from e.g. \$1m to \$25m. The range might reflect both new business coming in (starting small) and differing levels of profitability associated with different sizes.
- † Trade finance is short term in nature. Multiple uses of a facility means that flows of finance are as important as stocks (which are the more conventional way of thinking about e.g. a bank's loan book).
- † Trade finance is human resource intensive. Maximising capital deployment to human resources capacity ratios is important in managing business operations.
- † Lastly, different products within supply chain finance have different typical size profiles with e.g. factoring typically looking at bundles of smaller tickets versus e.g. loans against the transportation of large cargos.

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**Trade finance ticket size distribution**



Source: Mbuyu Data

## 4. Supply Analysis



### *Tenors vary widely*

- † The range of tenors of finance offered to borrowers is wide. One fund lends for as short a period as 15 days. Lending against 30, 60, 90 and 180 cycles is common and many funds lend out to one year.
- † Trade finance is traditionally (as well as according to the definition we have used in this research project) finance provided for less than one year and all of the suppliers in our database offer products that are within this tenor.
- † However, it is notable that a number of the major players in the sector have either already launched or are considering launching funds targeting longer tenors. The drivers of this trend are:
  - a) the low yield environment and a desire to access the higher returns associated with longer tenors
  - b) the ability to deploy larger tickets against CAPEX programs as AUM grow
  - c) the ability to leverage existing good relationships and their customers' credit history.
- † This trend is perhaps also unsurprising given that banks as pre-eminent providers of trade finance have also historically seen trade finance relationships as a route into other lending opportunities.

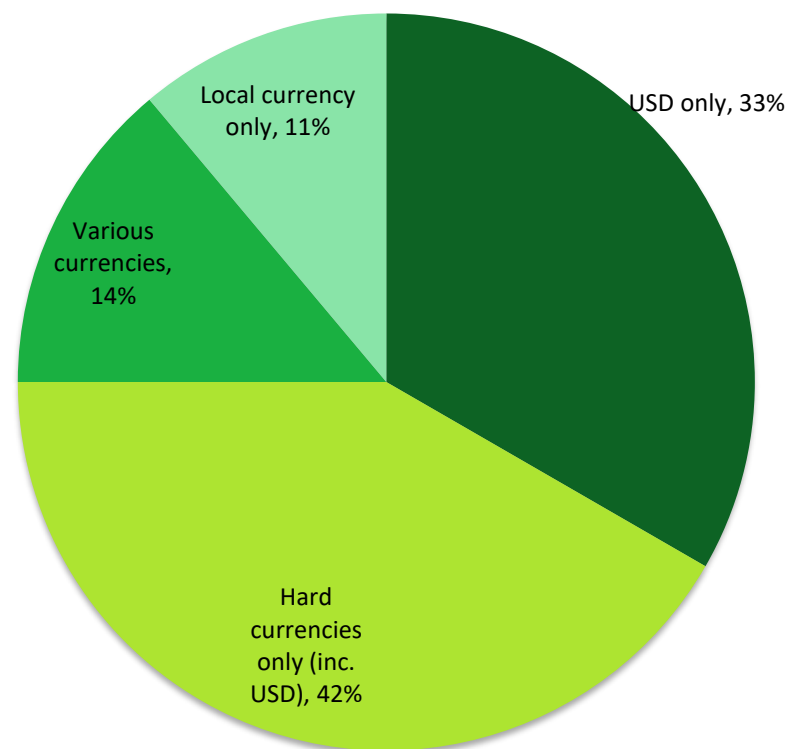
## 4. Supply Analysis



### *Trade finance supply currency*

- Trade in commodities is almost exclusively denominated in US dollars. For that reason, many of the suppliers we have interviewed offer only USD trade finance products and 75% will only provide finance in hard currencies.
- Suppliers operating in single countries and only in the domestic trade may offer financing in the local currency. However, even these suppliers may provide loans in USD. This reflects the pervasiveness of USD-denomination for commodities even at a local level.
- Suppliers who need to deal with FX risk often deal with it at a transactional level (even requiring hedging costs to be paid by the borrower in some instances) rather than at the portfolio level. This arrangement has advantages for investors in funds, where US Dollar classes are most common.

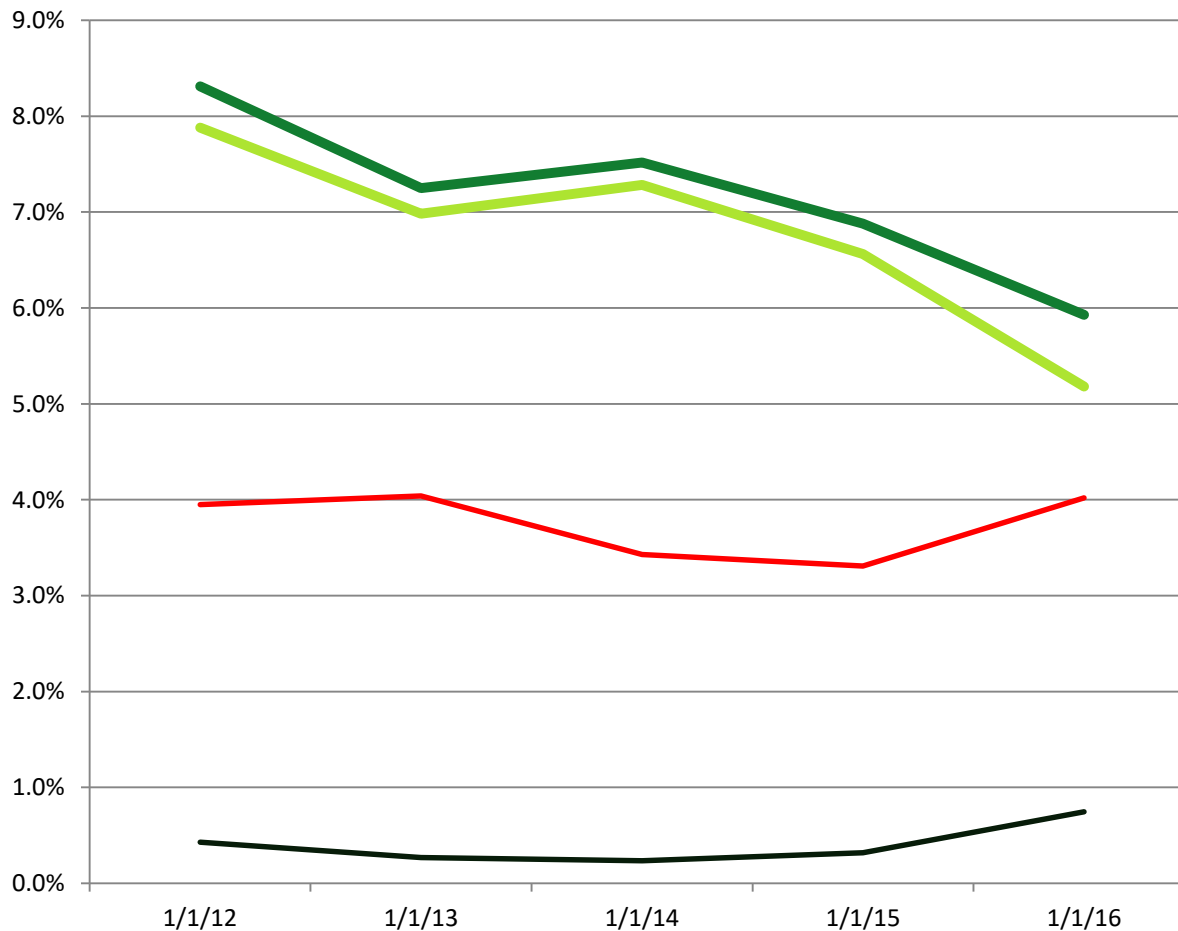
**Trade finance lending currency by # of suppliers**



## 4. Supply Analysis



### Historical returns



- ¶ The returns exhibited by larger funds have come down in recent years.
- ¶ We looked at the historical returns of selected funds with a global mandate. We found that this decline cannot be explained solely by a lower interest rate environment.
- ¶ It is far more likely that this trend is driven by the growth in AUM and the concomitant need to deploy larger tickets that command lower rates of interest. Competition for deal flow may also be playing a part.

- Trade finance funds average trailing 1 year returns
- Average 3M LIBOR
- Spread (Funds returns to LIBOR)
- BofA Merrill Lynch Emerging Markets Corporate Plus Index Option Adjusted Spread

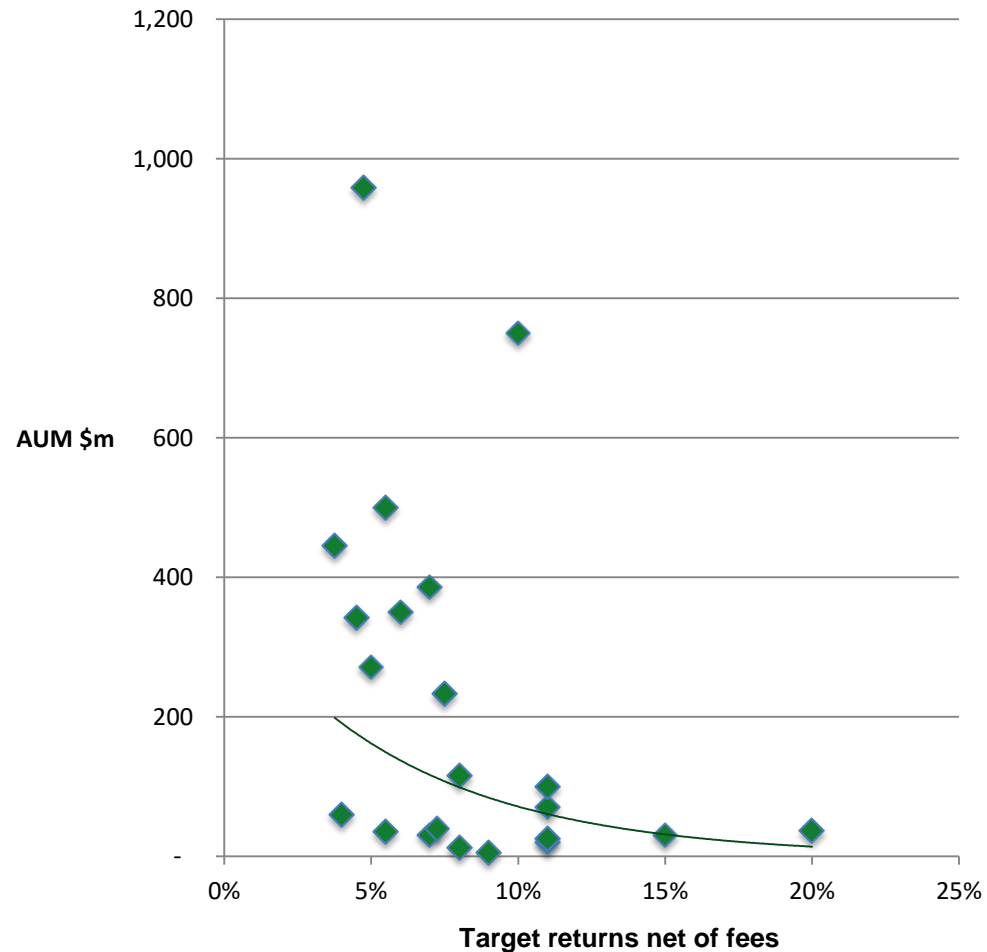
Source: Mbuyu Data, Federal Reserve Bank of St. Louis

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## 4. Supply Analysis



### *Target net returns and assets under management*



- ¶ As AUM grow, higher returns become harder to achieve.
- ¶ The basic relationship is shown (left) but other factors are important too.
- ¶ Longer tenors can command higher returns.
- ¶ Returns vary by region, even though products may be uniformly dollar-denominated.
- ¶ The type of trade or commodity financed is also a major factor, with niche markets and routes more expensive to finance.

Source: Mbuyu Data

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## 4. Supply Analysis



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### *Trade finance as an investible asset class*

- ¶ Trade finance as an investible asset class is at a very early stage.
  - The universe of funds is small.
  - The depth of the asset class is low.
  - There is very substantial scope for growth.
  
- ¶ The c. \$6.4bn of global trade finance fund capital we identify compares with the global invested capital in e.g.
  - Global private equity of \$2.5trn
  - Global bank loans of \$880bn.
  - Global EM \$ corporate bonds of \$680bn
  - Global private unlisted infrastructure of \$240bn
  
- ¶ The level of institutionalisation is consequently much lower than for more established asset classes.



## 5. Impact

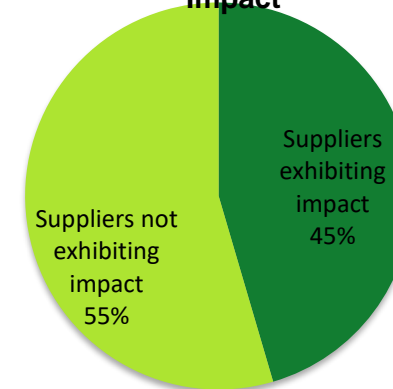
## 5. Impact



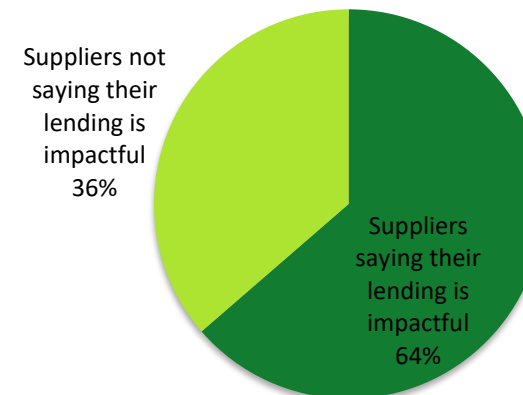
### *Trade finance and Impact*

- ¶ Providing finance to SMEs who would otherwise not be able to access finance is clearly impactful, whether it is measured or not.
- ¶ However, most suppliers do not exhibit impact, judged on the basis of:
  - Whether they explicitly identify as impact lenders;
  - Whether they measure the impact of what they do;
  - Whether they report on this impact.
- ¶ Nonetheless, when asked about impact, suppliers say they realise that their lending can make a difference and express a growing desire to harness that potential.
- ¶ As reporting on impact increases, the identification of a relationship between focus on impact and success in financial performance should emerge. Currently there is insufficient data to identify this systematically.
- ¶ Trade finance typically has short individual transaction tenors. However, lenders often maintain very long term relationships with borrowers, which can allow for impactful engagement.

**Proportion of Suppliers Exhibiting Impact**



**Proportion of Suppliers Acknowledging Impact**



Source: Mbuyu Data

## 5. Impact



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### *Impact: Definitions encountered*

- † “Impact investment” is a broad concept in general and we did not come across any precise definitions of impact as it relates to trade finance in our research.
- † The loose definitions we have encountered in talking to suppliers have been generally non-committal. The two recurring themes are 1) trade finance can drive SME growth and therefore employment; 2) trade finance sponsored by the IFC must comply with IFC ESG guidelines and therefore is, at least, not creating negative impact. Most suppliers did not have a conviction view on impact. There were notable exceptions to this general experience.
- † The few DFIs we spoke to are more focused on trade finance as it pertains to supply chains and ensuring that SMEs are able to participate in global value chains by closing the well-recognised credit gap. However, there is more focus on specific impact among DFIs. For instance, the IFC SME Enterprise Finance Gap Database attempts to log by country the number of SMEs owned by women. The Global Trade Finance Program established by the IFC focuses on facilitating partnerships between local banking institutions and confirming banks and provides guarantees to confirming banks as an incentive to increase trade flows through EM banks. The program also provides training to EM banks with a similar goal in mind.

## 5. Impact

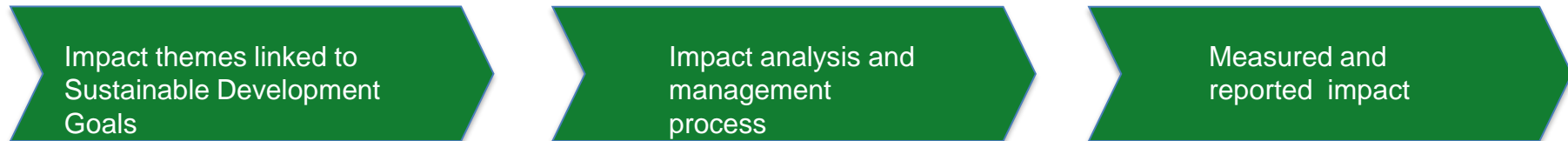


**Mbuyu Capital**  
*Africa private markets*

### *Impact best practice*

Among the suppliers we interviewed, one or two were strongly focused on impact.

The example of impact-related best practice we encountered involved a manager that links impact themes to Sustainable Development Goals. They incorporate these themes into their management process. They then measure and report on the impact their investment creates on an annual basis.



Another manager we interviewed is in the process of establishing a vehicle to provide trade finance in Africa and will specifically target addressing the credit gap for SMEs. They also plan to measure and report on impact relating to gender, specifically the number of women and female farmers reached through their finance. This vehicle is not yet active, however.

## 5. Impact



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### *Impact: Development Finance Institutions (DFIs) and trade finance*

- † DFIs are increasingly focused on trade finance as a means of addressing the credit gap faced by SMEs in frontier and emerging markets. To date, they have mainly supported trade finance provided by banks whether through lending or by providing guarantees.
- † The stated intent of DFIs in supporting trade finance is fairly consistent. DFIs want to encourage lending through local banks in order that SMEs can access the necessary finance. There are also those that target specific impact such as supporting women-owned SMEs (e.g. FMO through their Gender Finance products) or addressing Sustainable Development Goal No. 8 'Decent Work and Economic Growth' (e.g. Proparco). Furthermore, when the IFC supports lending institutions, this in itself can be impactful due to the stringent conditions relating to e.g. environmental governance with which borrowers must comply.
- † The IFC is now active in lending to a number of the managers we interviewed. Other DFIs are also actively financing innovative lending vehicles. However, DFIs are not yet involved in trade finance to the same extent that they have been in private equity and therefore there remains considerable scope for developing impactful strategies.

## 5. Impact



### *Impact: Summary table of selected DFIs and their trade finance programs*

	Trade Finance Programs	Resources committed	Impact sought
IFC	Global Trade Finance Program, Global Trade Liquidity Program, Global Trade Supplier Finance, Critical Commodities Finance Program, Structured Trade & Commodity Finance, Global Warehouse Finance Program, Working Capital Solutions	"To date, GTFP has covered over 54,000 trade transactions and supported over \$60 billion in emerging market trade... GTFP has supported over \$31 billion in trade in IDA countries and \$17 billion in trade in Sub-Saharan Africa."	"...enables the continued flow of trade credit into the market at a time when imports may be critical and the country's exports can generate much-needed foreign exchange."
ADB	ADB Trade Finance Program	\$31bn of transactions supported by the ADB TFP between 2009 and 2017.	"supporting... trade ..., which in turn helps create sustainable jobs and economic growth"
AfDB	AfDB Trade Finance Program	\$1bn for an initial four year period from 2013	Aim of "crowding in global banks and strengthening local Africa Financial Institutions"
FMO	Guarantees, working capital loans	Includes \$10m to Trade Development Bank in Mongolia	"We believe that a healthy private sector fuels the economy by creating jobs, mainly in the SME segment"
CDC	Risk participation agreements	Includes a \$100m risk participation arrangement with Standard Chartered	"The local banks will be able to pass on the benefits of the facility by offering trade finance to their clients who rely on trade for growth and job creation."
Proparco	Guarantees	\$50m guarantee package signed in 2017	The program will "will thus directly contribute to Sustainable Development Goal (SDG) number 8 dedicated to decent work and economic growth."

Source: Respective DFI websites

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## 5. Impact



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*Impact: An opportunity for DFIs to influence the development of non-bank trade finance*

- ¶ Some of the managers we interviewed are increasingly interested in the impact that their financing can create. At the same time, some managers say they are (for a number of reasons) taking an increasingly 'private equity-style' approach to their lending, working with borrowers on the longer-term development of operations within their supply chains. Furthermore, non-bank provision of trade finance is ripe for increased institutionalisation.
  
- ¶ Together, these factors create a strong opportunity for DFIs to:
  - Encourage a focus on impact
  - Participate in debates about the ability of trade finance to address the credit gap in frontier and emerging markets
  - Propose financing solutions that are in tune with what the private sector is already doing.
  
- ¶ Private sector investors are always likely to prioritise profitability. However, there remains considerable scope for DFIs to make the case that impact can also play an important role in investment decisions.



# 5. Impact



## *Opportunity for impact*

Focusing trade finance capital on impact has the potential to create positive outcomes throughout the investment process and at a system, supply chain and individual SME level.

### ***Benefits of impact focus on***

Investment Process	... Systems	Supply Chains	SMEs
Origination	Capital allocation for impact benefits SMEs as a whole and can provide first-time access to finance	Capital can be focused to benefit high impact value chains e.g. food, textiles	Capital allocation focused on impact can benefit SMEs in specific sectors
Due Diligence	Better understanding of F&EM SMEs by lenders and specialisation of the underwriting process	Supply chain audit promotes compliance and supply chain business and ESG best practice	Due diligence standards promote company business process and ESG best practice
Lending	Institutionalisation of working capital trade finance for F&EM SMEs	Financial enfranchisement of the bottom of the pyramid	SDG impact at the company level

## 5. Impact



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### *Impact at the system level*

- † In a broad sense, trade finance is one of the best-established and most systematised areas of international financial markets. However, among non-bank suppliers, there is currently a very low level of institutionalisation.
- † Promoting and enabling trade finance in frontier and emerging markets among institutional investors and in the international capital markets could be truly transformative for the value chains that need capital but currently are unable to access it. Trade finance can therefore be highly impactful at a system level.
- † In addition to carving out a niche for trade finance among non-bank capital providers (i.e. asset managers and capital markets), there is an opportunity to steer these players towards the SME portion of the market that banks are less incentivised to address as a result of regulatory capital requirements. Though higher risk, this is a very sizeable market that can generate the higher returns to compensate for the increased risk for specialised lenders. This risk can also be mitigated through mechanisms such as insurance and providing first loss capital through equity and/or guarantees.
- † System level impact should not be discounted. Embracing the proven qualities of trade finance at a high level can enable the direct impact on livelihoods desired.

## 5. Impact



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### *Impact at the supply chain level*

- ¶ Trade finance is, to a large degree (though not exclusively under our definition) about financing the movement of goods from A to B within a larger supply chain. Often there is a producer, an aggregator/trader and/or a processor involved. Sometimes there is overlap between stages; sometimes the supply chain is complex.
- ¶ At the single supply chain level, trade finance can create impact by:
  - Increasing the volume of goods passing through the supply chain by ensuring finance is not a limiting factor
  - Financially enfranchising producers at the bottom of the pyramid that are otherwise unable to access credit
  - Promoting good business and ESG practices throughout the supply chain
  - Enabling implementation of supply chain value-added (e.g. traceability), which allow premium pricing of products
  - Ensuring that labour and health and safety standards are adhered to throughout the supply chain.
- ¶ Trade finance has the ability to create, encourage and regularise the flow of goods through a value chain. Arguably, without trade finance of some sort, this will not happen at all. There is therefore the opportunity to create impact by favouring important value and supply chains that are not receiving the necessary financial fuel to operate.
- ¶ Trade finance is uniquely placed to achieve this impact as a result of the collateral management mechanisms which support the process, where creditworthiness and jurisdiction are otherwise unfavourable.



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### *Impact at the SME level*

- ¶ At the single SME level, trade finance can create impact by financing the growth of the business which, in general:
  - Leads to increased employment levels
  - Leads to higher wages
  - Allows improved labour conditions
  - Facilitates improvements in product quality and efficiency e.g. through access to better seeds and fertiliser
  - Allows improved ability to behave in an environmentally responsible manner.
  
- ¶ Furthermore, aside from the finance itself, the process of performing due diligence in order to evaluate the investment opportunity can:
  - Create awareness of factors likely to encourage access to sustainable finance from lenders, such as robust financial controls, good business and employment practices
  - Ensure that ESG standards are being adhered to.



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### *Impact: conclusions*

- † Non-bank trade finance suppliers are growing in size as they build their business and investors start to appreciate the attractiveness of the asset class. This is resulting in:
  - Larger deal sizes and SMEs;
  - Reduced supply to smaller SMEs;
  - Strategy drift (longer term lending vs trade finance);
  - Potentially lower additionality/impact.
- † New suppliers are being founded to fill the gap:
  - Innovative models to generate profitability at smaller size;
  - Traditional managers addressing the gap left by larger suppliers;
  - Potentially new sources of impact.
- † Impact money investing in trade finance is growing:
  - This is having a net beneficial effect through increased awareness by suppliers
  - However, impact awareness remains limited and impact is generally not a core part of managers' business models.
- † Trade finance focused on impact offers significant potential to create positive outcomes at the system, supply chain and individual SME level.



## 6. Innovation



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### *Origination*

- † Our main observation is that, on the whole, origination is largely driven by existing relationships and is therefore not very systematic. This was not the case with every trade finance lender, however, and there were examples of a more sophisticated approach. Partly this seems to be a function of size, with those with more AUM being able to justify increased headcount allocated to origination.
- † Whilst leveraging existing relationships is the primary driver of origination for suppliers in our universe, deal flow is also generated through the use of in-country agents and brokers. Suppliers also receive a certain amount of reverse enquiry, though the quality of this is often poor.
- † When done systematically by those with developed origination operations, deal flow is not only sought based upon its suitability for immediate capital deployment requirements. Rather, growth in AUM and cash management considerations are an integral part of the process. Some larger managers have teams dedicated to maintaining client relationships over many years and understanding borrowers' businesses as they develop with a view to finding the right deals for their portfolios over longer time horizons.
- † In spite of the large credit gap faced by emerging market SMEs, deal origination capacity remains a bottleneck for many suppliers. This is partly explained through variability of deal quality but information asymmetries also seems to be a factor. Improvements to the origination process could have a major impact on the sector.



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### *Processes and systems innovation*

- ¶ In some ways, trade finance remains a very traditional corner of the financial markets. For commodity trade finance, in particular, the need to be methodical and thorough in monitoring collateral continues to be a major factor in profiting from trade finance. This is unlikely to change any time soon. There is also unlikely to be any suitable substitute for physical, spot audits throughout the supply chain to minimise fraud.
  
- ¶ One technology that may improve existing processes is blockchain. For instance, ING, SocGen and ABN Amro recently announced that they had completed a US to China soy bean trade using their 'Easy Trading Connect' platform with commodity trader, buyer and shippers all participating in the transaction.
  
- ¶ Another technology already in use amongst the suppliers we have spoken to is the use of internet-based platforms to bring suppliers and buyers together so that financiers can discount SME supplier receivables. The exclusive use of electronic invoices should preclude the age-old problem of invoices being fraudulently discounted twice or more with multiple financiers.





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### *Blockchain and SMEs in frontier and emerging markets*

- † Blockchain has been hailed as an important development in trade finance. Benefits cited include increased transparency; faster transactions; real time monitoring of commodity and documents; and improved ability to conduct AML and KYC procedures.
- † Each of these benefits should assist SMEs in frontier and emerging markets sell their products into international supply chains since they should reduce the costs of doing business with businesses that are perceived as riskier by buyers.
- † Furthermore, the use of blockchain platforms for processing commodity trade transactions is likely to result in the disintermediation of correspondent banks since their role is usurped by the technology. In recent years, correspondent banking relationships have become harder and costlier to arrange due to the increased regulatory burdens associated with these relationships. Bypassing this bottleneck in capital flows should allow SMEs in frontier and emerging markets to access finance more easily.

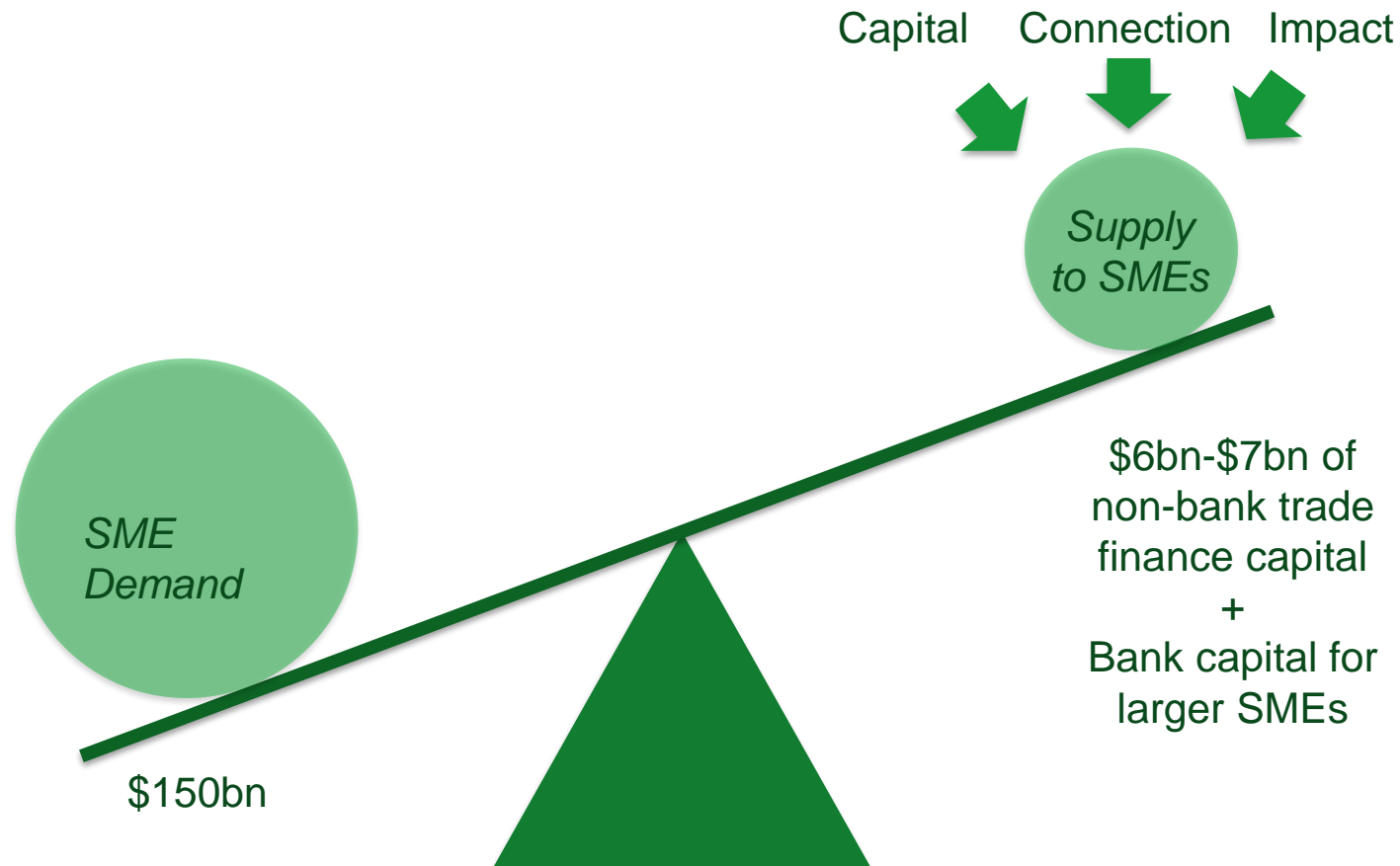


## 7. Key Conclusions

## 7. Key Conclusions



*Trade finance is a flexible, highly effective way to improve access to finance for SMEs. But demand by SMEs far outstrips supply. Addressing the balance requires three key components: capital, better connections between demand and supply and making impact a core part of trade finance.*



## 7. Key Conclusions



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### *Righting the demand/supply imbalance for SME trade finance*

- ¶ Established, international trade finance suppliers are able to attract capital from a variety of sources BUT
  - To retain SME focused they need to be able to access more dealflow which they can transact efficiently;
  - Mechanisms to mitigate risk and reduce transaction costs for smaller deals need to be developed;
  - Quality new entrants doing smaller deals need to be provided with capital.
- ¶ Local, smaller trade finance suppliers in frontier & emerging markets have strong SME dealflow and often innovative technology solutions BUT
  - They need capital, generally on-balance sheet in small \$1m-\$5m size initially;
  - They are often small, early stage businesses with associated risks;
  - Investor transaction and monitoring costs are high.
- ¶ Impact capital is the key to realising the opportunity
  - Innovative capacity building initiatives funded by grants, low-cost and innovative finance to unblock the pipe between demand and supply, such as improving connectivity between SMEs and suppliers of trade finance, technology to reduce transaction costs, supply chain solutions and innovative financing and risk mitigation solutions;
  - Creating investable products with identifiable impact outcomes and return/risk profiles to mobilise capital at scale from investors.



## 8. Appendices



## A1. Trade finance definitions

# A1. Trade Finance Definitions



## *Receivables Discounting*

Receivables Discounting is a form of Receivables Purchase, flexibly applied, in which sellers of goods and services sell individual or multiple receivables (represented by outstanding invoices) to a finance provider at a discount.

Receivables Discounting is normally provided to large corporate clients selling to multiple buyers. Coverage of these buyers depends upon those for buyers for which the finance provider is willing to assume credit risk. The finance provider offers finance based upon a security margin applied to the open accounts receivable.

Receivables Discounting is typically offered to a client base whose receivables meet certain criteria such as a credit rating. Finance can be provided on a non-, limited- or full-recourse basis, though it is normally without recourse to the seller.

Synonyms: Receivables Finance, Receivables Purchase, Invoice Discounting, Early Payment (of Receivables)

Security: Generally a 'true sale' where rights and title are transferred to the finance provider

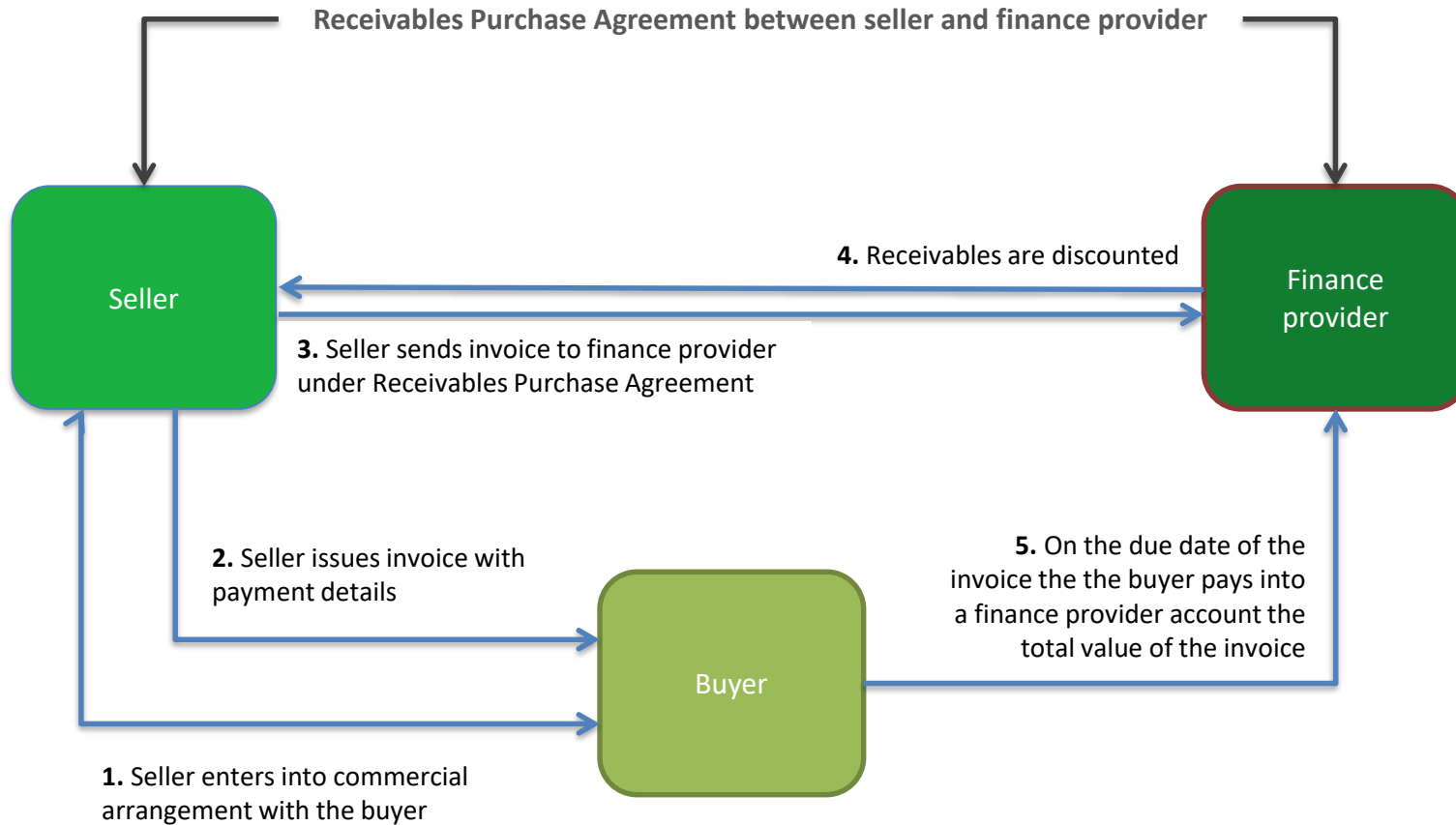
Tenor: 1 month to several years

Relevant for F&EM SMEs? The financier takes on the credit risk of the purchaser of the goods, so generally only used for larger purchasers, who would tend to buy from larger suppliers, rather than SMEs.

# A1. Trade Finance Definitions



## Receivables Discounting





# A1. Trade Finance Definitions



## *Forfaiting*

Forfaiting is a form of Receivables Purchase, consisting of the without recourse purchase of future payment obligations represented by financial instruments or payment obligations (normally in negotiable or transferable form), at a discount or at face value in return for a financing charge.

Forfaiting requires the existence of an underlying payment obligation usually embodied in some form of legal instrument distinct from the commercial transaction that gave rise to it. These instruments may include bills of exchange, promissory notes or letters of credit. The legal autonomy of these instruments and the legal regime enjoyed by them makes forfaiting possible.

There is a primary and a secondary market for forfaiting.

Synonyms: Without recourse financing or discounting of promissory notes / bills of exchange

Security: Generally a 'true sale' where the buyer owns all the rights in a forfeited payment obligation. Security in respect of the forfeited asset can be given in the form of an aval or guarantee from a third party.

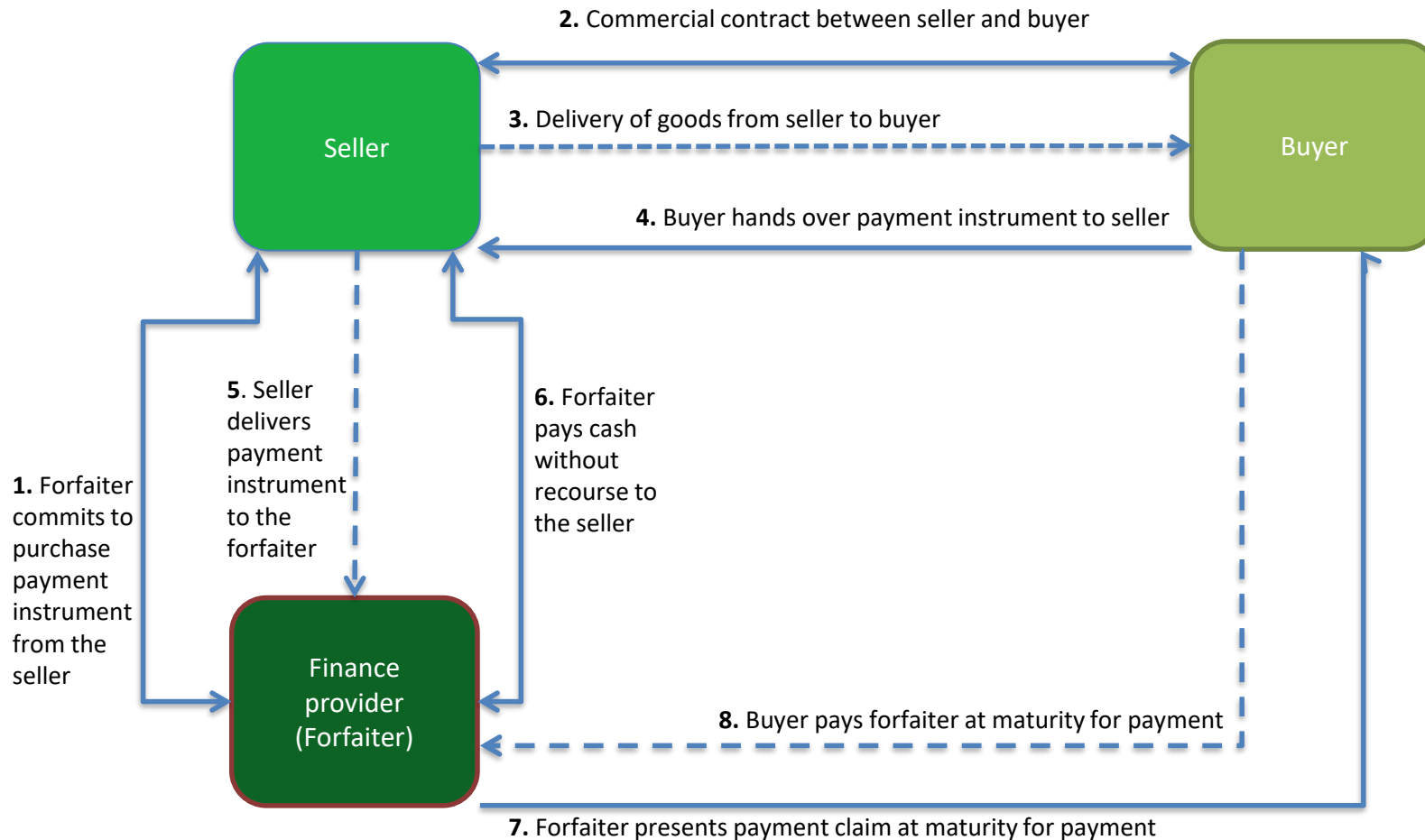
Tenor: 1 month to several years

Relevant for F&EM SMEs? Transaction sizes are generally at the higher end of the supply chain spectrum.

# A1. Trade Finance Definitions



## Forfaiting



# A1. Trade Finance Definitions



## *Factoring*

Factoring is a form of Receivables Purchase in which sellers of goods and services sell their receivables (represented by outstanding invoices) at a discount to a finance provider (commonly known as a “factor”). A key differentiator of Factoring is that typically the finance provider becomes responsible for managing the debtor portfolio and collecting the payment of the underlying receivables.

In Factoring, ownership of the receivable lies with the factor and the buyer settles the invoice with the factor rather than the seller. Factoring can be provided with or without recourse depending upon credit insurance, jurisdiction, market practice etc.

There are many variations of the basic factoring model including whether or not the buyer is aware that the invoice has been sold to a factor (Confidential or Non-notification Factoring versus Disclosed or Notification Factoring).

Synonyms: Receivables Finance, Receivables Services, Invoice Discounting, Debtor Finance

Security: An assignment of rights (or a transfer of title or equivalent) to the asset(s) being financed. Additional security may be taken by the factor. Credit insurance is commonly applied.

Tenor: generally 90 days

Relevant for F&EM SMEs? Yes.

Source: *Global Supply Chain Finance Forum*

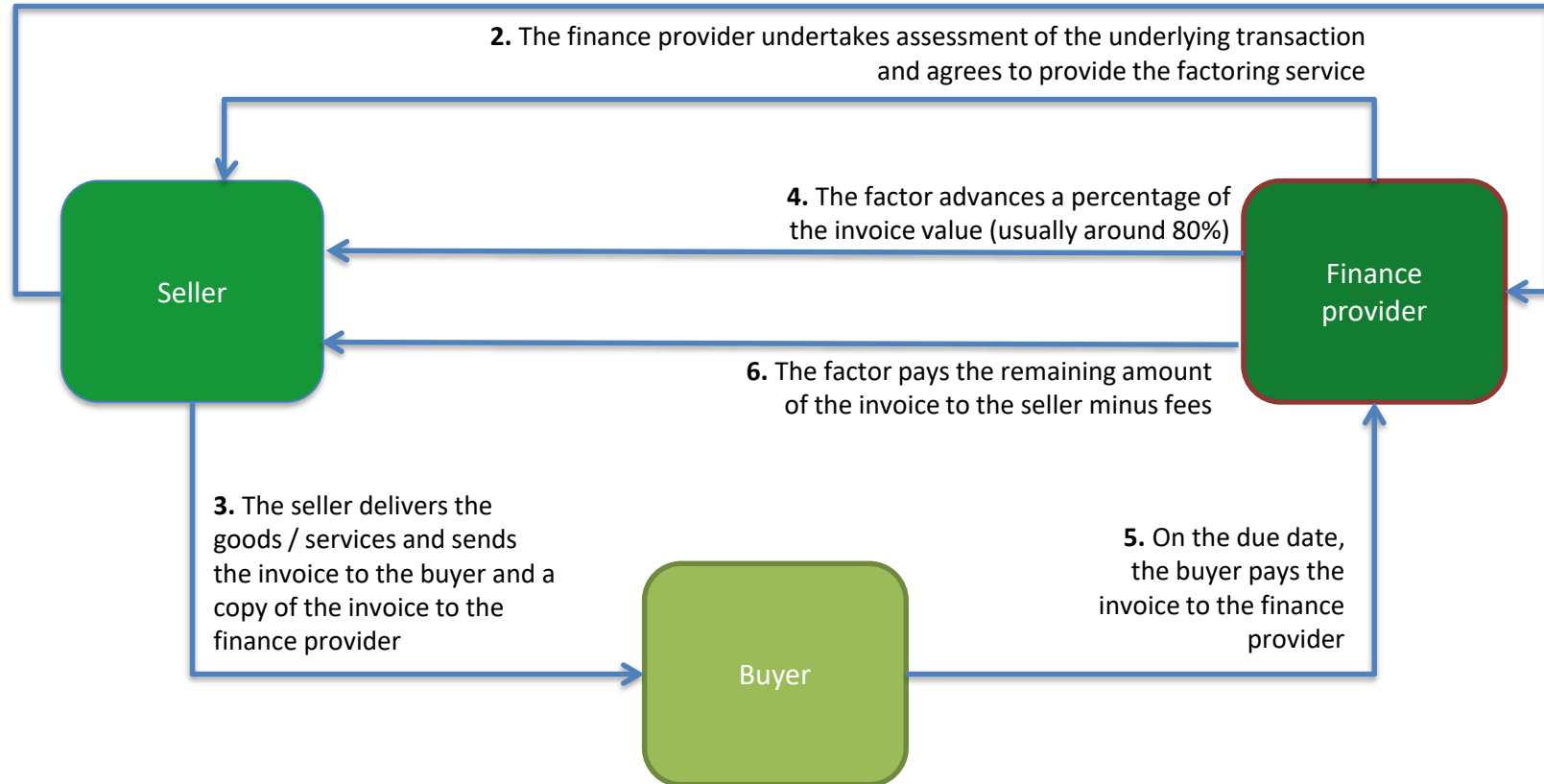
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# A1. Trade Finance Definitions



## Factoring

1. The seller looks for a finance provider (factor) for a factoring service



# A1. Trade Finance Definitions



## *Payables Finance*

Payables Finance is provided through a buyer-led program within which sellers in the buyer's supply chain are able to access finance by means of Receivables Purchase. The technique provides a seller of goods or services the option of receiving the discounted value of the receivables (represented by outstanding invoices) prior to their actual due date and typically at a financing cost aligned with the credit risk of the buyer. The payable continues to be due by the buyer until its due date.

The technique is buyer-centric. The buyer encourages its suppliers to consider using their Payables Finance program; the suppliers make an independent decision as to whether they want to. The finance provider relies on the creditworthiness of the buyer and provides the financing without recourse to the seller.

There may be a single or multiple finance providers participating in the program for the benefit of a buyer's suppliers.

Synonyms: Approved Payables Finance, Reverse Factoring, Confirming, Confirmed Payables, Supplier Payments, Vendor Pre-Pay, Trade Payables Management, Buyer-led Supply Chain Finance or, inappropriately, Supplier Finance and Supply Chain Finance

Security: A receivables purchase is effected by means of an assignment of rights to the accounts payable

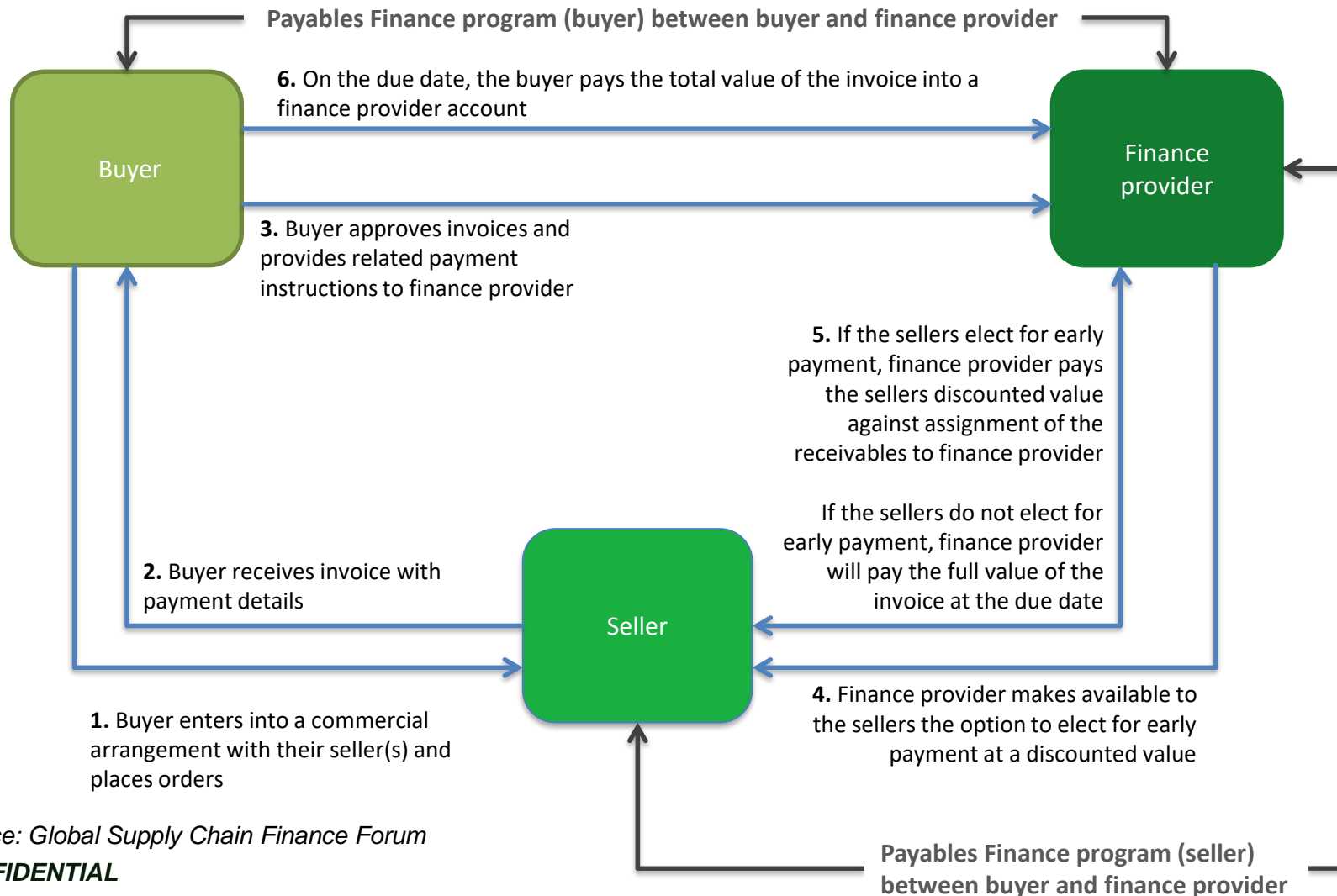
Tenor: *less than 1 year to as much 5 years*

Relevant for F&EM SMEs? Not as the buyer, only as suppliers within the supply chain

# A1. Trade Finance Definitions



## Payables Finance



# A1. Trade Finance Definitions



## *Loans Against Receivables*

Loan or Advance against receivables is financing made available to a party involved in a supply chain on the expectation of repayment from funds generated from current or future trade receivables and is usually made against the security of such receivables, but may be unsecured.

Loan or Advance against receivables is a form of working capital finance.

Synonyms: Receivables Lending, Receivables Finance, Invoice Financing, Trade Receivable Loans, Trade Loans

Security: Generally secured against receivables

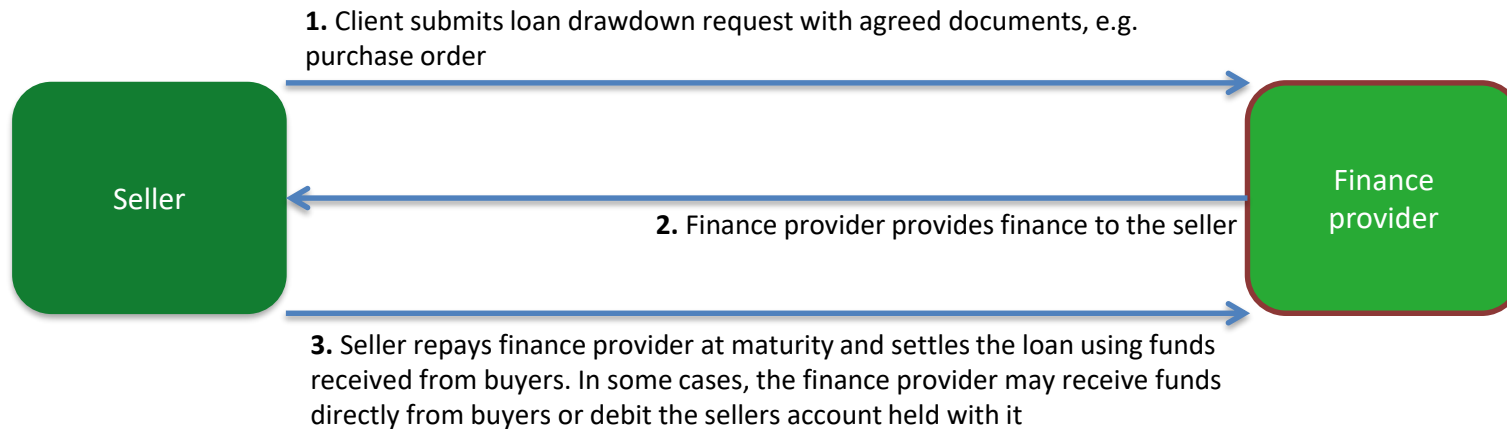
Tenor: generally less than 120 days

Relevant for F&EM SMEs? Yes

# A1. Trade Finance Definitions



## *Loans Against Receivables*





# A1. Trade Finance Definitions



## *Distributor Finance*

Distributor Finance is the provision of financing for a distributor of a large manufacturer to cover the holding of goods for re-sale and to bridge the liquidity gap until the receipt of funds from receivables following the sale of goods to a retailer or end-customer.

Finance is normally provided in the form of an loan, reviewed annually, and is used to fund inventories and receivables. Typically, the distributor is a third-party company but might also be owned – in part or fully – by the large manufacturer (often referred to as the ‘anchor party’). It is the involvement of the manufacturer that reduces the risk associated with this finance.

A facility letter and a distributor finance agreement document the contractual aspects of the financing.

Synonyms: Buyer Finance, Dealer Finance, Channel Finance, Floor Plan Finance (latter not always strictly comparable)

Security: The security is usually an assignment of rights over inventory and receivables and/or other forms of security, as agreed between the distributor and finance provider.

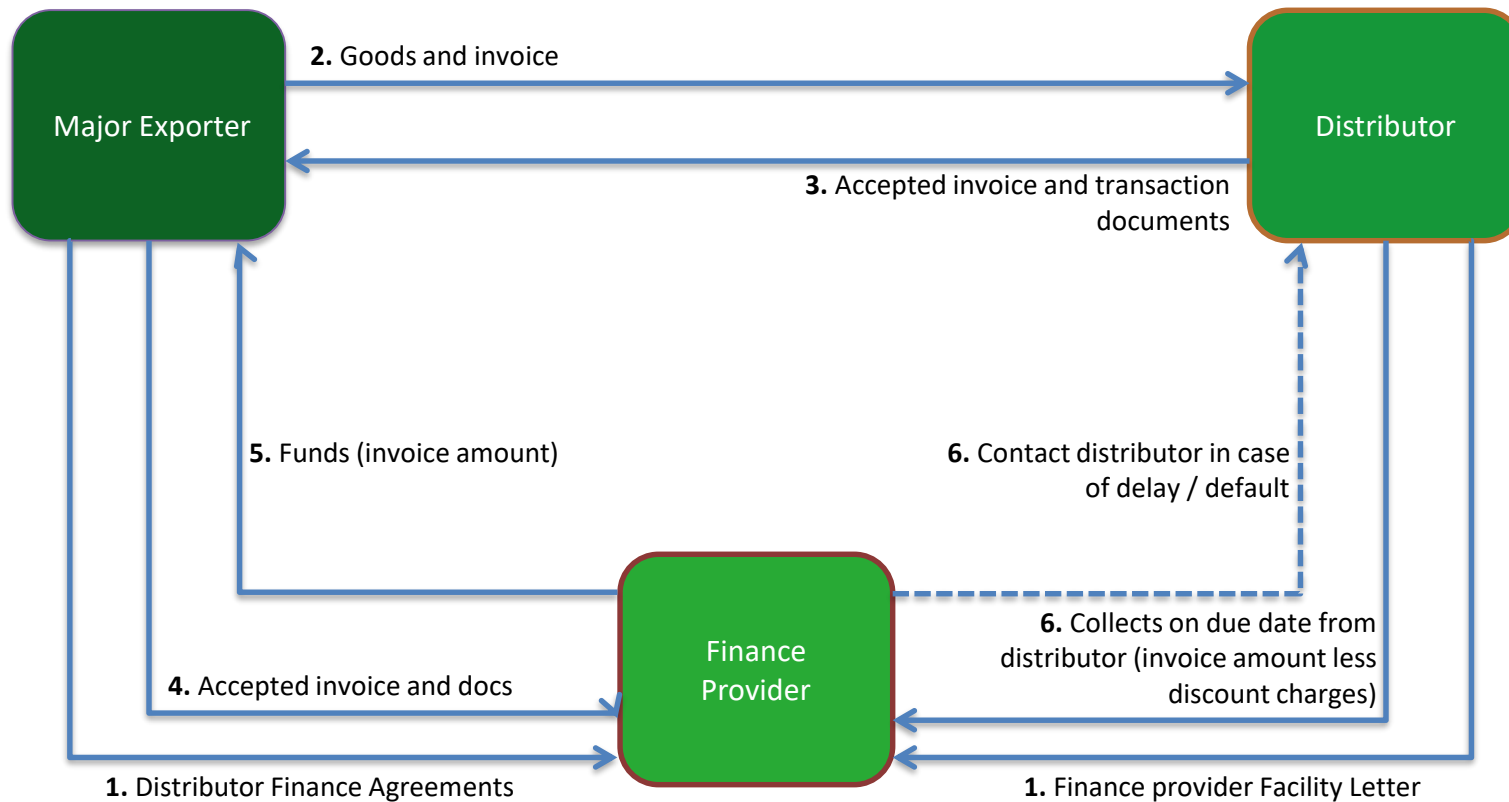
Tenor: generally one year, renewed annually

Relevant for F&EM SMEs? Yes. The borrower is likely to be an SME.

# A1. Trade Finance Definitions



## Distributor Finance



Source: Global Supply Chain Finance Forum

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# A1. Trade Finance Definitions



## *Loan / Advance Against Inventory*

Loan or Advance against Inventory is financing provided to a buyer or seller involved in a supply chain for the holding or warehousing of goods (either pre-sold, un-sold, or hedged) and over which the finance provider usually takes a security interest or assignment of rights and exercises a measure of control.

The financing can take place at any point in the supply chain and be provided to buying or selling parties. The key requirement is for either qualifying marketable commodities (mineral, metal and agricultural) for which a value can be readily ascertained or for finished goods or WIP where there is a purchase order.

Synonyms: Inventory Finance, Warehouse Finance, Financing against Warehouse Receipts, Floor Plan Finance.

Security: The finance provider obtains title over the goods for the duration of the transaction and only releases title when the loan is repaid.

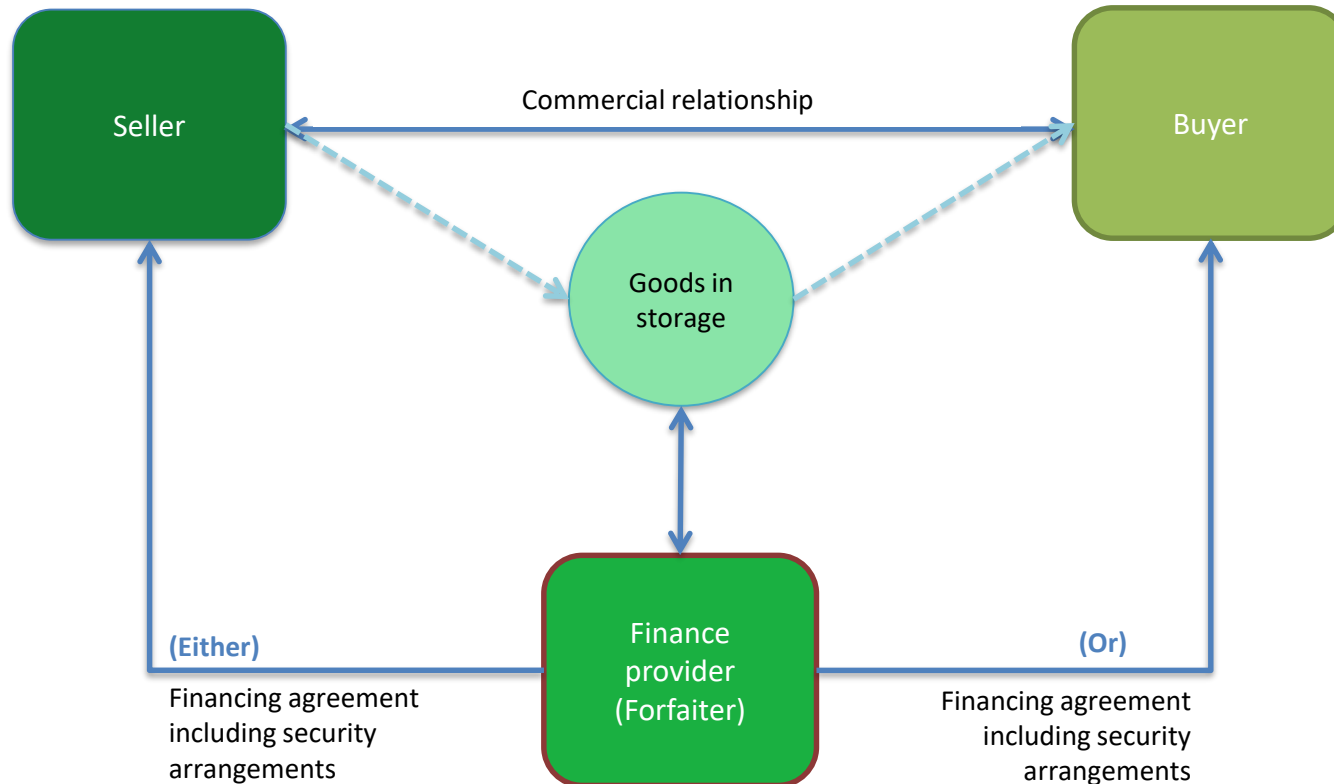
Tenor: generally less than 90 days

Relevant for F&EM SMEs? Yes

# A1. Trade Finance Definitions



## *Loan / Advance Against Inventory*



Source of repayment is proceeds of sale from buyer to seller (if seller is borrower) or proceeds of sale from the buyer's customer (if buyer is the borrower)

# A1. Trade Finance Definitions



## *Pre-shipment Finance*

Pre-shipment Finance is a loan provided by a finance provider to a seller of goods and/or services for the sourcing, manufacture or conversion of raw materials or semi-finished goods into finished goods and/or services, which are then delivered to a buyer.

A purchase order from an acceptable buyer, or a documentary or standby letter of credit or Bank Payment Obligation, issued on behalf of the buyer, in favour of the seller is often a key ingredient in motivating the finance in addition to the ability of the seller to perform under the contract with the buyer, though it is most commonly provided on an open accounts basis.

Synonyms: Purchase Order finance, Packing credit/finance, Contract monetization financing.

Security: An assignment of rights to underlying WIP and finished goods underpins the financing agreement.

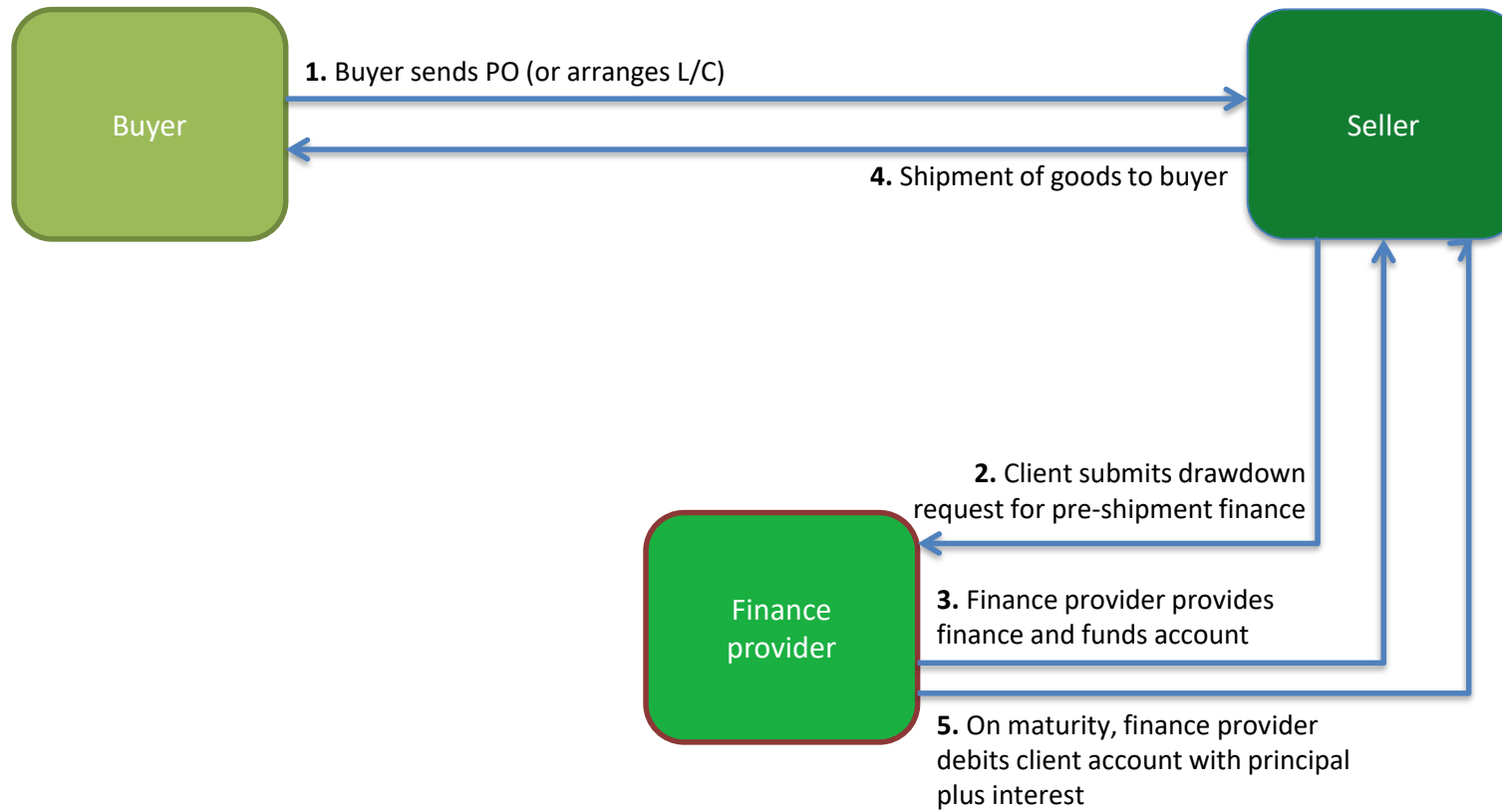
Tenor: generally less than 90 days, but longer term facilities for 1 year are also provided

Relevant for F&EM SMEs? Yes, particularly in agricultural value chains eg coffee, cocoa, cotton

# A1. Trade Finance Definitions



## Pre-shipment Finance



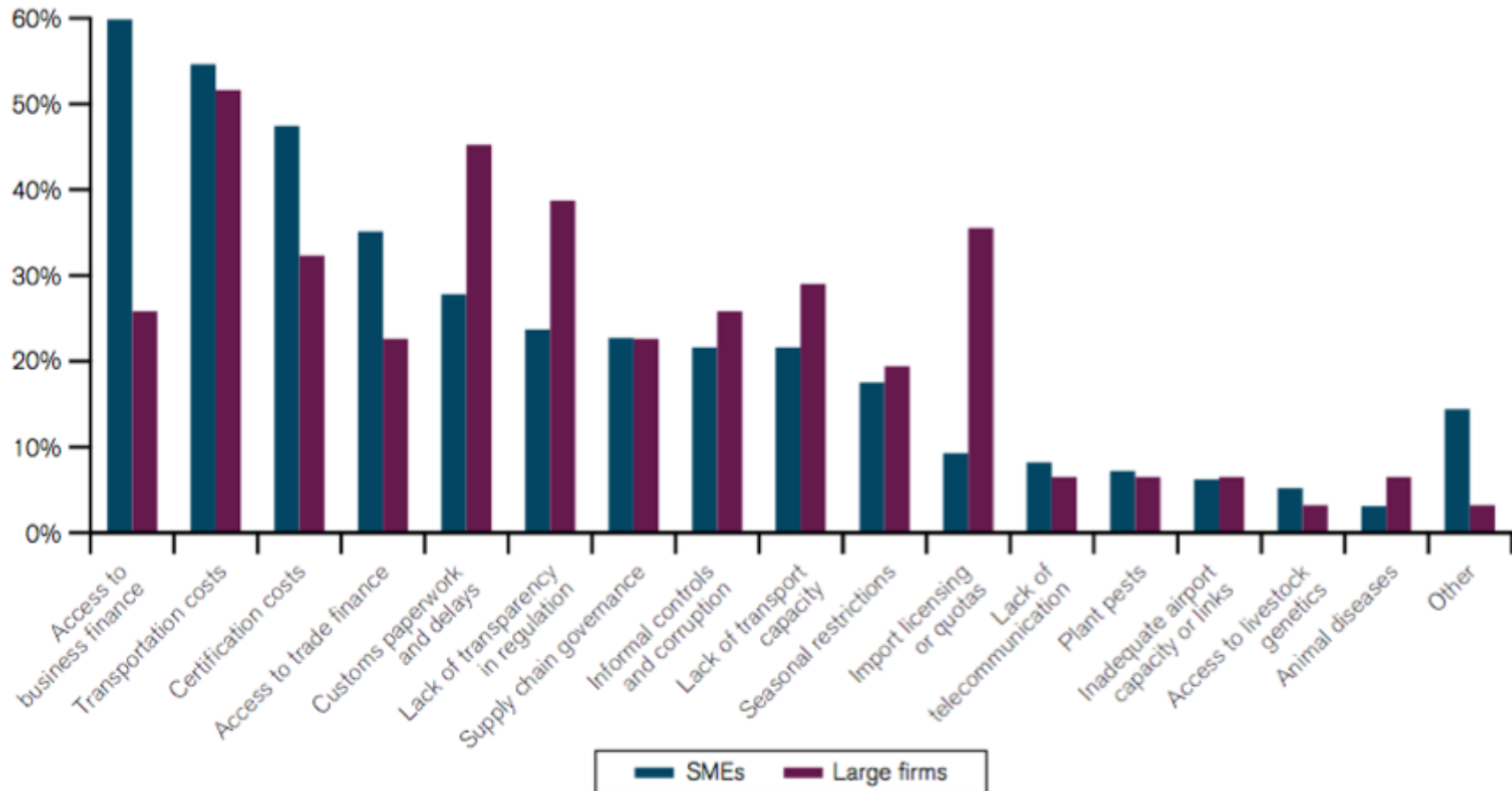


## A2. WTO World Trade Report 2016 Survey Results by Value Chain

## A2. WTO World Trade Report 2016 Survey Results



WTO survey data on impediments to SMEs entering or rising up agribusiness value chains



Source: WTO World Trade Report 2016: Levelling the Playing Field for SMEs

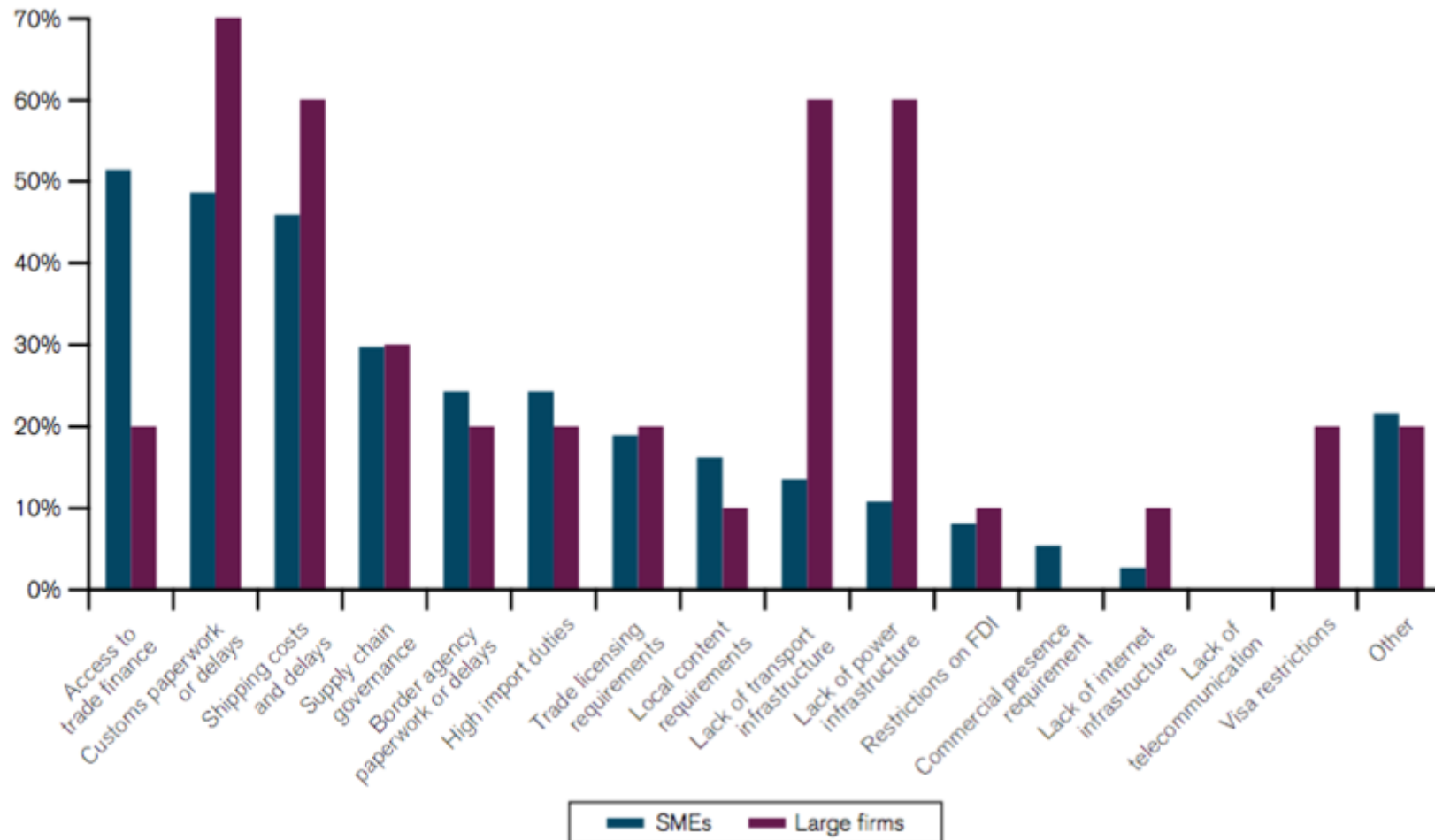
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## A2. WTO World Trade Report 2016 Survey Results



*WTO survey data on impediments to SMEs entering or rising up textiles value chains*



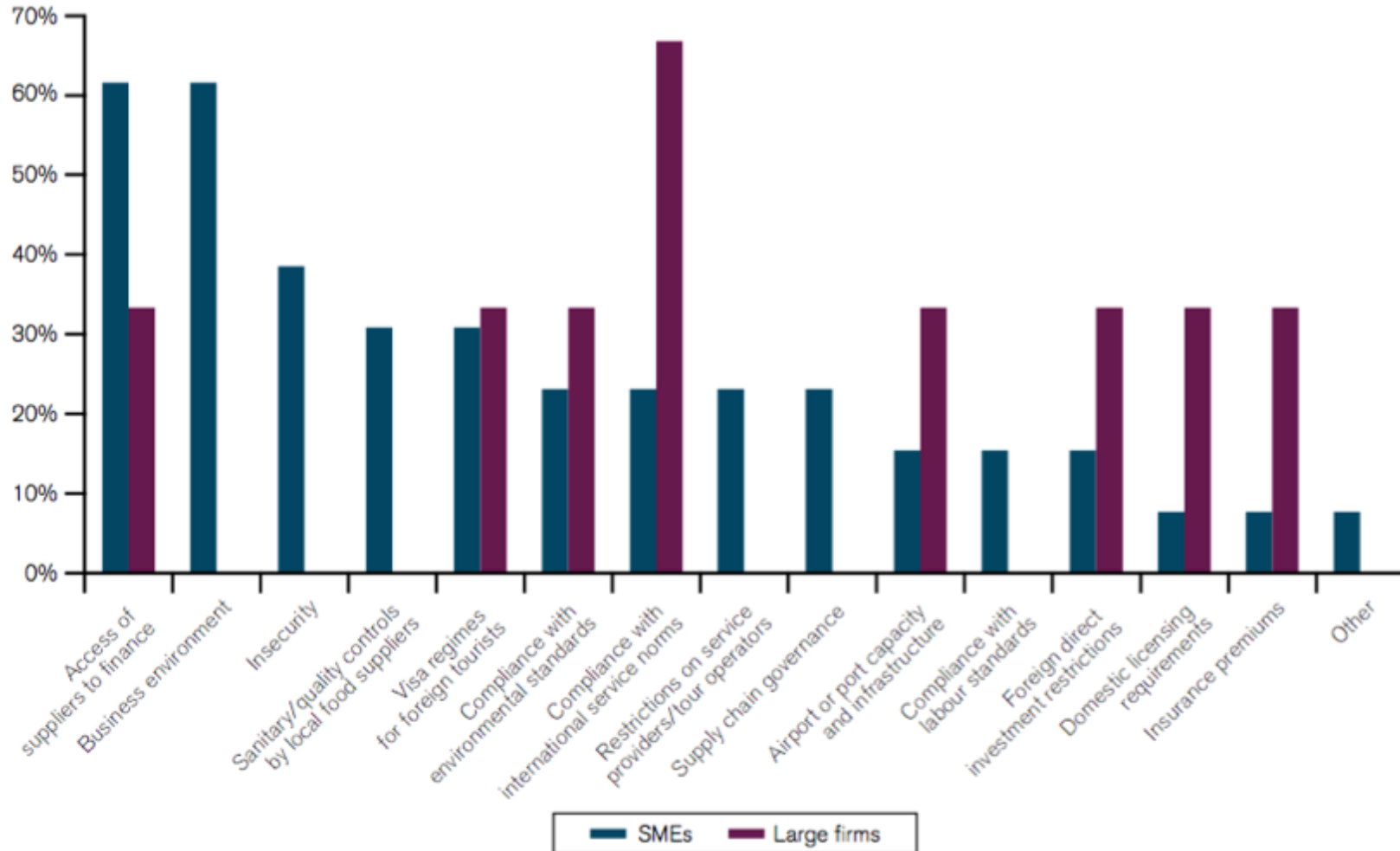
Source: WTO World Trade Report 2016: Levelling the Playing Field for SMEs

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## A2. WTO World Trade Report 2016 Survey Results



### WTO survey data on impediments to bringing SMEs into tourism value chains



Source: WTO World Trade Report 2016: Levelling the Playing Field for SMEs



### A3. Demand Analysis Database Description

## A3. Demand Analysis Database Description



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### *Demand Analysis Database*

- ¶ The database includes data for the 125 countries on the DAC list. We classify each country according to (1) region and (2) level of income, enabling the analysis of the corresponding categorisations as well as of the whole data set.
  
- ¶ For each country, we provide the following:
  - The credit gap split between size categories of SME (informal, micro, very small, small and medium)
  - The credit gap split by sector (agriculture, manufacturing, trading and services)
  - The credit gap split by applicability of trade finance
  - A proprietary index score that quantifies qualitative aspects of the opportunity for credit provision.



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### *Demand Analysis Methodology*

- ¶ We have made various assumptions in compiling data for credit and trade finance demand.
1. In order to derive estimates of country-level supply of credit, we take the credit gap for each country as shown in the IFC's SME Enterprise Finance Gap database and apply the regional supply to gap ratios calculated by McKinsey / IFC in their original 2010 study. We are thus able to provide regional sub-totals of credit supply. Although rather blunt, this enables us to estimate the demand for credit on the basis that this should equal outstanding supply of credit plus any unmet demand for credit (the 'credit gap').
  2. In determining the level of unmet demand on a sector basis, we have used data provided in the IFC's MSME Country Indicators dataset to. In many cases there is data available for individual countries. Where there is not, we have created regional averages from the data available and applied these to the gaps in the data.
  3. As explained above, in seeking to determine the degree to which trade finance constitutes an appropriate set of products to address the credit gap, we have assumed that 100% of the trade sector gap could benefit from trade finance, 75% of agriculture and 50% of manufacturing.

## A3. Demand Analysis Database Description



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### *Demand Analysis Methodology – Data Reliability*

- ¶ We use the data from the IFC’s SME Enterprise Finance Gap database. We chose this data because it is sufficiently granular to allow a country-by-country analysis of trade finance demand. We believe this is the best data set available for this research and take comfort that the data has been gathered by the IFC, the leading global DFI.
- ¶ However, as the SME Finance team at the IFC themselves acknowledged to us, the data is far from perfect. There are several issues to bear in mind.
  1. The SME Enterprise Finance Gap database is currently being updated over Q417 / Q118 to reflect both updated information, a more robust methodology and improved data gathering techniques. Even after the data has been improved, we are given to understand that it will be reliant upon sweeping assumptions.
  2. The methodology driving the credit gap numbers we have used are quite crude. Further detail is available here: <https://www.smefinanceforum.org/data-sites/ifc-enterprise-finance-gap>.
  3. We have assumed that the credit gap numbers the IFC have derived would include trade finance credit as a component. This seems a reasonable assumption. However, it is not something that was considered in the IFC data gathering exercise, which has a far more general approach in mind.



## A4. Mbuyu Trade Finance Business Index Methodology



### *Mbuyu Trade Finance Business Index*

- ¶ We have created a Trade Finance Business Environment Index. The index is designed to quantify qualitative aspects of the opportunity for offering trade finance products in a country. We extract relevant parts of data compiled by the World Bank to construct their 'Ease of Doing Business' Index, being the:
  - 'Getting Credit' indicator
  - 'Trading across Borders' indicator
  - 'Enforcing Contracts' indicator.
  - 'Resolving Insolvency' indicator.
- ¶ We then create an index by:
  1. Creating a score for the country based upon its position in the ranking between 0.00 and 1.00 (rank / no. of countries), and
  2. Averaging the indicators to give an overall score between 0.00 and 1.00.
- ¶ Although we only use the scores for DAC list countries, the index is created for all (190) countries.