# Trade finance in the Arab region: an overview

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Economic and Social Commission for Western Asia

# Trade finance in the Arab region: an overview

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# 1. Trade finance – a key for short-term financing

Trade finance is a monetary activity that is considered a crucial component in trade facilitation and scaling operations regionally and internationally. The global trade finance market was valued at $39,714.2 million in 2018 and is expected to reach $56,065.7 million by 2026.[1] International trade finance aims to reduce the risks involved in cross-border exchange borne by the importer and exporter, respectively. It permits world trade to flow predictably and securely through offering a range of financing methods and tools used to facilitate the payment for goods to exporters, who require payment for the goods and services they sell from importers, who, in turn, insist on receiving the right goods on time and in good condition.[2]

It is important to note that trade finance focuses more on the trade than the underlying borrower, for it is not balance-sheet led. This is an opportunity for small businesses with weaker balance sheets to use trade finance and trade larger volumes of goods or services and work with stronger foreign customers. However, access to finance remains an acute problem for micro, small and medium enterprises (MSMEs). In specific, more than half of trade finance requests submitted by MSMEs are rejected, against only 7 per cent for multinational companies.[3]

Hence, trade finance helps MSMEs and corporations ensure fewer delays in payments and in shipments, thereby enabling them to plan their cash flow and working capital more efficiently. Without trade finance, it remains very likely that companies fall behind on payments and lose key and potential clients, which, in turn, might have long-term ramifications for the company. International trade finance can provide options that can help companies conduct business internationally and help them through times of financial difficulties.[4]

## Participants/players in trade finance:

The conflict of interest between the exporter and the importer has raised the need to shift towards trade finance.

### (a) Core players:

- **Exporter (seller/beneficiary)**: The exporter is the end user offering the products or services and requiring payment in return for the material and labour in a timely manner.

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1 https://www.alliedmarketresearch.com/trade-finance-market#:~:text=The%20report%20provides%20a%20comprehensive,Royal%20Bank%20of%20Scotland%2C%20and.

2 https://globaltradefunding.com/trade-finance-solutions/import-financing/consignment-purchase/.

3 WTO, 2016. Trade finance and SMEs: Bridging the gaps in provision. Available from https://www.wto.org/english/res_e/booksp_e/tradefinsme_e.pdf.

4 http://www.tradearabia.com/news/IND_380019.html.

- **Importer (foreign buyer/applicant)**: The importer is the end user receiving the products or services and supposed to pay on time and the accurate amount.
- **Financial institution/ financial intermediation/ service provider/trading intermediaries/bridge financing**: **I**n most cases, it is the bank, and it facilitates the whole trade finance transaction process concerned with accurate payments based on the agreed terms and conditions. It manages payment and supply risk. In some cases, an importer's bank and exporter's bank are involved to liaise together.

### (b) Other players:[5]

Other players have a role in the overall trading process and include the following:

- **Manufacturer**: produces the goods or services and may sell the manufactured products by themselves or using other sellers.
- **Shipping agency (carriers)**: depending on geographical and courier's conditions, transfer the goods using air, land, sea, or multimodal ways of transportation.
- **Insurance companies**: cover the risks of loss or damage of goods during delivery based on the contract terms and delivery options**.**
- **Government and trade organizations**: include different organizations such as chamber of commerce, trade unions, goods inspection companies, and customs (for instance, exporters must receive an export license to complete the pre-shipment or sanitary inspections to fulfill the requirements by the respective Government and customs).

[5] https://slideplayer.com/slide/14653100/.

# 2. COVID-19 and trade finance

Trade finance's main drawback is its vulnerability to increased risks such as the COVID-19 pandemic. COVID-19 is considered as a black swan event for many businesses, which leads finance providers to limit or even curtail their financing. The pandemic has imposed external and internal risks on trade finance. In fact, the role of trade finance is thus more important in the post-COVID 19 environment where financing trade became riskier as default rates inevitably rise.

### (a) Disadvantages and risks imposed by COVID-19:

- Dilution, compliance risks, credit losses, political risk, swings in foreign exchange and insolvency risks.
- Heightened fraud risks: exploitation scams, emerging money laundering and terrorist financing risks.
- Logistical challenges: business and border closures, coupled with the reduced global capacity to move cargo, naturally reducing global trade flows and further hindering more Arab exports.
- Stress on supply chains: caused an increase in debts, which could increase the stress on financial institutions and liquidity problems.
- Banks: the primary source of trade finance, were not spared from COVID-19 economic shocks in terms of liquidity and profitability.

The International Chamber of Commerce (ICC) reported that $5 trillion of trade credit is needed for the rapid recovery from the COVID-19 crisis and warned about the dangers of trade financing gaps for the survival of small businesses.[6]

### (b) COVID-19 advantages:

- The pandemic has accelerated the widely predicted fourth industrial revolution driven by artificial intelligence and the Internet of things. This wave of innovation most certainly extends to banking and financial services, which have received a boost towards tech adoption caused by COVID-19.
- With less staff running key processes, this has resulted in moving companies more quickly to the cloud, applying more robotics to their processes and exposing the need for advanced analytic technologies to plan effectively.

Achieving the Sustainable Development Goals is at risk if the persistently large trade finance gap continues to hamper international trade. According to the United Nations, the trade financing gap was large but stable at $1.6 trillion pre-COVID-19 and is expected to double post-COVID-19. This is a complex global problem that necessitates a concerted global response in the context of the United Nations 2030 Agenda for Sustainable Development.[7]

In response to the gap created by COVID-19, many Governments are turning to their export

[6] https://iccwbo.org/publication/trade-financing-and-covid-19/.

[7] https://iccwbo.org/media-wall/news-speeches/icc-welcomes-enhanced-focus-trade-finance-un-financing-development-review/.

credit agencies to fill the financing gaps, as they did in response to the 2008-2009 financial crisis.

**Box 1. Basel III for banks and trade finance**

In response to the 2008 financial crises the world witnessed, significant international regulatory reforms have been undertaken, mainly the Basel III reform (updated in 2017), which many Arab countries are members of. In short, Basel III requires banks to obtain high levels of capital against trade finance, mainly letter of credit. In order to achieve this, tightened capital requirements, stricter rules on liquidity management, supervision, and risk management are imposed on member banks.

### (c) Sustainable trade finance overview

Trade finance, if not implemented correctly, might lead to environmental, social and governance issues. Hence, the Addis Ababa Action Agenda declared the inevitable need to commit to market-oriented incentives such as trade, credit, letters of credit, and other innovative financial instruments. Furthermore, it calls on development banks to depend on market-oriented finance, further digitalization and address their failures mainly in financial exclusion facing MSMEs in specific.[8]

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[8] https://developmentfinance.un.org/trade-finance.

# 3. Risks facing trade finance

### (a) External environment

The external environment consists of imposed risks not directly controlled by the trade finance process, including the following:

- **Country risks**: political instability, economic crises and uncertainties such as country's inability to pay its sovereign debt, strict regulations, legal structure and limited legal certainty, unfair trade practices, high tariffs on exports to protect infant industries and imposed trade restrictions and import duties, sanction regimes, emerging markets economies, technology issues and poor infrastructure, lack of awareness, and intellectual property risks
- **Currency risks**: restrictions on foreign exchange outflows from the country, currency crises, foreign exchange rate volatility, and foreign currency translation exposure
- **Transport risks**: distribution disruptions, difficulties in managing territory-based risks, high transport costs (including shipping costs and tariffs), and cargo risks (including storms, collisions, theft, spoilage, piracy, and fire).

**Box 2.** The 2008 global financial crisis ("The Great Recession") and its effects on trade finance

In 2008, the global capital markets were put on hold, the availability of bank financing for trade declined and, if available, costs increased significantly. Moreover, uncertainty increased during the crisis, and financing options declined. Exporters became less willing to give importers the goods on credit and increased demand for bank financing and letters of credit. After the crisis, many banks limited their exposure to smaller businesses. It became clear, over the course of 2008, that the overall liquidity squeeze was hitting trade credit. The refinancing of such credit was becoming more difficult, and lending was affected by the general re-assessment of risk linked to the worsening global economic climate.[a]

The global financial crisis pushed the international community to swiftly orchestrate a large-scale $250 billion trade finance programme in order to channel liquidity via the banking sector into the real economy.[b]

[a] https://www.wto.org/english/thewto_e/coher_e/challenges_e.htm.

[b] https://www.elibrary.imf.org/view/IMF001/26085-9781498317030/26085-9781498317030/26085-9781498317030_A001.xml?language=en.

### (b) Internal environment:

The internal environment consists of imposed risks directly associated with the trade finance process, including the following:

- **Dilution risks**: The amount payable by the debtor on a trade receivable will be less than the invoiced amount(s). The importer chooses not to pay for several reasons including return of goods, short shipment, warranty claims, billing error, rebates and commercial dispute, uncommitted financing arrangements, level of trust between importer and exporter, and product-related risks such as product inefficiencies and defects, non-environment-friendly products, pricing of the products, and dual used-goods (goods that can be substituted with restricted activities such as the military).
- **Compliance risks**: Such risks include bankruptcy, financial losses, legal or regulatory sanctions, damaged reputation,

money laundering, fraud, bribery and corruption, and cash-flow problems.

- **Process complications risks**: Such risks include lack of automation, missing or incorrectly prepared documents, time constraints and lack of competitiveness, incompetent staff in trade finance and more time wasted, limited visibility across account payables and account receivables.
- **Fraud risks**: Such risks include risk of default, fraudulent counterparty, receiving forged documents and insurance scams, impersonated buyers, double-financed trades or payments gone missing, forged or fake documents, false valuation, and multiple pledges.

This paper will tackle international export trade finance with a closer look at the Arab region's export finance. It contains the results of a survey conducted to give a clearer picture about the status of trade finance in the region using data collected from banks, companies and Government agencies in charge of overseeing trade and trade finance.

# 4. Trade finance in the Arab region - a catalyst for growth

Trade finance in the Arab region, similar to the rest of the developing world, is characterized as weak and not fulfilling the needs of development. This could be attributed to the following reasons:

- High dependence on banks which carry rigid trade finance processes and relatively low approval rates (moreover, Basel III has reduced the amount of capital that banks are able to lend).
- Reluctance of banks to take risks by lending to small and medium-scale enterprises (SMEs).
- Heavily paper-based industry and high complexity of operations.
- Lack of collateral and knowledge about customers.
- Slow adoption of technologically advanced tools and online platforms.
- Lack of comprehensive data on international trade finance.
- Global economic uncertainty such as trade tensions.
- Anti-money-laundering measures, which are an impediment to closing trade finance gaps.
- COVID-19 and increasingly tight regulations in light of its aftermath (imposed challenges will be discussed later).
- Others (based on further survey results). To better understand the status of trade finance and challenges facing businesses to obtain trade finance in the Arab region, the Economic and Social Commission for Western Asia (ESCWA) conducted surveys of firms, banks and Government agencies in the region aiming to provide an evidence-based analysis that contributes to the development of the domain in the region. The surveys were conducted in partnership with ICC, the Union of Arab Banks and the Union of Arab Chambers.

The results and a brief analysis of the three surveys are presented below.

## 1. Survey of firms

### (a) Overview of the structure of the survey

The survey aims to deepen the understanding of the challenges facing exporting enterprises and to assess the trade finance activities and the availability of trade finance as the lubricant of trade in the Arab region.

The survey was answered by 183 firms from the region operating in various sectors such as retail and wholesale, manufacturing, insurance, beauty industry, law, consultancy, and contracting.

**Figure 1.** Gender of top manager (*Percentage*)

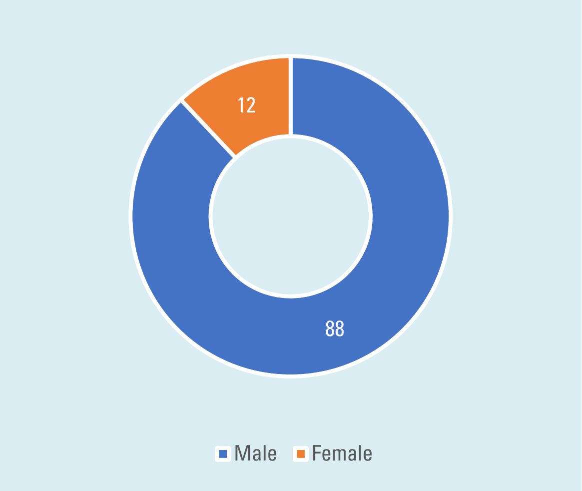



**Figure 2.** Age of top manager (*Percentage*)

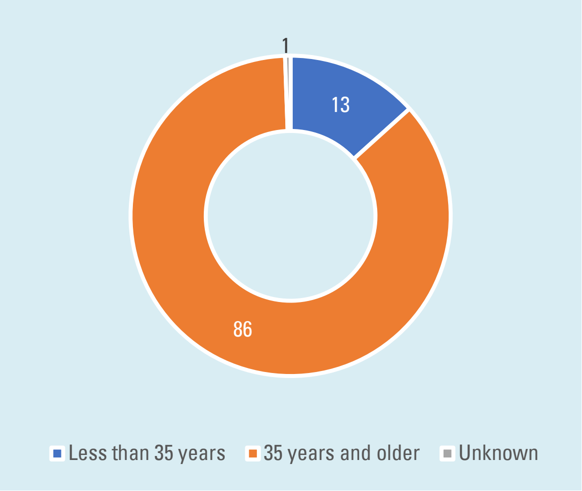



**Figure 3.** Registration/licensing of business by a national authority (*Percentage*)

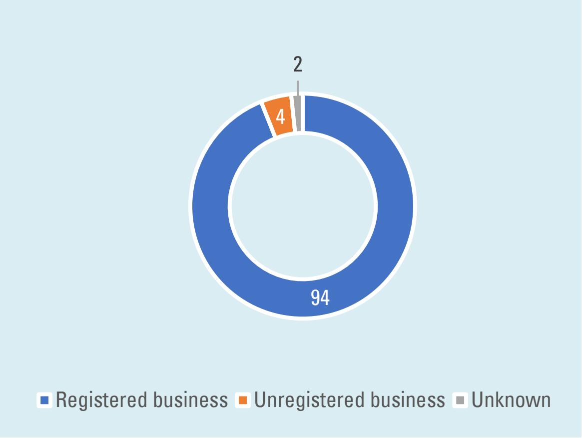



**Figure 4.** Number of full-time employees (including managers) (*Percentage*)

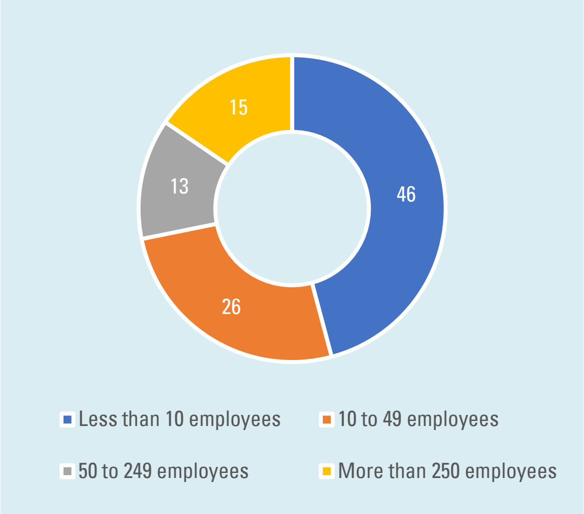
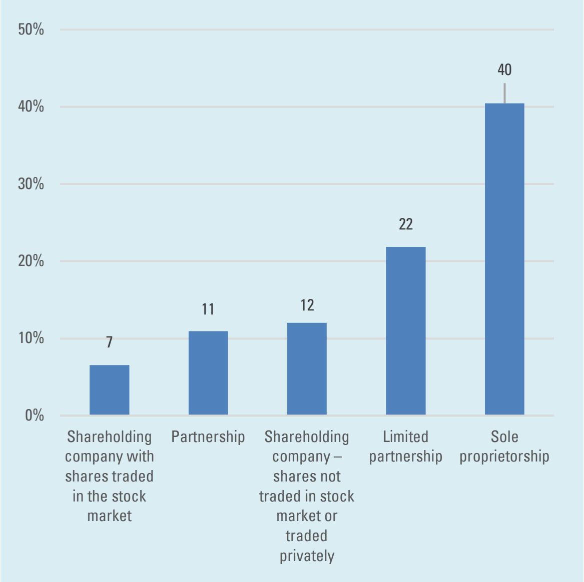



**Figure 5.** Current legal status (*Percentage*)




## (b) Overview of exports

44 per cent of the surveyed firms are non-occasional exporters having no future export plans or well-formulated vision. 41 per cent of the firms have been exporting for more than 10 years and 33 per cent less than three years. Moreover, around half of the firms state that they merely export roughly up to 20 per cent of their goods or services.

**Figure 6.** Export activities (*Percentage*)

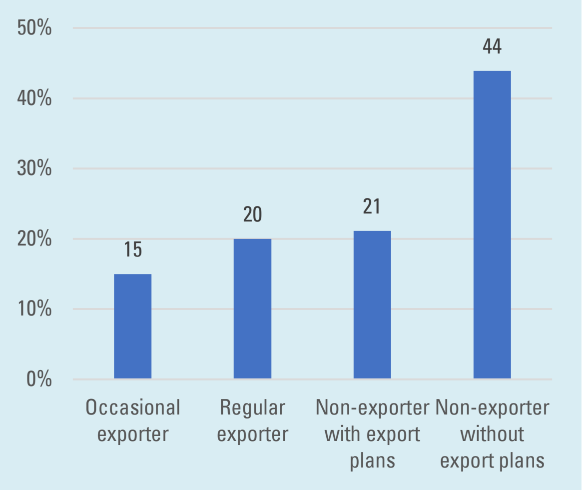
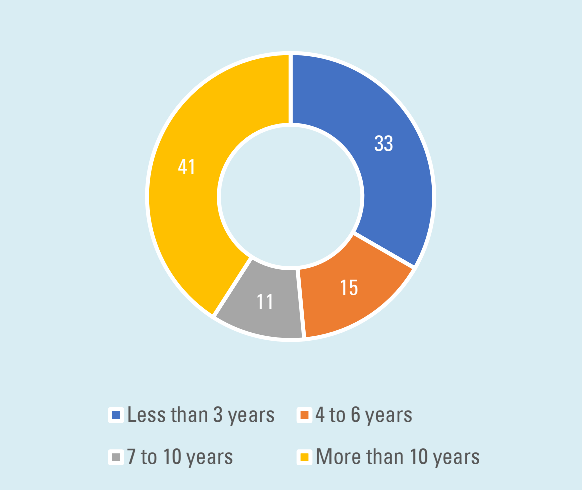



**Figure 7.** Export activities, in years (*Percentage*)




In general, 74 per cent of the firms are currently engaged in export activities, with almost half of the respondents exporting some 20 per cent of their business activities, of which 62 per cent are ESCWA member countries, with Saudi Arabia, Oman and Egypt as their most popular destinations. Saudi Arabia, Egypt, the United Arab Emirates, and Kuwait continue to be very popular destinations within the Arab region for exports and market development; outside the Arab region, the United States and some European countries, such as the United Kingdom and France, are among the main export destinations.

**Figure 8.** Current export activities (*Percentage*)

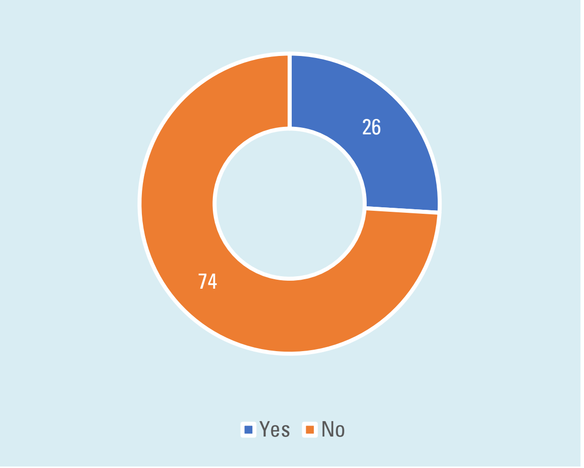



**Figure 9.** Exports as proportion of entire business (*Percentage*)

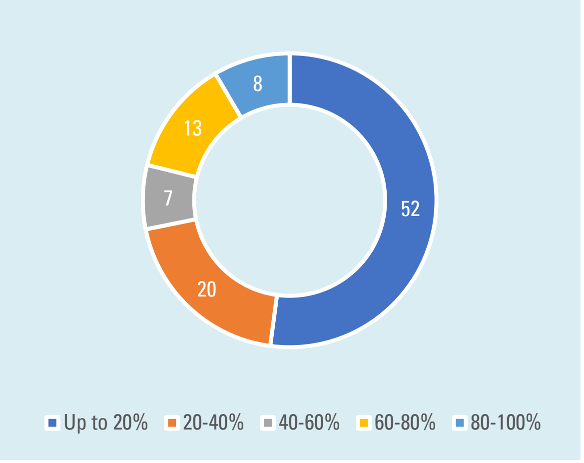



**Figure 10.** Planned proportion of exports (*Percentage*)

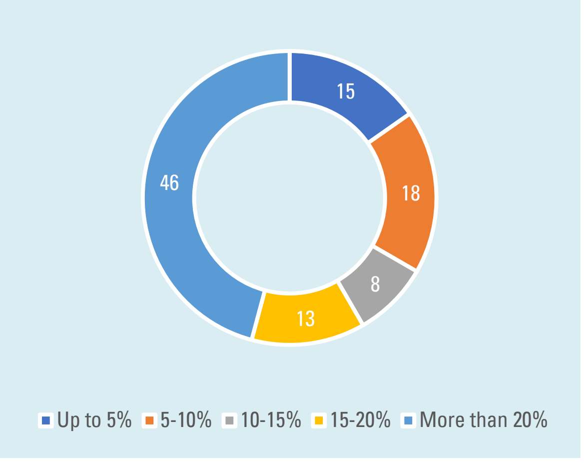


**Figure 11.** Top export destination countries (*Percentage*)

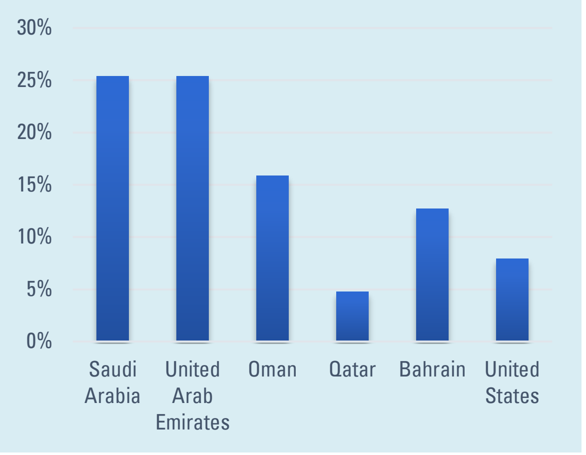
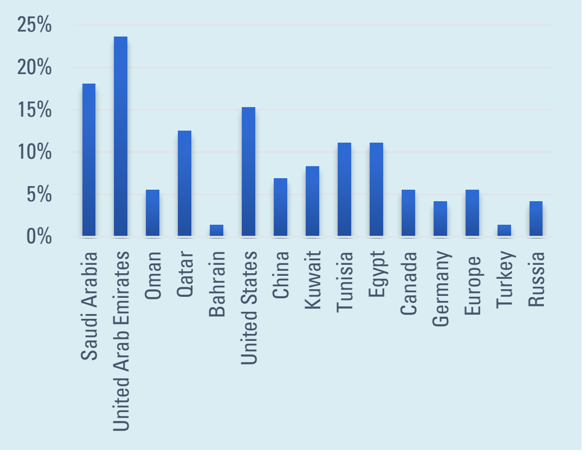


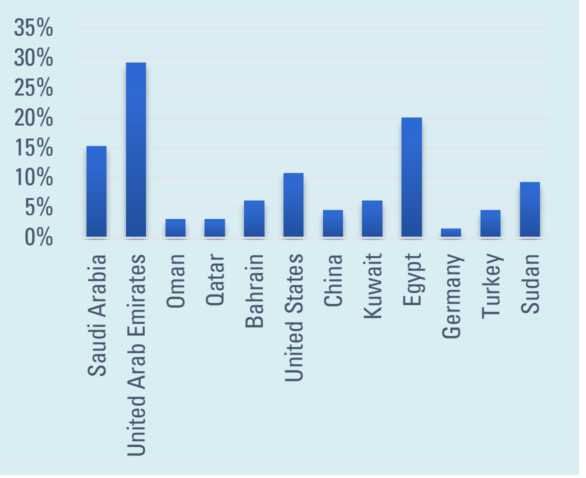

**Figure 12.** Planned export destination countries/regions (*Percentage*)




Saudi Arabia and the United Arab Emirates were the main export destination by most respondents, followed by Oman (figure 11).

In terms of countries targeted for export development, Saudi Arabia and the United Arab Emirates were the most frequent answers within the Arab region, and the United States outside the Arab region (figure 12).

**Figure 13.** Countries targeted for export development (*Percentage*)




According to figure 13, Egypt, the United States and the Sudan are the main future target countries for most respondents.

### (c) Annual export turnover

**Figure 14.** Annual turnover for 2019 or the latest available year (*Percentage*) (in US dollars or equivalent)

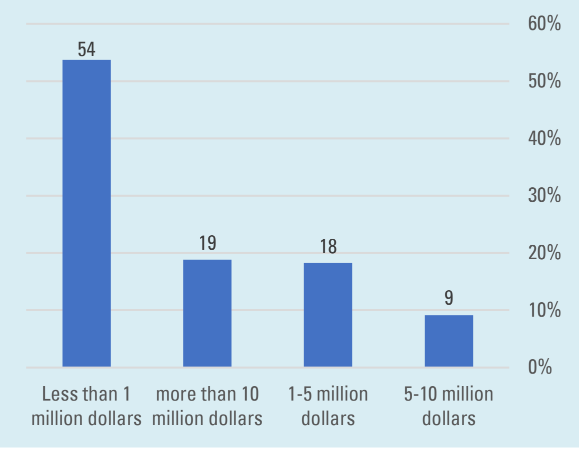
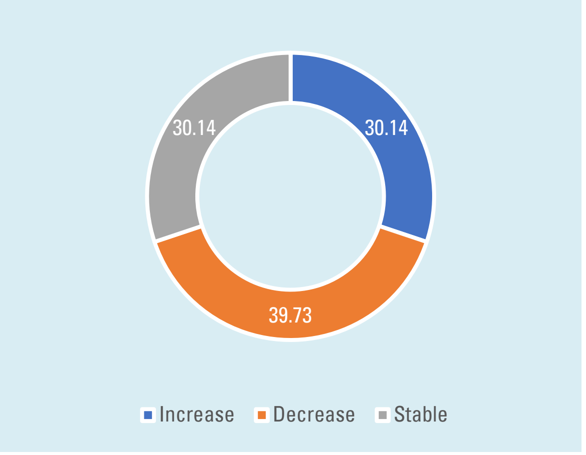


Figure 15. Change in export turnover (*Percentage*)




### (d) Main export barriers

Out of the businesses surveyed, 41 per cent stated that their main export barriers was a result of lack of exportable goods, 19 per cent the inability to get financing to offer to foreign customers,13 per cent the risk of not receiving their payment, and 12 per cent regulatory barriers and complexity. Additional reasons included sanctions and regulations illegally imposed on businesses, and the lack of courier companies willing to assist in export.

Sixty-five per cent of the firms declared access to finance as the greatest challenge, while less than 6 per cent were not affected by it. Receiving foreign payments, shipping costs and identifying foreign customers were main concerns expressed by most. The results also show that management know-how, internal capacity and the capacity and reliability of transportation infrastructure constitute minor challenges for Arab exporters.

Figure 16. Main export barriers (*Percentage*)

**Figure 17.** Elements causing difficulties in exports (*Percentage*)

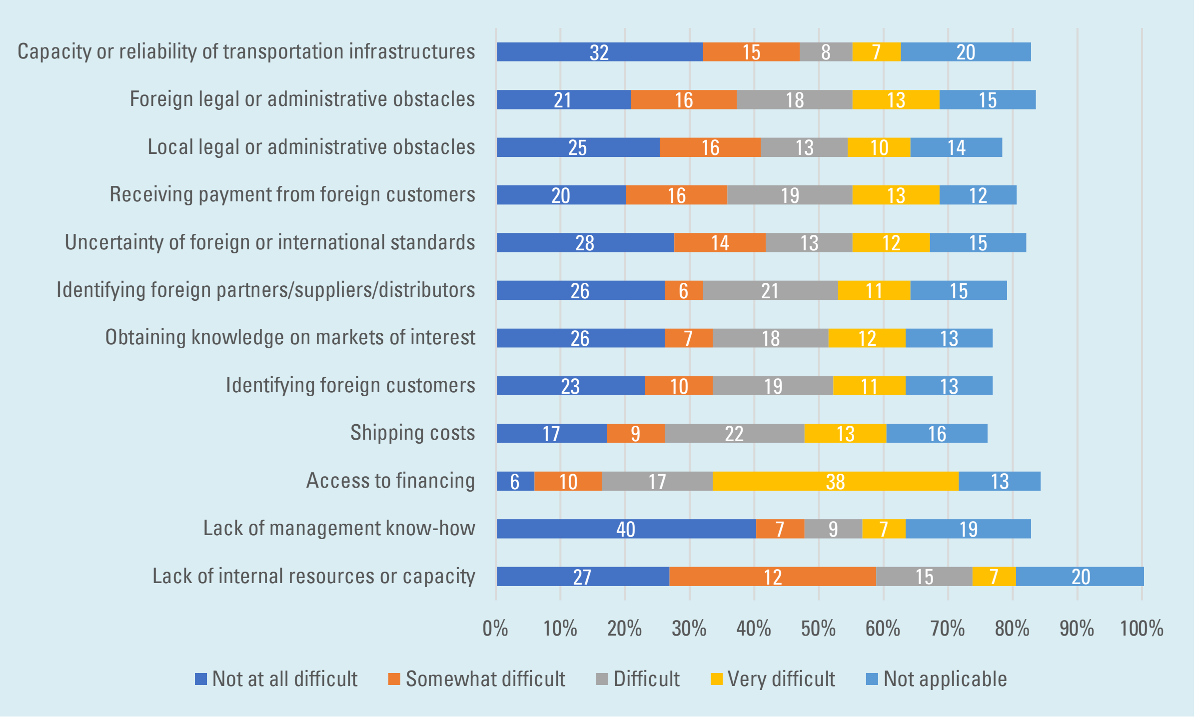
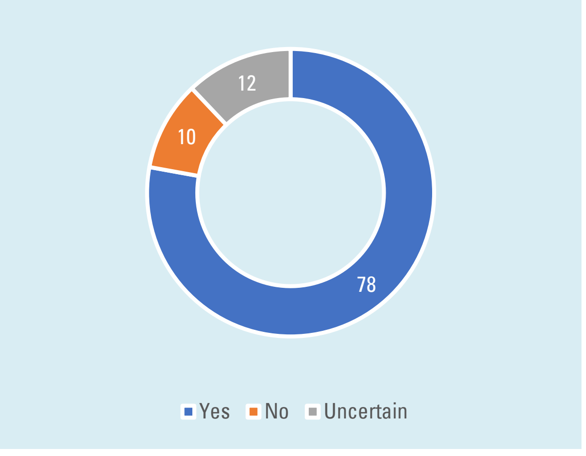


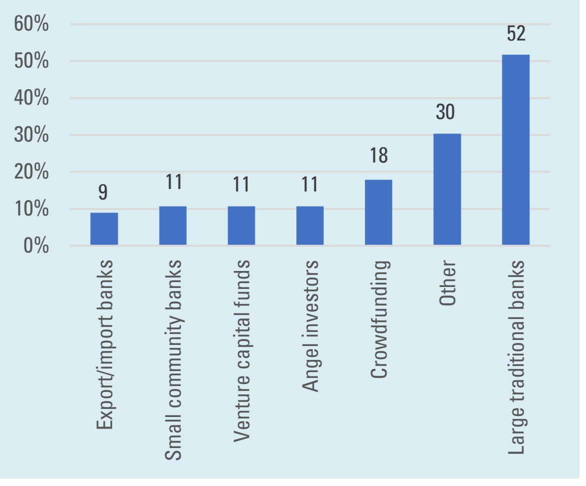

**Figure 18.** Interest in increased future exporting (*Percentage*)




## (e) Experience of various firms with trade financing opportunities and corresponding providers

The results below show that the most successful attempts to obtain debt financing involve the owners (34 per cent) or family and friends (28 per cent). National credit and investment companies (NCICs) are the least successful source, at only 12 per cent. Moreover, 46 per cent of these debt financing options required collateral.

**Figure 19.** Sources of financing for export operations (*Percentage*)



### (f) Financing through banks

Banks seem to remain the main financing source of trade activities with little increase of activities in the past three years and an increasing cost of credits for trade finance.

**Figure 20.** Change in availability of credits from trade banks, 2018-2021 (*Percentage*)

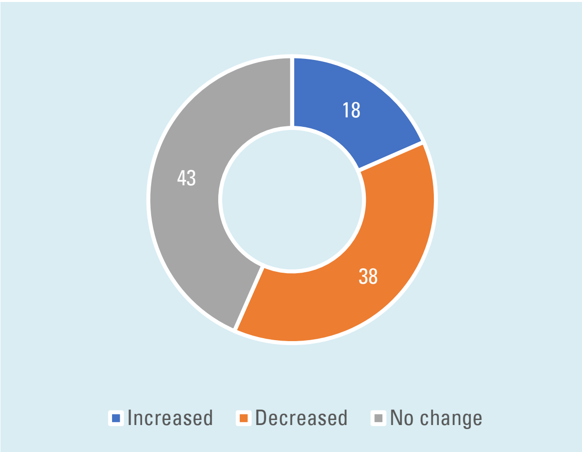
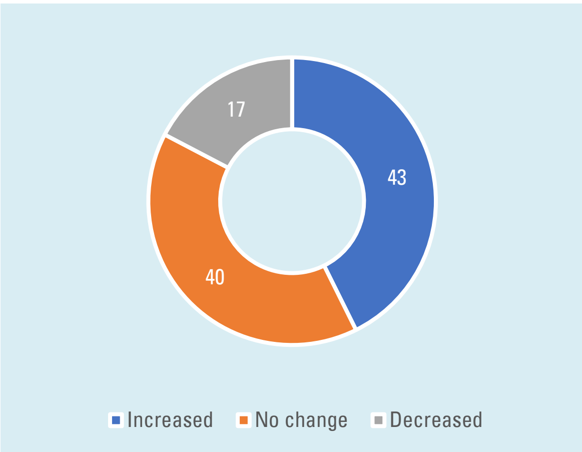
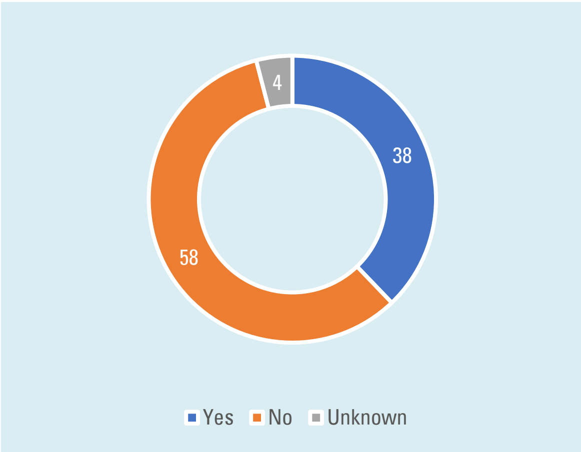



**Figure 21.** Change in cost of credits from trade banks, 2018-2021 (*Percentage*)



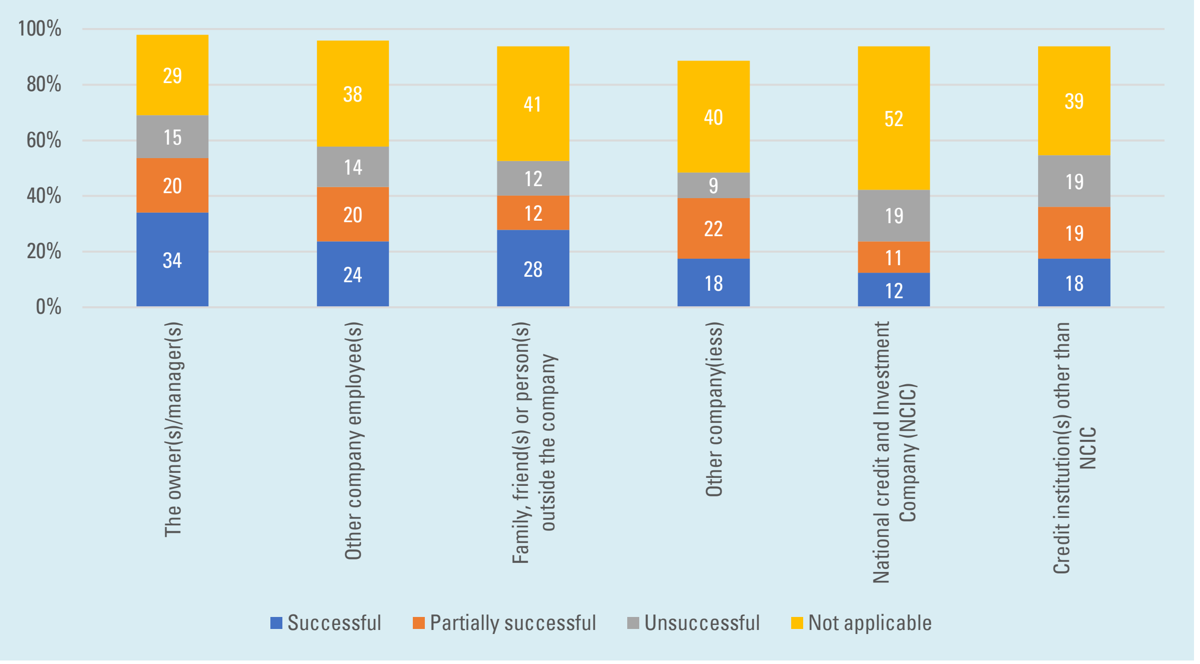

### (g) Loans

**Figure 22.** Financing businesses by means of loans, 2018-2021 (*Percentage*)



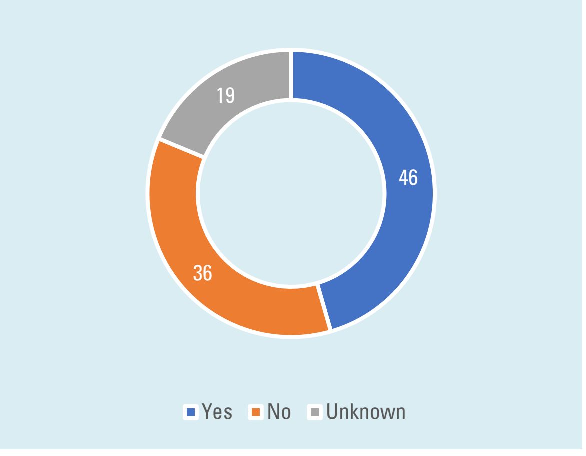
### (h) Debt financing

**Figure 23.** Success rate of obtaining debt financing from various sources (*Percentage*)



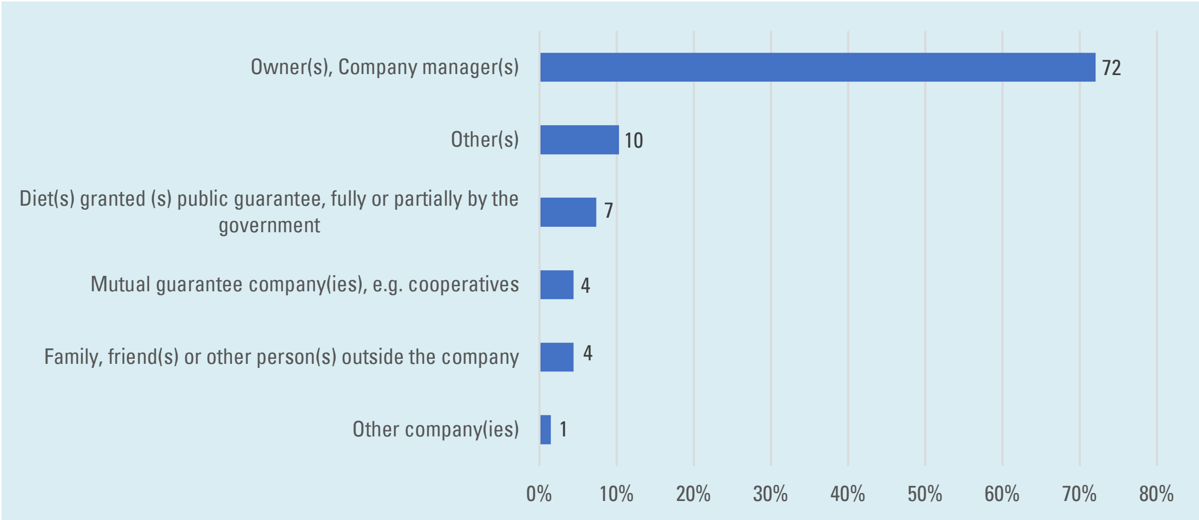

**Note:** "Partially successful" means that the financing was not provided to the full satisfaction either as to the requested amount or as to the desired conditions.

**Figure 24.** Requirement of collateral in debt financing, 2018-2021 (*Percentage*)




Out of the companies that obtained debt financing, 72 per cent were vouched by owners and company managers.

**Figure 25.** Providers of vouching in debt financing (*Percentage*)




### (i) Credit institutions

The main reasons for credit institutions to reject applications for trade finance are insufficient guarantees, low rating or financial assessment, and insufficient capital. In 22 per cent of all cases, the credit institute did not provide any reason for the rejection.

**Figure 26.** Reasons for credit institutes to reject applications for trade finance (*Percentage*)

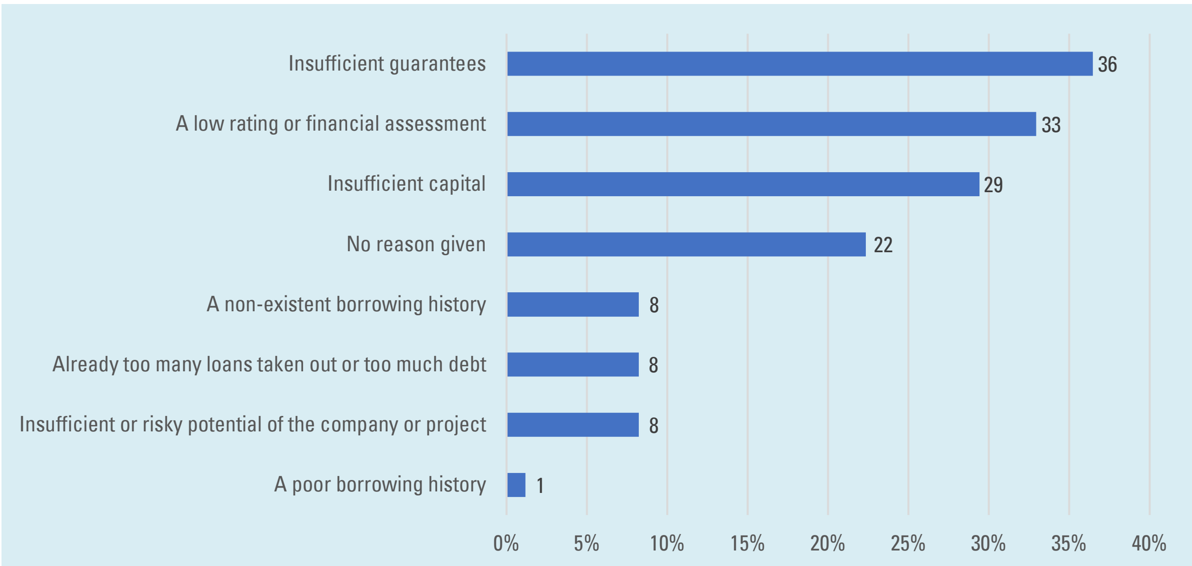
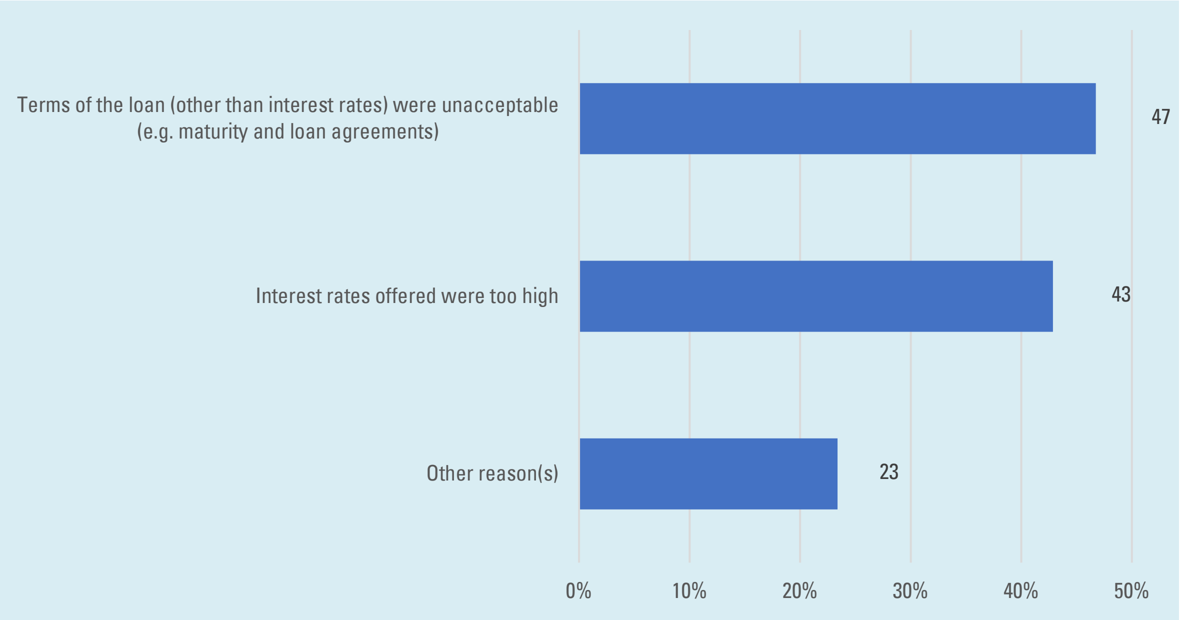
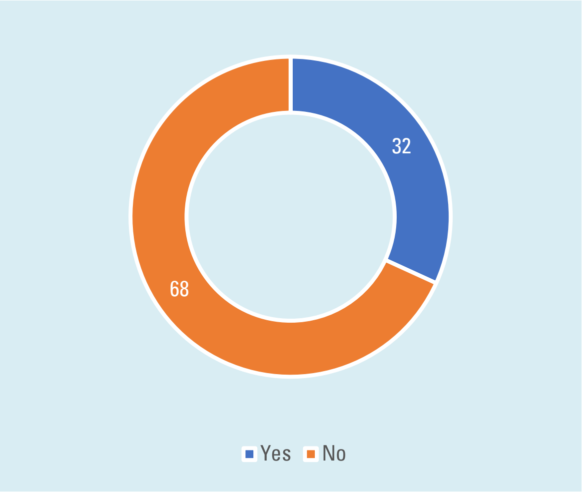


Figure 27. Reasons for firms to reject requested loans (*Percentage*)




### (j) Capacity-building and awareness

Figure 28. Attending export capacity-building activities, 2018-2021 (*Percentage*)




Out of the firms surveyed, 68 per cent did not attend trainings, workshops or other export capacity-building activities or use consulting services by consultants, trade commissioners, export promotion agencies, and others. For those attending export capacity-building activities, the majority felt that the content did not target their needs and the services offered lacked specialization. Respondents suggested trade missions as the most beneficial approach.

Figure 29. Reasons for not attending export capacity-building activities (*Percentage*)

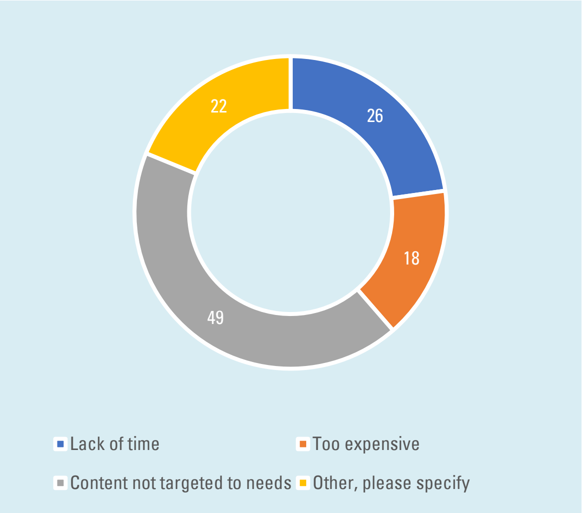


**Figure 30.** Rating of usefulness of attended export capacity-building activities (*Percentage*)

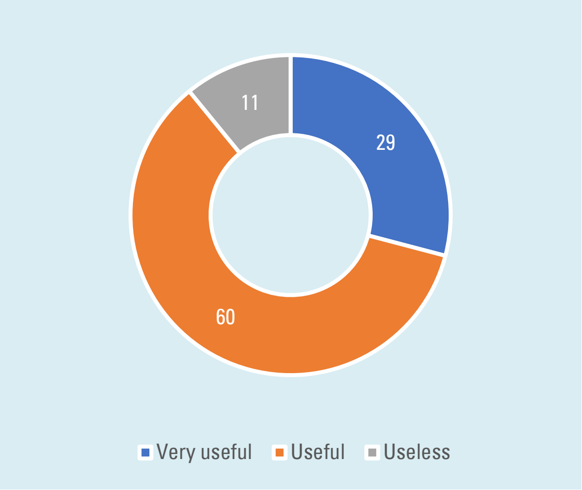
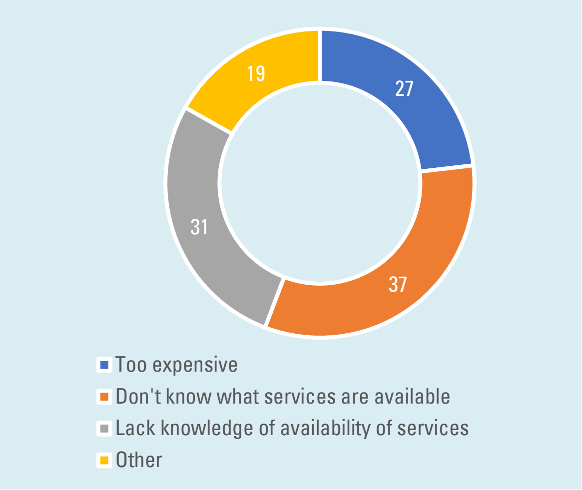



**Figure 32.** Reasons for not having used consulting services, 2018-2021 (*Percentage*)




### (k) Consulting services and awareness

**Figure 31.** Use of consulting services, including consultants, trade commissioners and export promotion agencies, for export activities, 2018-2021 (*Percentage*)

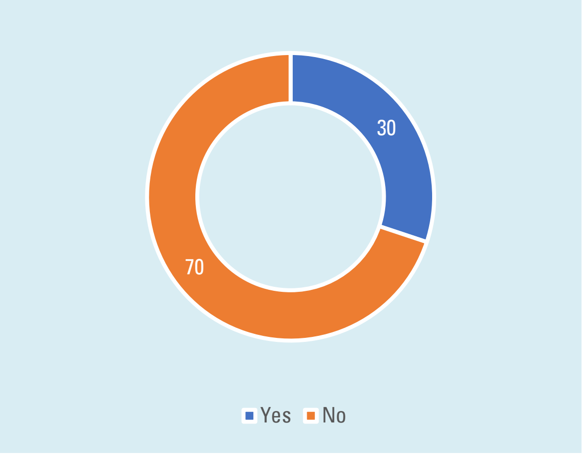



**Figure 33.** Usefulness of consulting services if utilized (*Percentage*)

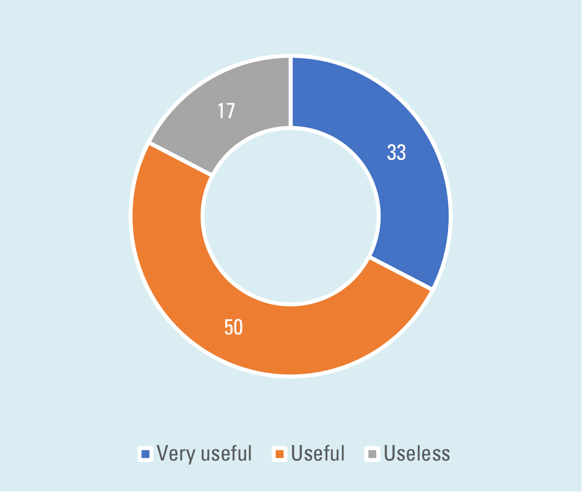
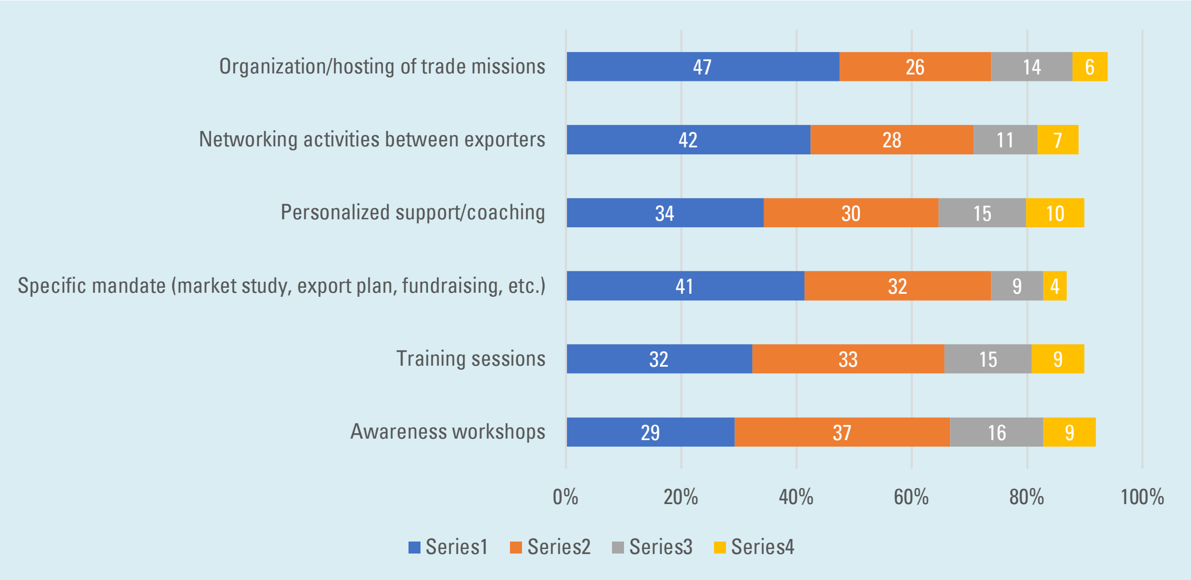


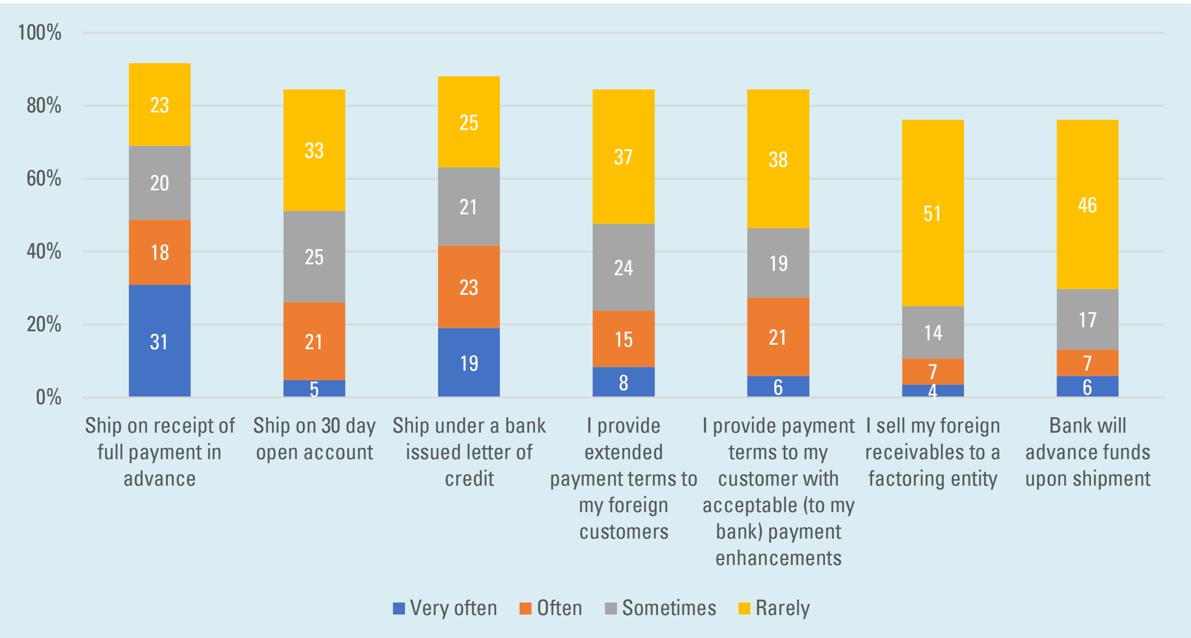
Figure 34. Most useful support services in export activities (*Percentage*)




## (I) Payment methods in international trade finance

Among Arab exporters, 31 per cent accept full payment in advance and 19 per cent the traditional letter of credit offered by banks. However, half of the firms rarely sell through a factoring entity.

Figure 35. Payment methods accepted from foreign customers and frequency (*Percentage*)



## (m) Access to export financing and payment enhancement options

Figure 36. Level of importance of access to export financing (*Percentage*)

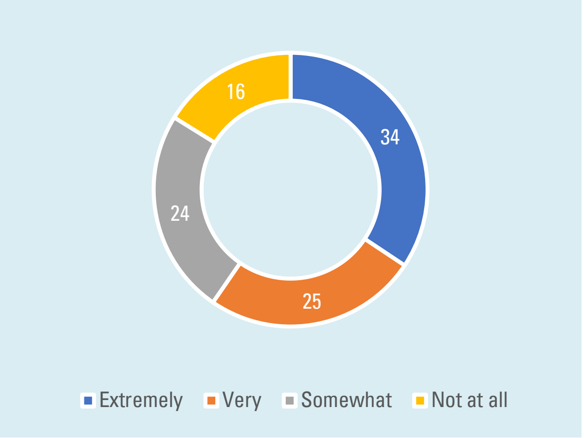
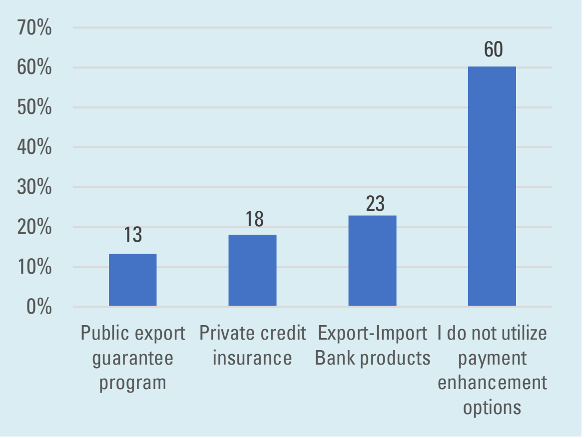



Figure 37. Payment enhancement options utilized (*Percentage*)



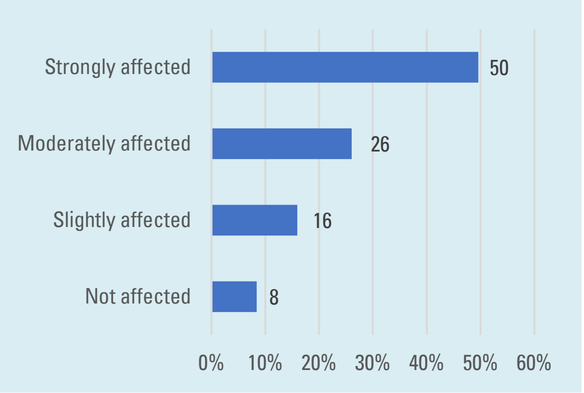

## (n) COVID-19 and trade finance

### (i) Effect of COVID-19 on business operations

In the Arab world, COVID-19 has affected the operations of 50 per cent of businesses. More than half, however, stated that they do not envision closure due to the pandemic.

COVID-19 has led to lower domestic sales to consumers (46 per cent), lower domestic sales to other businesses (33 per cent) and difficulty importing inputs from abroad (30 per cent).

Figure 38. Effect of COVID-19 on business operations (*Percentage*)




The COVID-19 pandemic has led to reduced employment rates by 44 per cent compared to previous years. Yet, it boosted teleworking (by 33 per cent) and online sales (by 31 per cent). However, only 3 per cent of businesses had to file for bankruptcy due to the pandemic. As a positive aspect, COVID-19 has led Arab firms to think outside the box and come up with new and customized products (27 per cent).

Figure 39. Risk and envisaged time frame of business closure due to COVD-19 (*Percentage*)

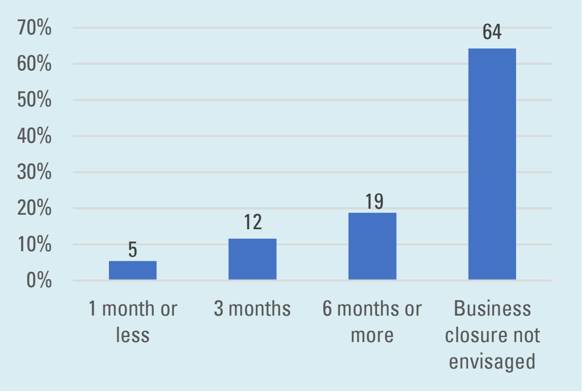
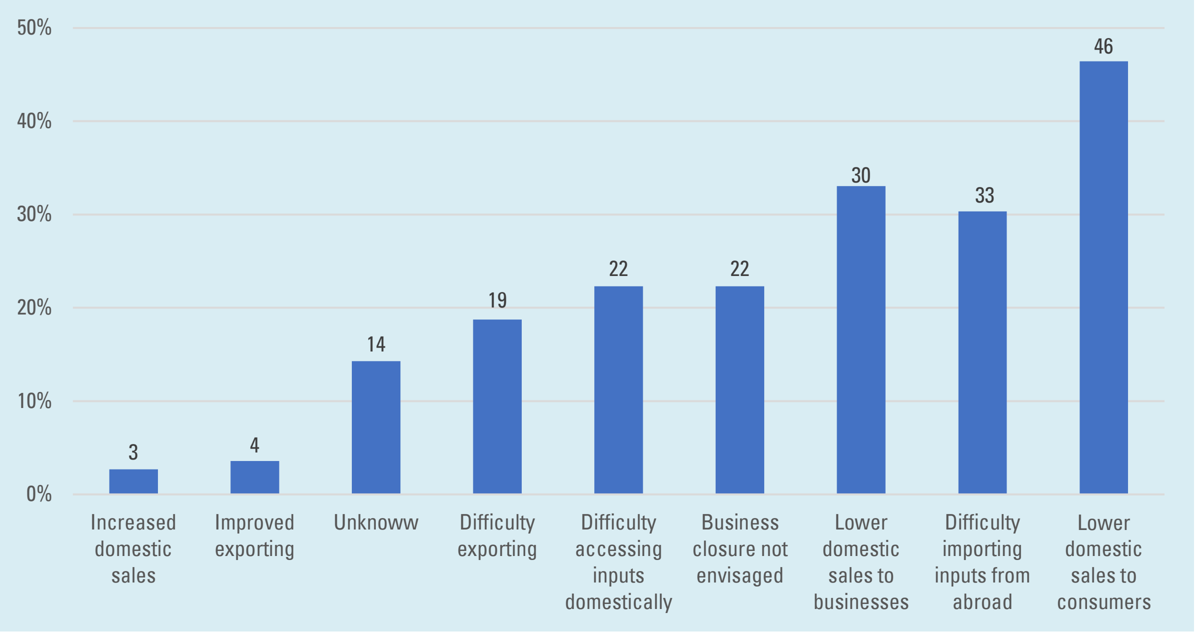
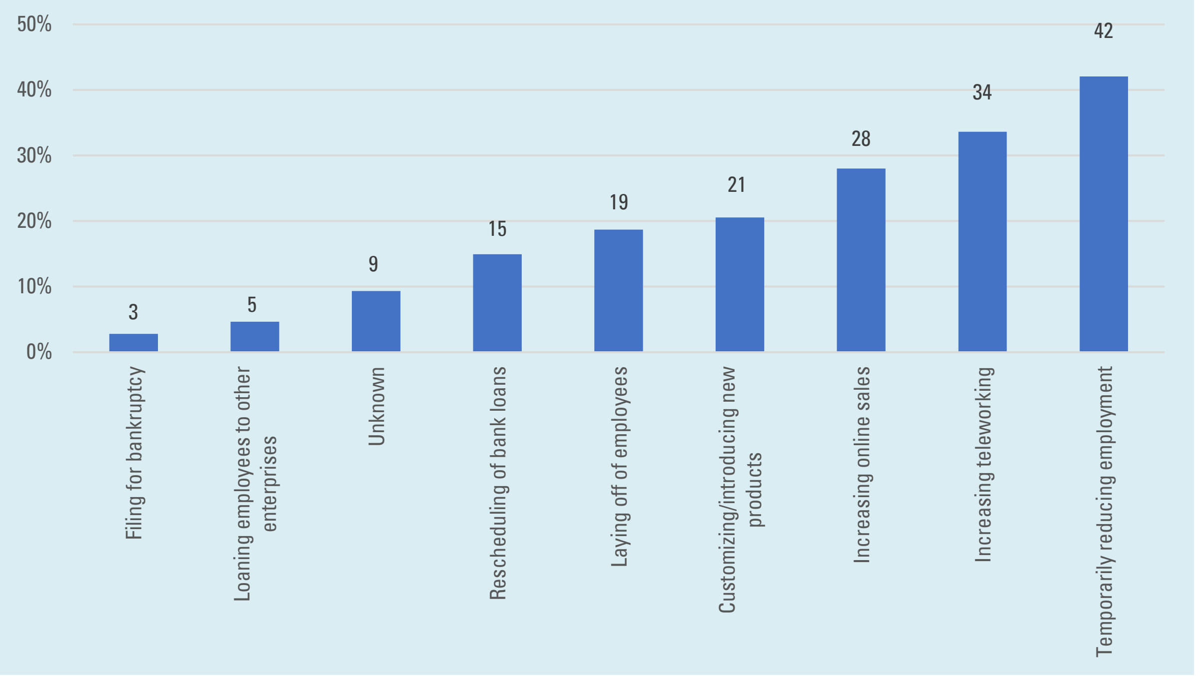


Figure 40. Impact of COVID-19 on the ability to purchase inputs (*Percentage*)




### (ii) Strategies of firms to cope with COVID-19

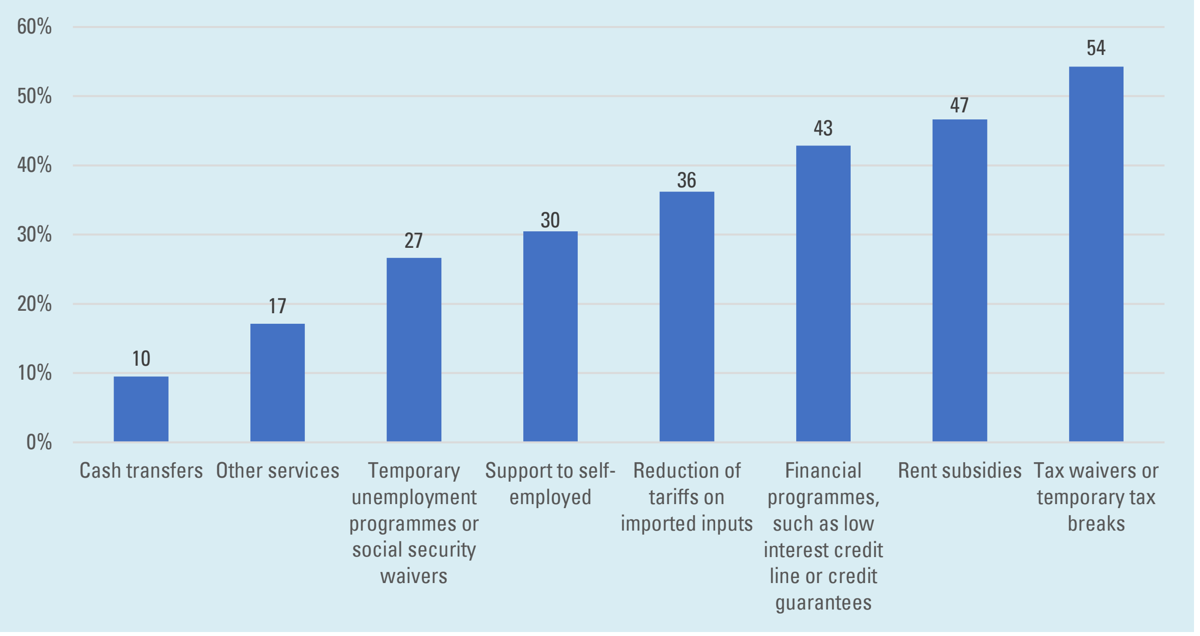
Figure 41. Utilization of strategies to cope with the COVID-19 pandemic (*Percentage*)



#### (iii) Government procedures to cope with COVID-19

Firms suggested that the top three Government measures most helpful to cope with the COVID-19 crisis would be to waiver taxes or temporary tax breaks (54 per cent), provide rent subsidies (47 per cent) and offer financial programmes (43 per cent).

Figure 42. Top Government measures to cope with COVID-19 crisis (*Percentage*)



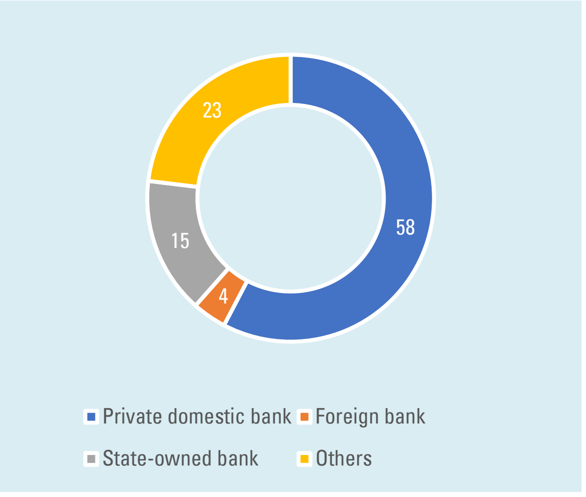

## 2. Survey of banks

### (a) Overview

Out of the 27 banks across the Arab region which responded successfully to the survey, 93 per cent were commercial banks, and the rest were retail banks, out of which 58 per cent were private domestic banks, 15 per cent State-owned banks and 4 per cent foreign banks (figures 43 and 44).

Figure 43. Types of bank (*Percentage*)

Figure 44. Ownership structure (*Percentage*)



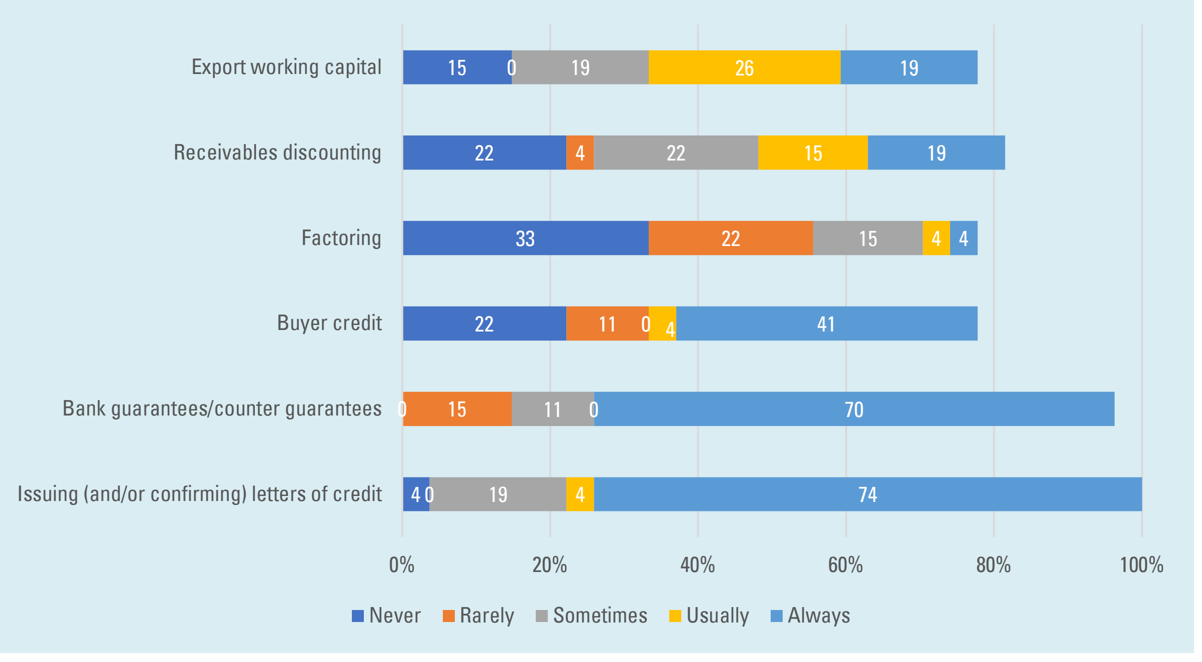

Between 2018 and 2021, banks mainly engaged in international trade finance tools such as letters of credit (74 per cent of banks), bank guarantees (70 per cent) and buyer credits (41 per cent), while factoring and receivable discounting were the least used trade finance tools.

The largest two types of trade finance operations executed by Arab banks are letters of credit and bank guarantees; exports working capital financing and receivables discounting are moderately used; and factoring transactions are very limited. This calls for increased diversification of trade finance operations, benefiting both banks and firms.

### (b) Scope of operations

Trade finance transactions realized by banks for the year 2019 had a common margin, with almost half of their transactions valued between $100 million and 1 billion, 30 per cent worth $1-10 billion and 15 per cent exceeding $10 billion.

Figure 45. Tools used in international trade finance, 2018-2021 (*Percentage*)



### (c) Geographic scope

More than 62 per cent of business destinations of banks are within the Middle East and North Africa (MENA) region, 35 per cent in Europe and Central and South Asia (regular business), 31 per cent in East Asia and the Pacific (occasional business), 23 per cent of institutions in Latin America and the Caribbean (rarely), and 19 per cent never engage with banks within that region.

The major regional trading partners of banks of the Arab region are Europe, with which 70 per cent of respondent banks usually or always do business, and East Asia (mainly China) with which 69 per cent of banks usually or always do business. Other than inter-Arab trade, Arab banks rely heavily on business coming from Europe and China, which makes them susceptible to recession or shocks that may hit these two regions.

However, opinions between institutions differ on the reliability of these trade finance activities and tools. While 58 per cent of the institutions rate these activities are reliable with low risk, the remaining institutions are almost entirely of opposite opinion.  This may explain why their scope of operations is mainly within the MENA region.

The majority of respondent Arab banks consider trade finance as a low-risk business because they mainly work with letters of credit and bank guarantees, which are relatively low-risk and avoid riskier options such as factoring and discounting of receivables.

Figure 46. Regions in which banks do business, and frequency (*Percentage*)

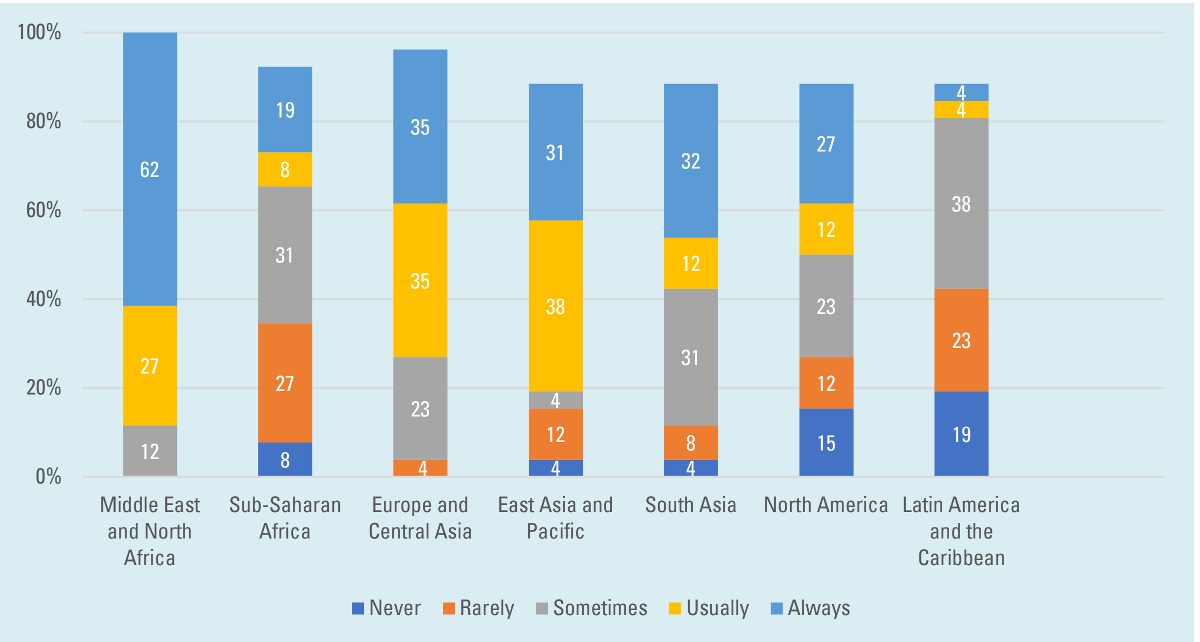
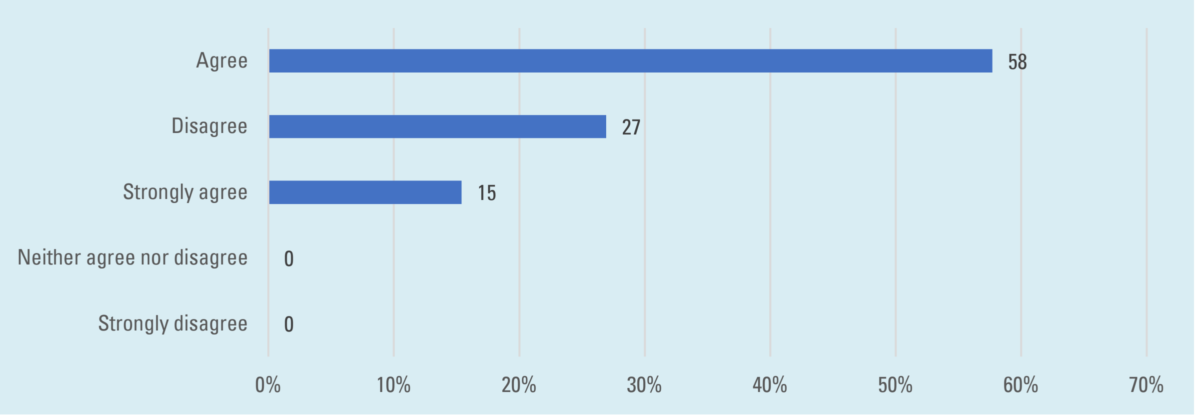


**Figure 47.** Reliability of international trade finance activities (*Percentage*)

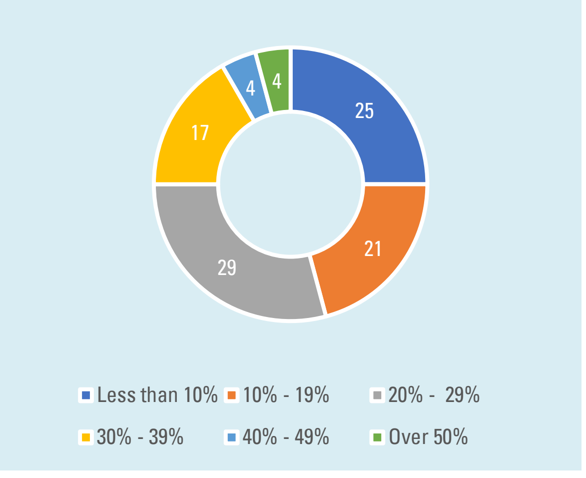



### (d) Trade finance revenues for banks

Out of the surveyed banks, 4 per cent stated that trade finance activities contribute to more than half of their income, while 29 per cent stated that trade finance activities only contribute to 20-29 per cent.

Arab banks, in general, are traditional in terms of products and services and still rely heavily on lending and depositing operations, which generate the largest proportion of income for these banks.

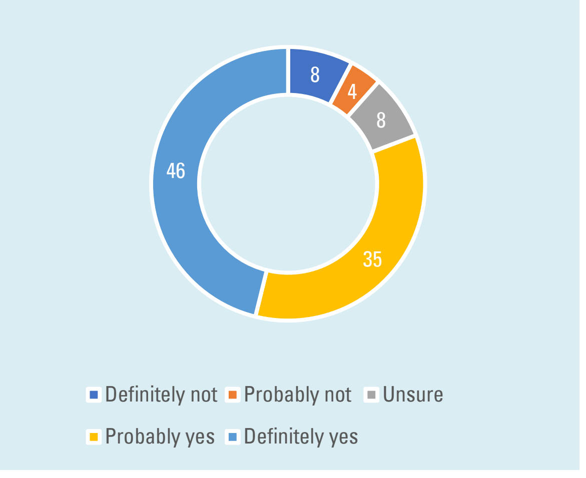
**Figure 48.** Income from international trade finance activities as proportion of total income (*Percentage*)




### (e) Outlook on the international trade finance market

Arab banks are skeptical about the development of trade finance over the upcoming three years despite the fact that economic outlooks predict a considerable improvement in global and regional economic conditions and fast economic recovery. This could be due to banks' concerns about the global geopolitical tensions and the increasing complexity of international regulatory requirements and corresponding banking requirements.

**Figure 49.** Expectations for a growing international trade finance portfolio during the next three years (*Percentage*)



As biggest constraints on their international trade finance activities, banks identified the issuing bank's low credit ratings (44 per cent), the low credit rating of the company or its country (40 per cent) and global economic uncertainty such as trade tensions (36 per cent), followed directly by anti-money laundering (AML) and know-your-customer (KYC) requirements and limited foreign exchange liquidity (24 per cent).

Supporting the numbers in figure 50 the global economic uncertainty and AML and KYC requirements are major constraints on international trade according to 72 per cent and 52 per cent of respondent banks, respectively.

As additional constraint, some banks mentioned the Lebanese economic and financial crisis and the dual-use-of-goods business activity.

Figure 50. Main constraints on the growth of international trade finance portfolios for banks in the Arab region (*Percentage*)

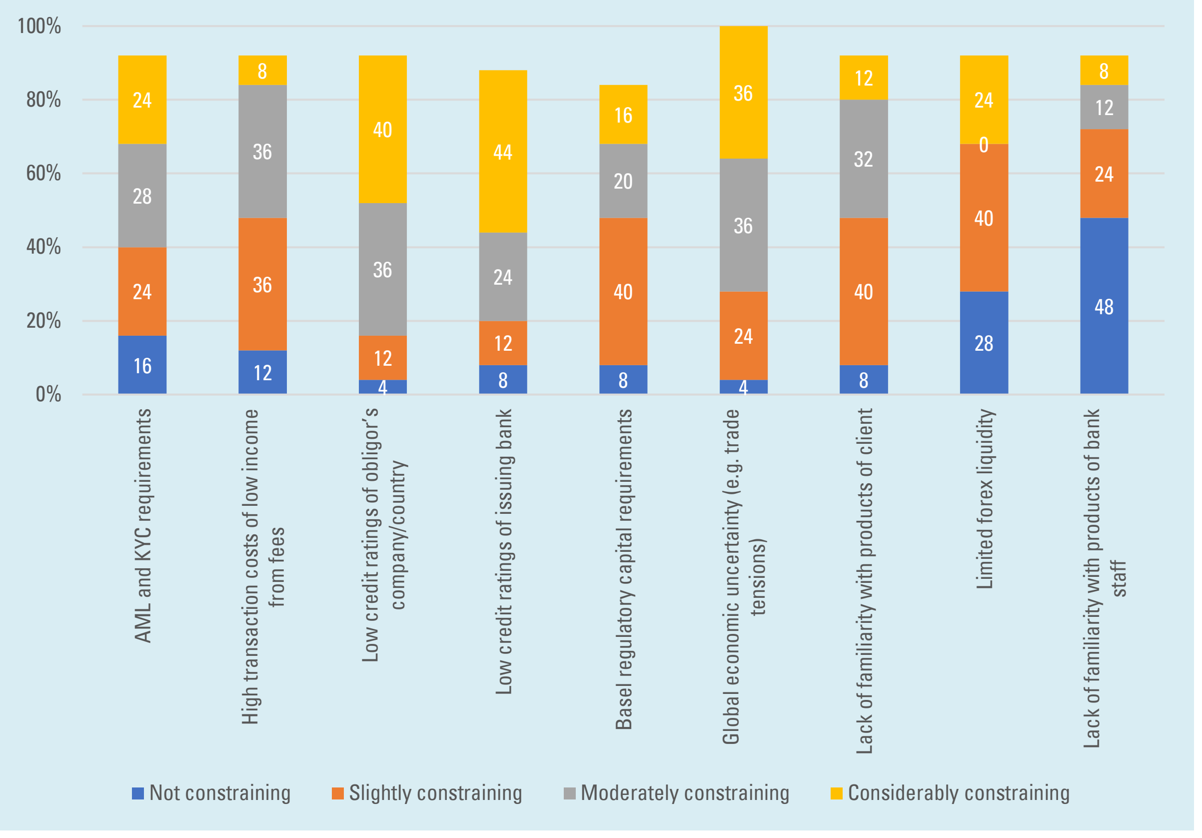
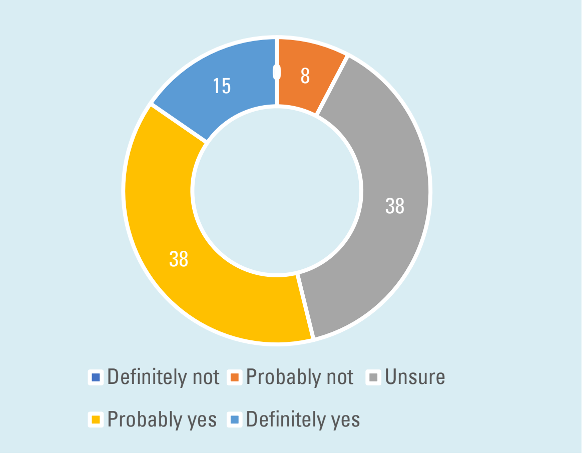


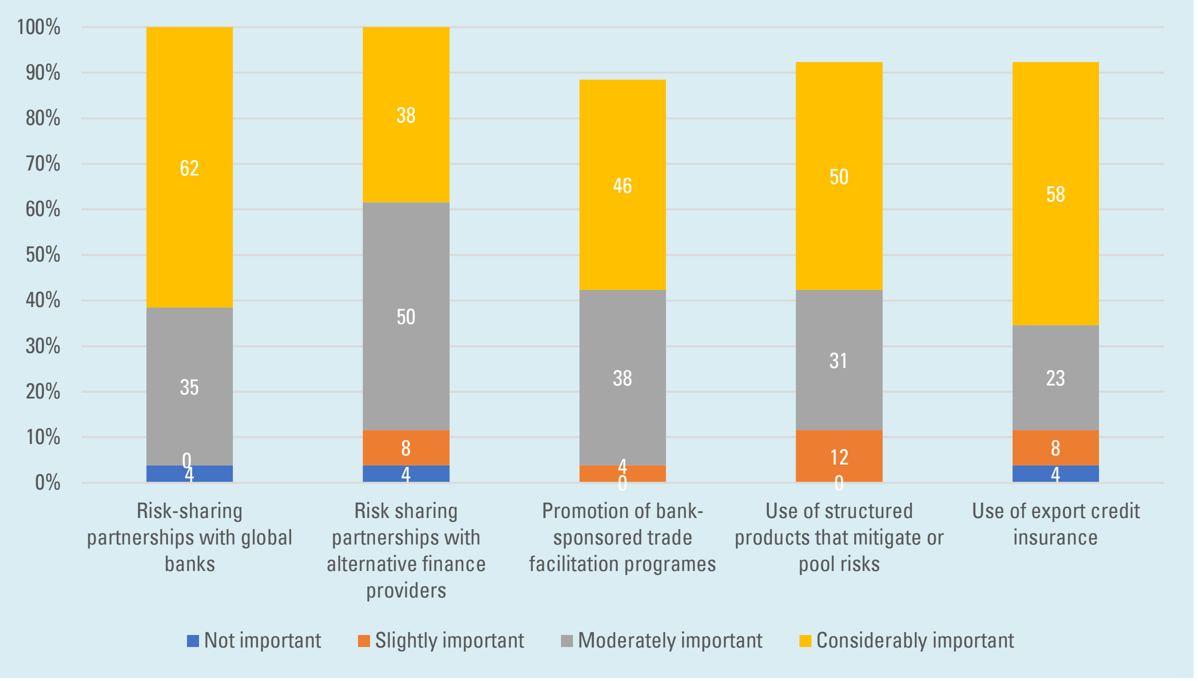
**Figure 51.** Anticipated change of the unmet demands for trade finance support over the coming two years (*Percentage*)




Due to uncertainty about global economic conditions and the complex AML requirements, 38 per cent of respondent banks expect a possible inability to meet trade finance demand, while 15 per cent are sure of this inability.

Global correspondent banks play a very important enabling role in trade finance; thus, 62 per cent of banks pointed out that risk-sharing partnerships with global banks could boost the financing capacity of Arab banks. The second-most cited means to mitigate risk was the use of insurance, by 58 per cent of banks.

**Figure 52.** Best ways to make available additional financing capacity (*Percentage*)

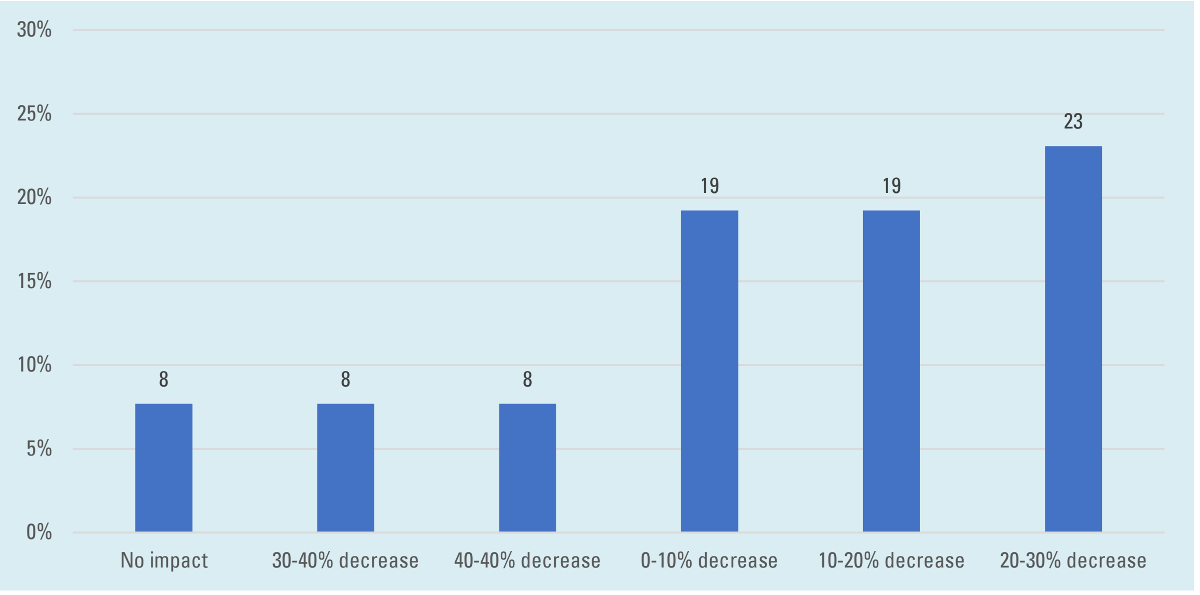


### (f) The impact of COVID-19 on international trade finance

COVID-19 has had a huge effect on global supply chains, disrupting all trade activities. Forty-two per cent of banks have experienced a decrease of 10-30 per cent in trade finance transactions versus their expectations. Fifteen per cent of banks experienced a decrease of more than 50 per cent, and only 15 per cent experienced no impact at all.

These figures reflect the large decline in international trade for the Arab region.

**Figure 53.** Impact of COVID-19 on trade finance transactions versus expectations during the first half of 2020 (*Percentage*)




According to the survey, banks strongly wish to increase their trade finance businesses; 81 per cent have introduced measures to support customers impacted by COVID-19, and 62 per cent noticed an increase in trade finance defaults due to COVID-19.

**Figure 54.** Institutions putting in place measures to support customers impacted by COVID-19 (*Percentage*)

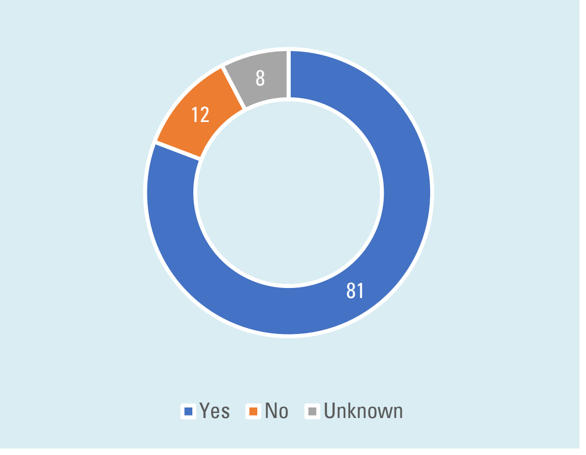
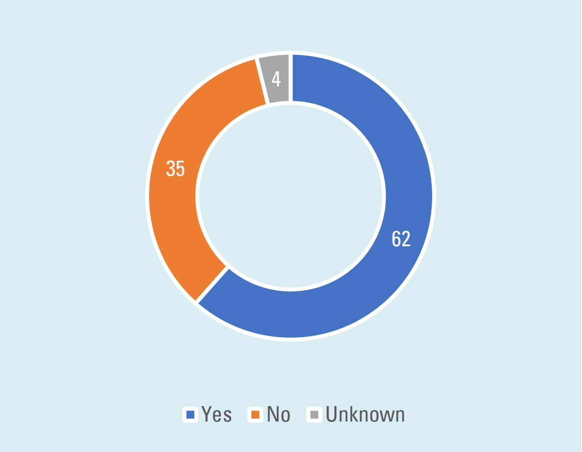


Figure 55. Institutions noticing a rise in trade finance defaults owing to COVID-19 (*Percentage*)




### (g) Rections of trade finance transactions pre-COVID-19

The trade finance transaction rejection rate in 2019 represented almost 10 per cent for 21 banks (88 per cent of the respondent banks); only one bank rejected more than 50 per cent of proposed transactions. Rejection rates have slightly accelerated for 33 per cent of the banks interviewed, have not changed for 25 per cent and have accelerated considerably for 17 per cent.

This development can possibly be linked to the mounting complexity of AML/CFT requirements by international regulatory authorities and correspondent banks. In fact, the complexity in compliance requirements represents an obstacle to boosting trade finance as well as other operations such as cross-border money transfers.

Insufficient collateral was one of the main reasons behind these refusals, with 48 per cent of banks stating it as a considerable reason and 28 per cent as a moderate reason. Economic concerns and insufficient credit are also major factors affecting trade finance transactions as seen by some of these banks. Economic concerns were stated by 40 per cent of banks as cause for rejecting trade finance transactions, revealing the impact of global economic uncertainty and correspondent banking relationship requirements on trade finance.

Figure 56. Rejection rate of proposed transactions for international trade finance, in 2019 (*Percentage*)

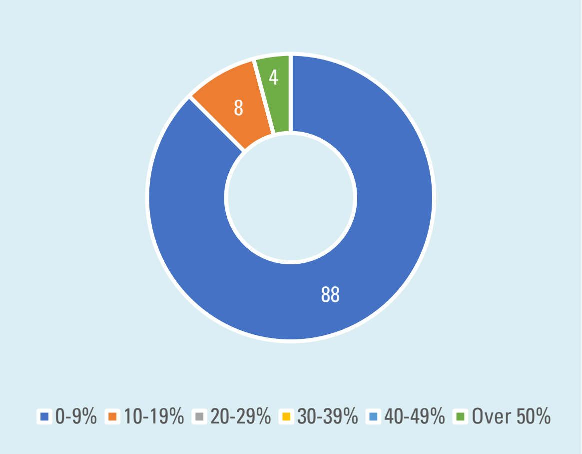



Figure 57. Acceleration of rejection rate between 2019 and 2020 (*Percentage*)

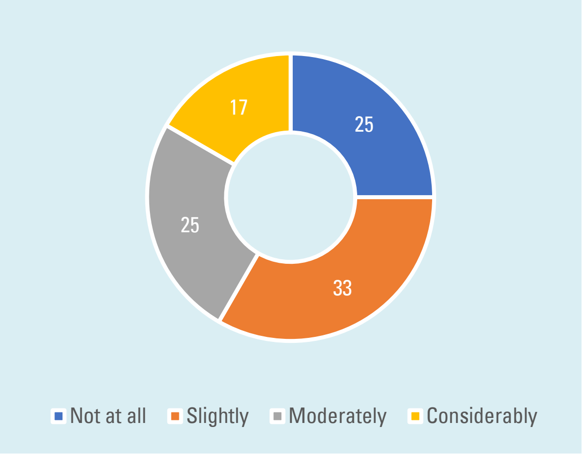
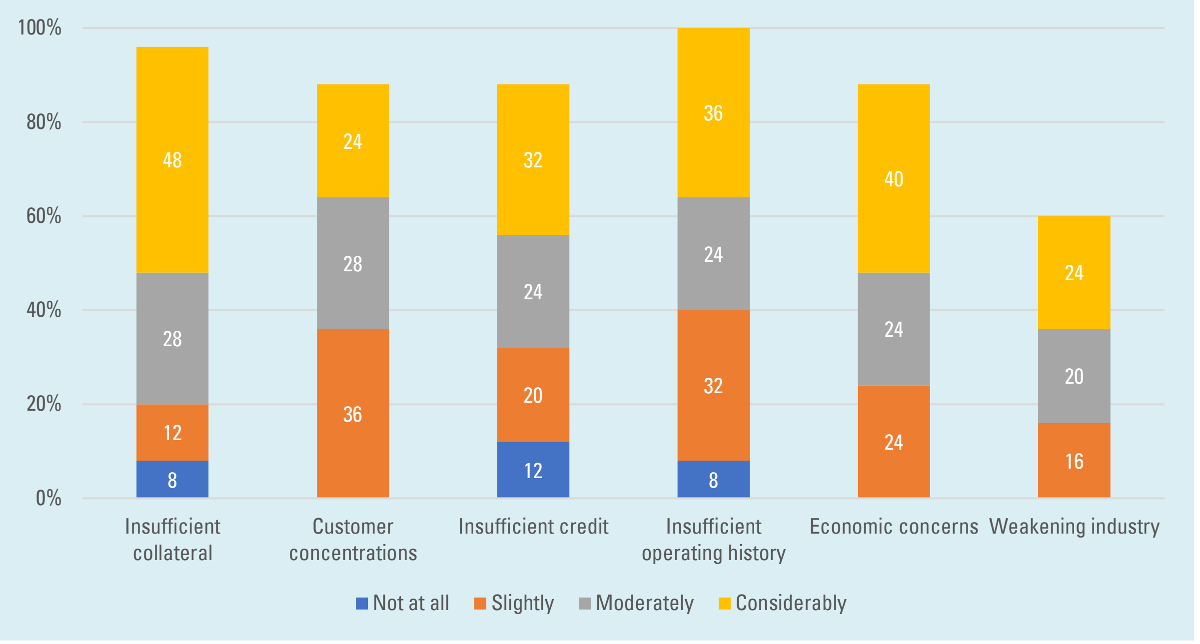


Figure 58. Main reasons for denying proposed international trade finance transactions (*Percentage*)




### (h) International trade financing of banks and SMEs

The share of SME financing in the Arab region is relatively low. Out of the banks surveyed, 38 per cent reported their SMEs portfolio at 20-29 per cent.

The share of SMEs in the trade finance portfolio of banks is generally low. No bank stated more than 50 per cent as the rate of SME financing. These figures point out that the overwhelming majority of Arab SMEs do not export their products and rely mainly on local markets and, thus, do not request trade finance services.

Forty per cent of SMEs are moderately concerned with the rejection of trade finance transactions.

More than half of the banks signified their willingness to provide more trade finance, particularly for SMEs, if trade asset market places were created, the visibility and efficiency of transactions was improved and overall transaction costs were reduced. However, an average of 10 per cent of banks were undecided whether or not to increase trade finance support over the coming two years.

Figure 59. Share of SMEs in the trade finance portfolio of banks (*Percentage*)

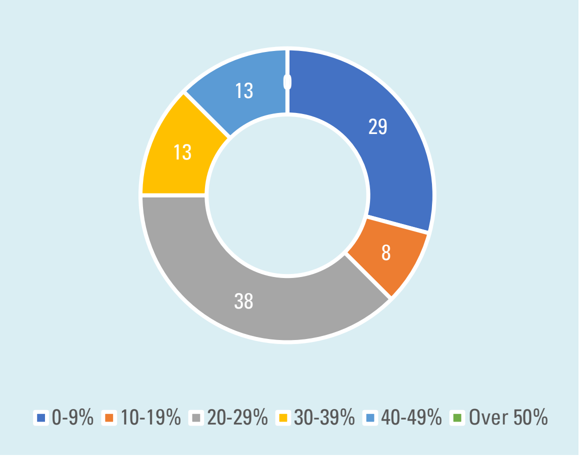


**Figure 60.** Rate of concern of SMEs about the rejection of proposed international trade finance transactions (*Percentage*)

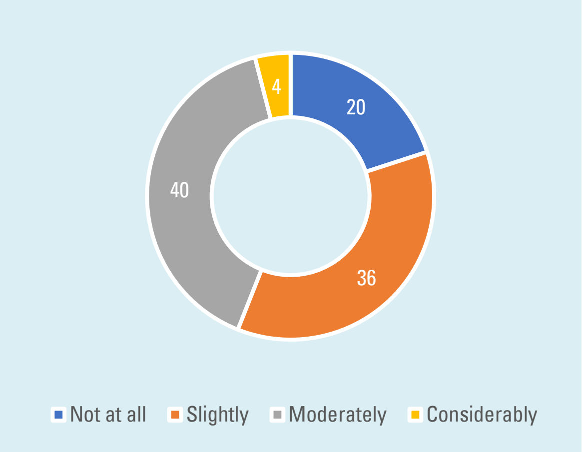
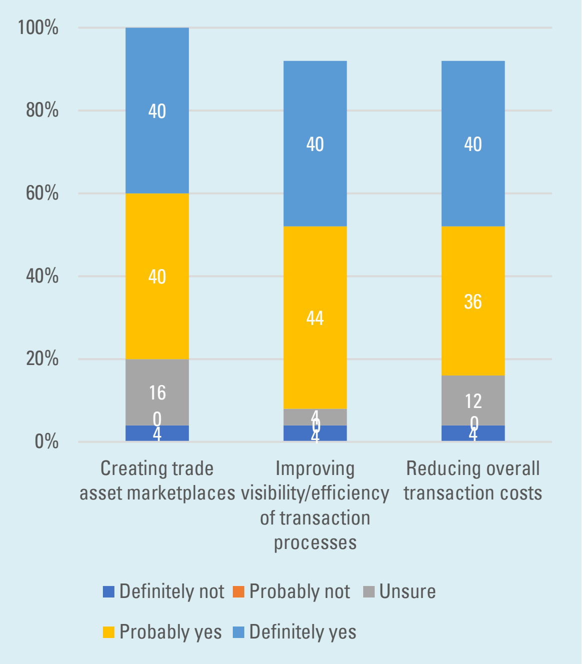



**Figure 61.** Preparedness of banks to provide more trade finance, particularly for SMEs, if any of the following were addressed (*Percentage*)




The three suggested enablers seem to be of similar importance for banks to boost SME trade finance.

### (i) Digitization and trade finance

Digitization is widely seen as one of the most important trends to shape trade and trade finance in the coming years. Technology was used by 38 per cent of banks to acquire credit information and risk management solutions, and 27 per cent of banks digitalized trade information. The considerable investment in technological infrastructures and digital transformation observed in Arab banks will facilitate the execution of trade finance transactions and eventually boost the volume of this business. Furthermore, it may develop trade finance services for SMEs.

Trade finance business models are actively being reconsidered by the majority of banks; for instance, 54 per cent of respondents have changed to paper-free transactions.

Figure 62. Technologies used by banks in their operations (*Percentage*)

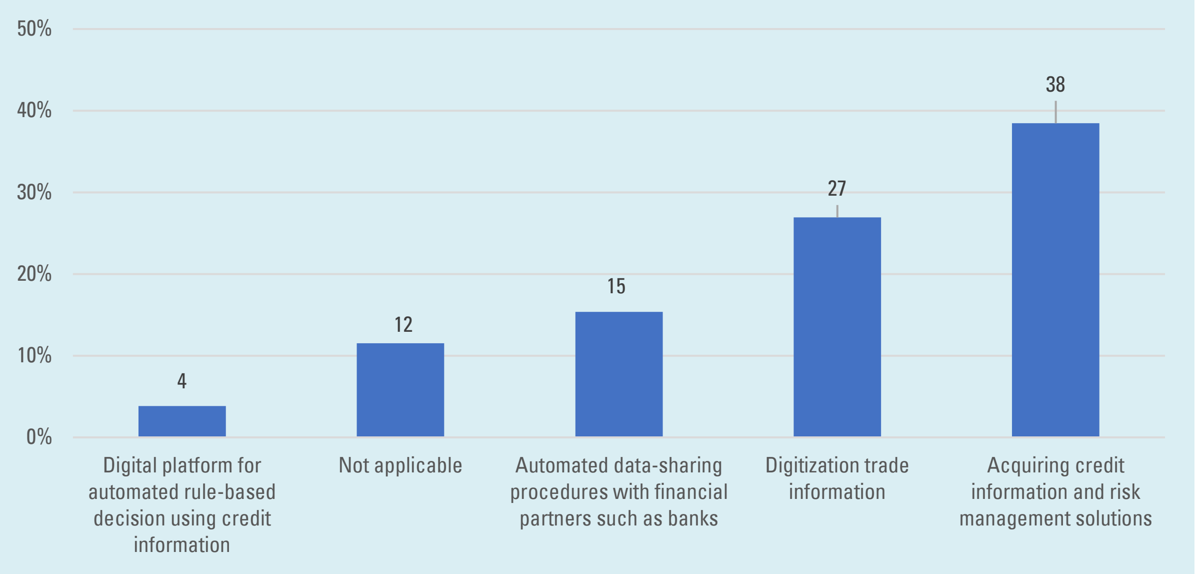
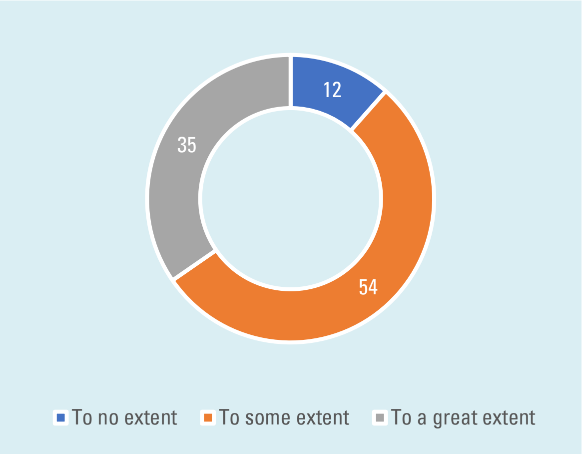



Figure 63. Extent of reduction of paper-based transactions (*Percentage*)




### (j) Reconsidering trade finance business models

Sixty-nine per cent of respondents welcome reconsidering trade finance business models. New trade finance models such as the transition to digital operations, serving new customers, expanding products offered, and expanding market participation are considered by 73 per cent, 36 per cent, 27 per cent, and 18 per cent of institutions, respectively.

In light of the fourth industrial revolution and the spread of COVID-19, the adoption of financial technology and digital transformation seems to be the most dominant change witnessed in the Arab banking sector, which will affect trade finance, among many other areas.

Figure 64. Banks reconsidering their trade finance business model (*Percentage*)

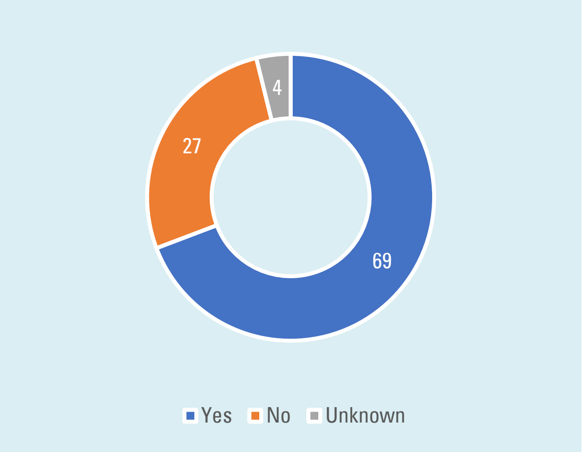
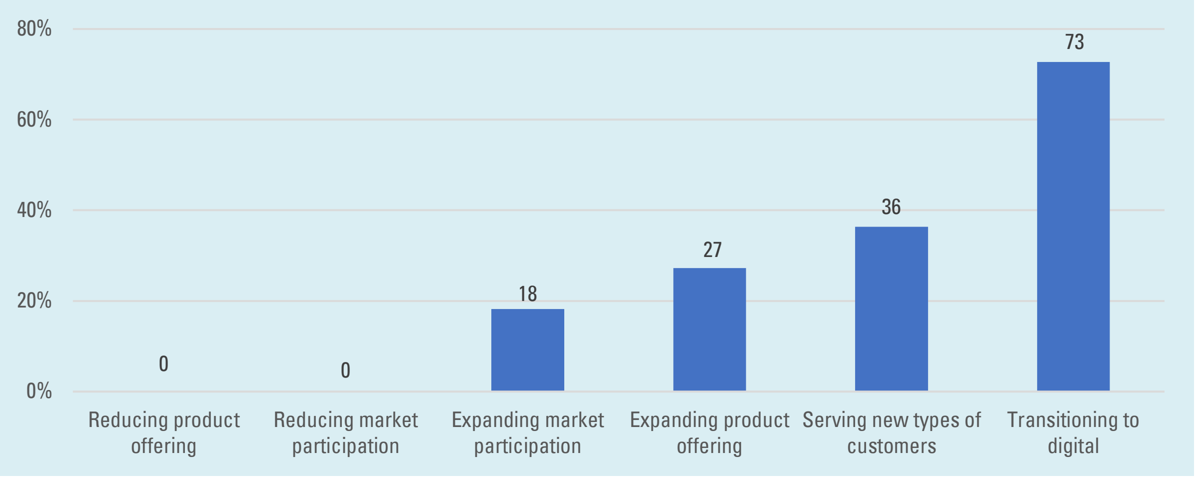


Figure 65. Possibilities for banks reconsidering their trade finance models (*Percentage*)

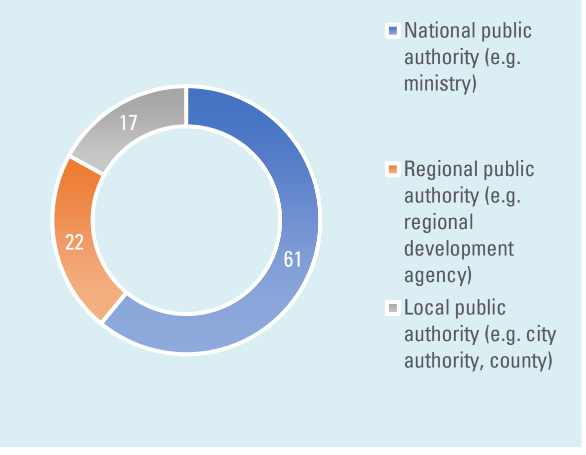



## 3. Survey of policymakers

Official letters were sent out to all ministers of finance of all member States requesting them to nominate a focal point to respond to the survey on behalf of their respective institutions. Fourteen member States responded to the survey, namely, Algeria, Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Mauritania, Morocco, Oman, the State of Palestine, Saudi Arabia, the Syrian Arab Republic, and the United Arab Emirates.

### (a) Overview

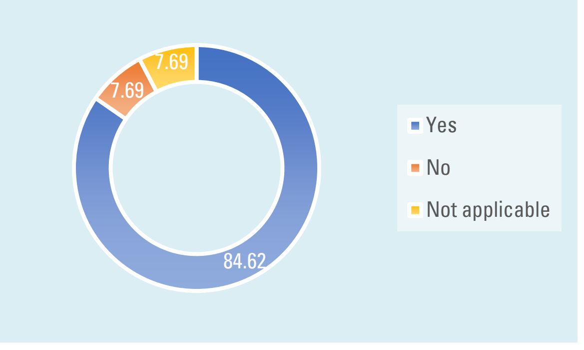
Figure 66. Type of organization represented (*Percentage*)




Out of the respondents of the survey, 61 per cent represented national public authorities, 22 per cent regional public authorities, and 17 per cent local authorities.

### (b) Trade finance goals and priorities

Figure 67. Changes in goals and priorities of trade finances, 2018-2021 (*Percentage*)




Out of all respondents, 92 per cent confirmed that their trade finance goals have changed during the past three years, and 8 per cent reported no change. Changes were mainly due to modifications in national commercial polices, which 72 per cent stated as very important reason for change, and to new development priorities and the modification of regional commercial policies, stated by 64 per cent.

Figure 68. Main causes for change, if any, in trade goals and priorities, 2018-2021 (*Percentage*)

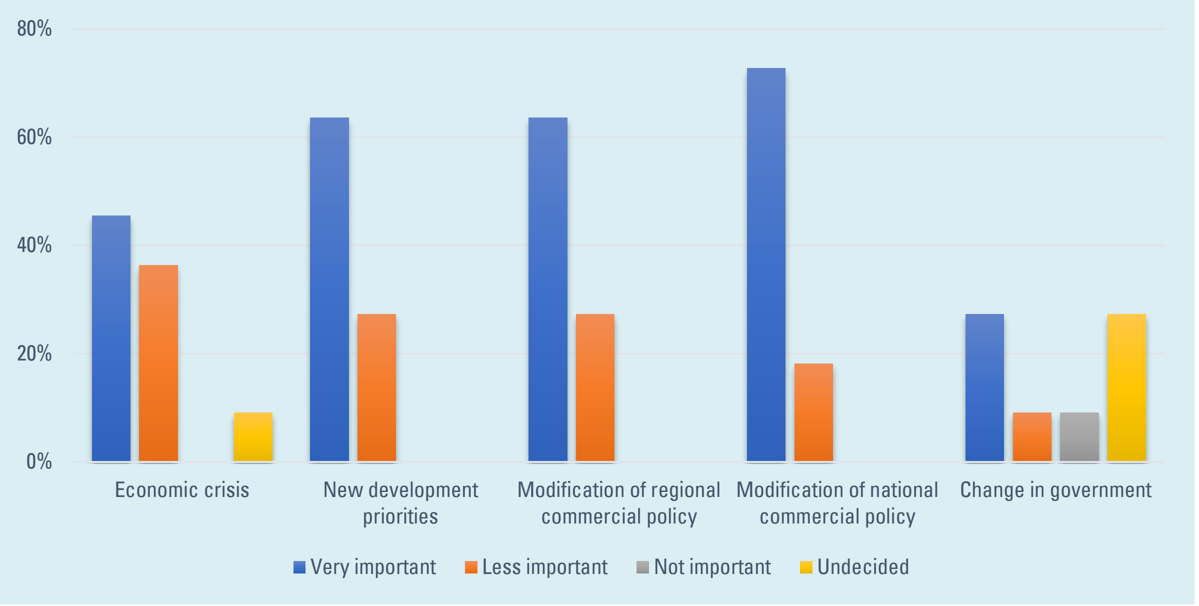
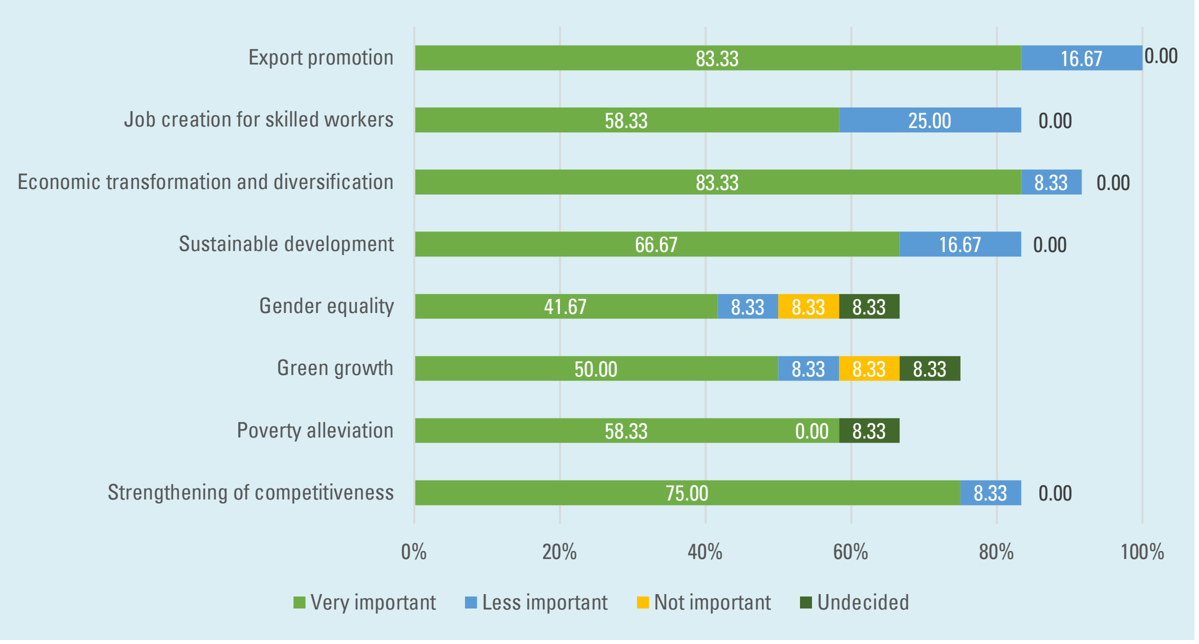



Figure 69. Effects of changes in the goals of trade finance and their importance (*Percentage*)




Changes in the goals of trade finance affected different areas: the promotion of export was stated as a very important aspect of change by roughly 83 per cent of respondents, economic transformation and diversification again by approximately 83 per cent and the strengthening of competitiveness by 75 per cent.

### (c) Trade finance at the Government level

Figure 70. Monitoring of external trade financing at the central government level (*Percentage*)

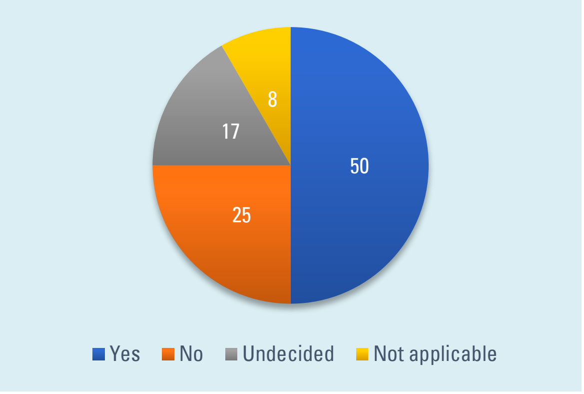
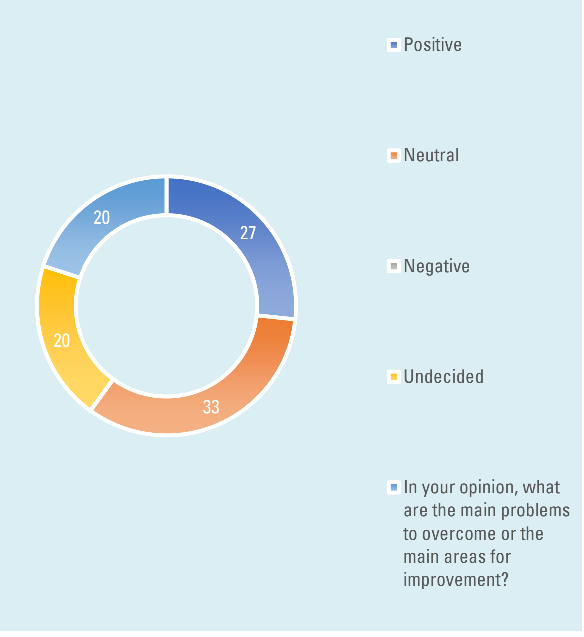
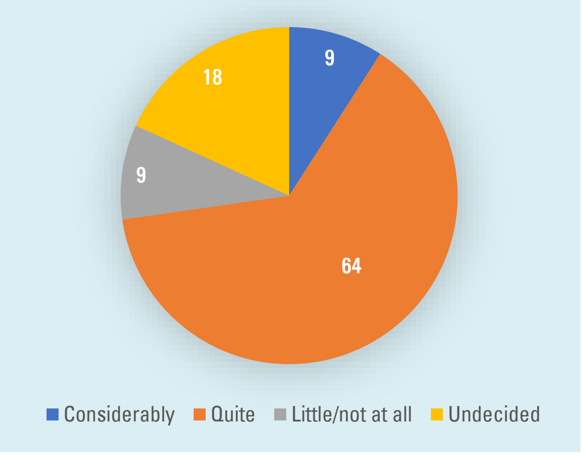



Figure 71. Assessment of the monitoring of the overall trade finances performance by the Government to date (*Percentage*)




Twenty-seven per cent of the Governments who participated in the survey assess the performance of trade finances as positive, 33 per cent are neutral and 20 per cent are undecided. One of the respondents stated economic sanctions, the effects of war and the decline in corporate work and economic growth due to COVID-19 as the main challenges to overcome and areas for improvements. Other respondents suggested to determine which sectors and projects should be funded and develop practical plans how to achieve the expected results.

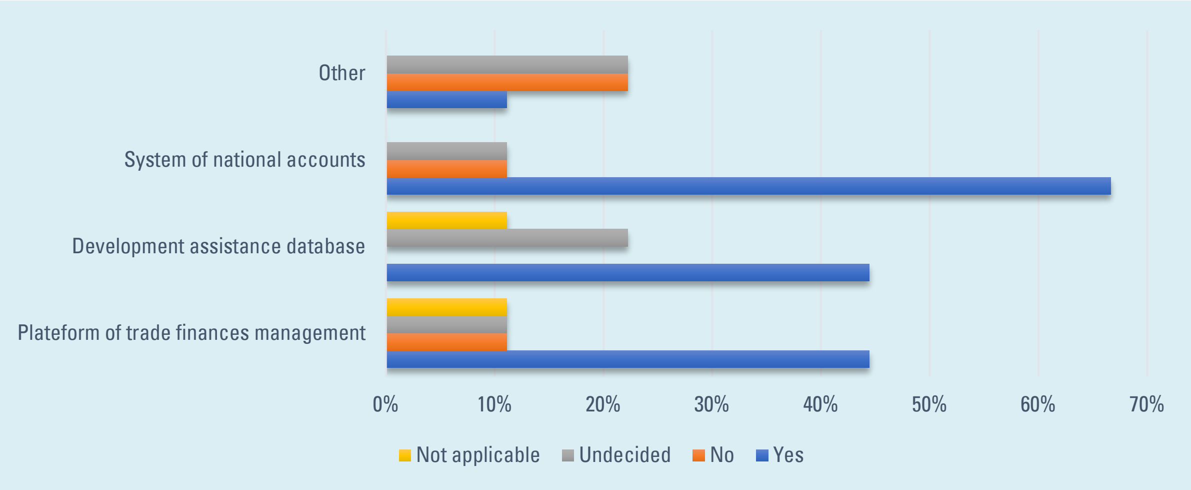
Figure 72. Improvement of trade finance monitoring programmes during the last three years (*Percentage*)




It should be noted that external trade financing is only monitored by half of the policymakers at the central government level (figure 70). 64 per cent of the respondents identified improvements in monitoring programmes, with Egypt experiencing considerable improvement, while Kuwait reported no improvement at all (figure 72).

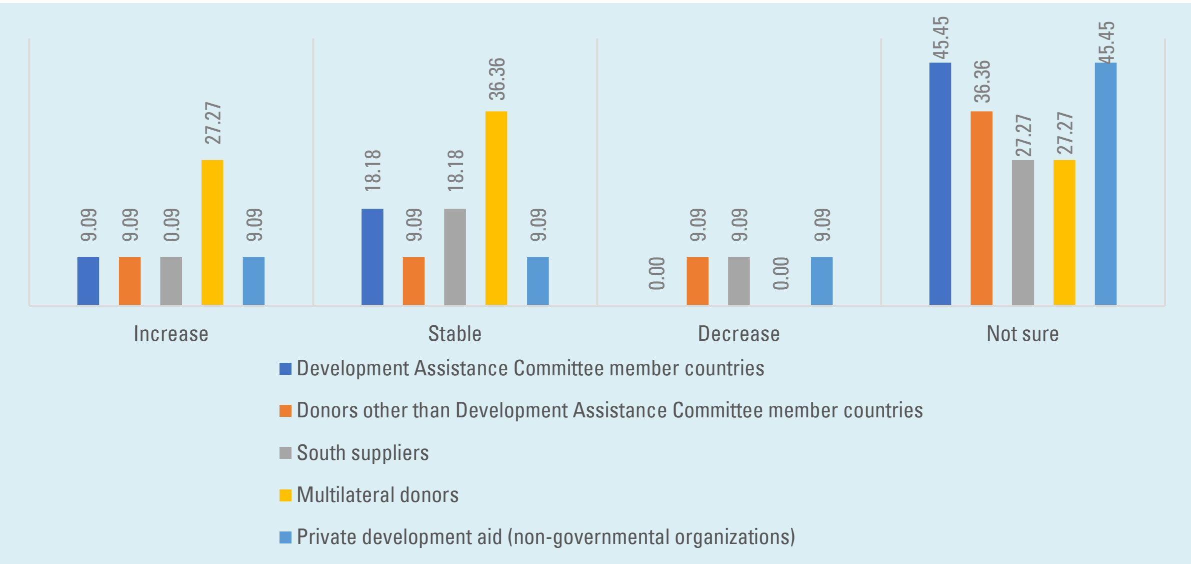
Regarding the main follow-up systems used to monitor trade financing, 67 per cent of respondents utilize the system of national accounts, and almost half of the policymakers use plate-form of trade finances management and development assistance databases (figure 73). Follow-up and coordination of these new trade policies are continuously monitored by most national focal points and a committee on trade finances development.

Figure 73. Follow-up systems used (*Percentage*)




### (d) Improvements of trade financing programmes

Figure 74. Evolution of the volume of external trade finances support and projects, 2018-2021 (*Percentage*)

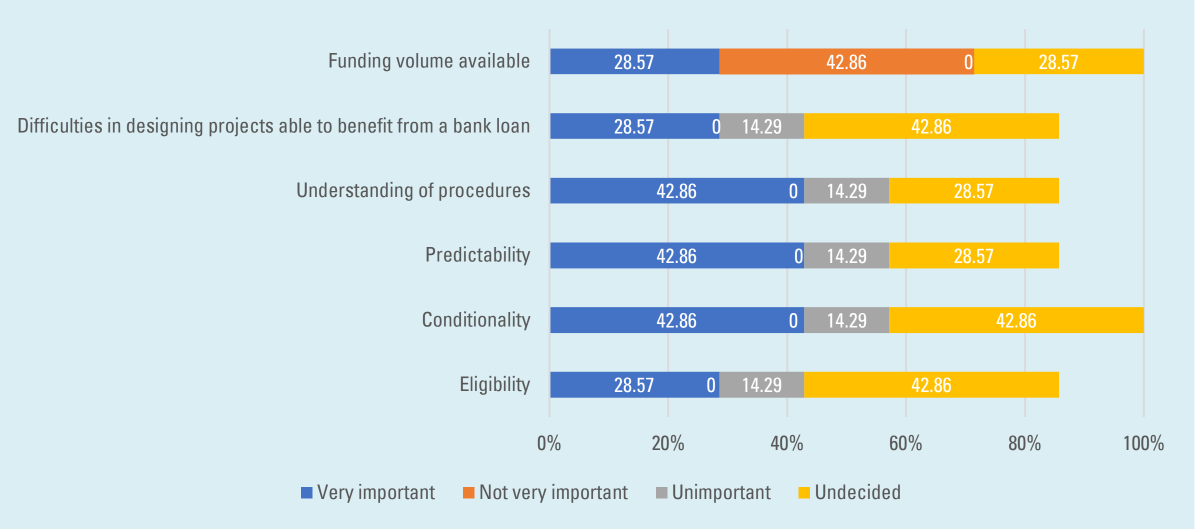



Out of the Governments participating in the survey, some 27 per cent have reported increasing support of external trade finances and projects from multilateral donors during the last three years, with 50 per cent recognizing them for providing more than 90 per cent of aid for trade services. Trade finance support provided by member countries of the Development Assistance Committee, south suppliers and private development aid remained stable; some Governments were unsure of the volume of their trade finance support (figure 74).

### (e) Problems in trade finance

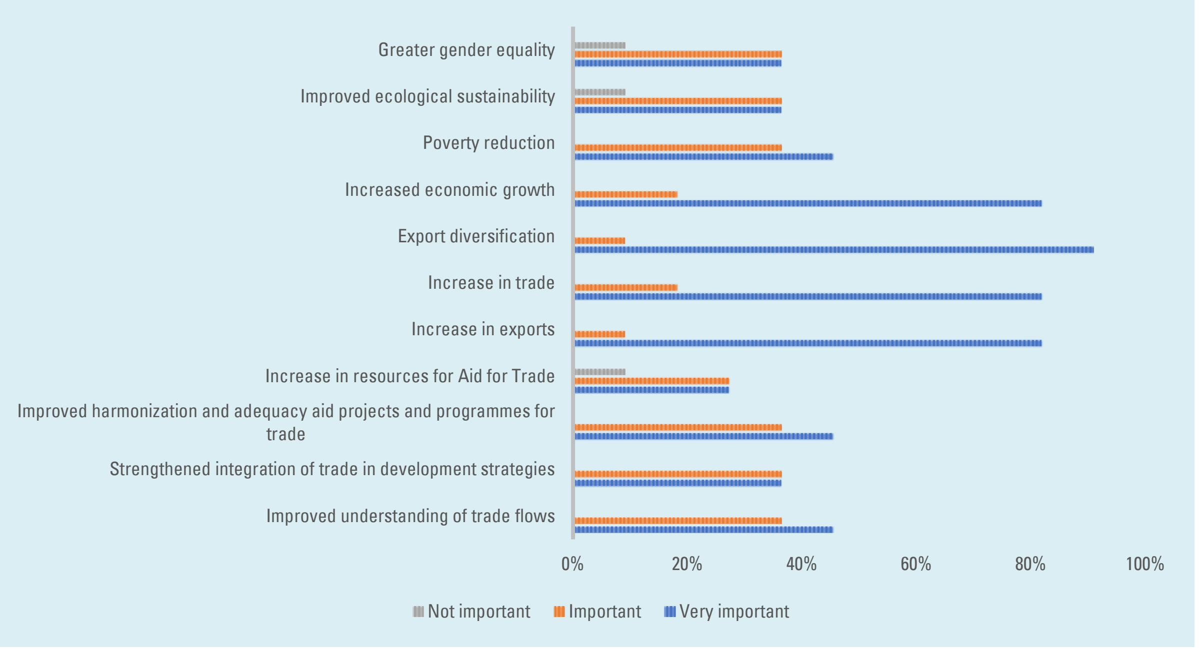
Respondents identified a number of obstacles to trade finances. Approximately 43 per cent of respondents identified the understanding of procedures and predictability as very important obstacles. Another 43 per cent, however did not attribute that importance to the funding volume available (figure 75).

Figure 75. Challenges to obtain financing in the field of trade and their relevance (*Percentage*)




### (f) Success of trade finance at the country level

Figure 76. Defining the success of trade finance strategies at the national level (*Percentage*)



It is without a doubt that export diversification, increases in trade and exports, and economic growth are the most important aspects attributed to success of trade finance strategies by between 80 and 90 per cent of the respondents. Trade finances resulted in a significant increase in exports and resources for trade promotion, with 36 per cent in strengthened integration of trade in development strategies as illustrated in figure 76.

# 5. Conclusion

Trade finance remains a big challenge for the Arab region and is believed to be a stumbling block facing export development and access to foreign markets, especially by SMEs. This difficulty is added to the hardship of most firms in the region of accessing foreign markets due to regulatory and tariff and non-tariff barriers along with a general weakness of firms to comply with the technical and specific requirements in foreign markets. The survey has revealed interesting but alarming results regarding the difficulty of accessing finance for SMEs.

In order to support firms in the region to thrive in foreign markets, it is highly necessary to address all kinds of barriers hindering access to foreign markets. While some of the required work rests in the hands of firms, certain work is needed by other players including Governments. Trade finance is an issue that needs strong Government support and the active role of the financial sector, with an effort by the private sector and its upgrade ability to obtain debt financing. It should be noted that innovation is essential in the development of trade finance. Modern technologies play an important role in bridging the gap between financers and borrowers and should be utilized to improve the situation in the Arab region. Some of the interventions that should be considered are as follows:

- Create a digital finance ecosystem to ensure that all players are electronically connected, including, for instance, the acceptance of digital signatures.
- Adopt legal frameworks to enable digital trade such as electronic bill of lading and electronic payments.
- Build legal databases on how to adhere to electronic methods of payment in trade finance.
- Enhance and/or set laws for electronic transfers such as those adopted by the 2017 United Nations Commission on International Trade Law (UNCITRAL) Model Law on Electronic Transferable Records (MLETR).[9]
- Facilitate access to more databases, noting that trade finance data should support early warning analysis of possible liquidity shortage and analysis of the links between global trade, investment and growth of gross domestic product.
- Develop digital standards and protocols for driving interoperability among importers, exporters, customs, warehouses, insurers, and banks.
- Create a market for trade finance assets and a market network and infrastructure for investors to access assets through technologies that enable banks and non-bank originators to distribute their trade finance exposures to other investors.
- Arab banks should diversify their trade finance products beyond letters of credit and bank guarantees, which will attract new customers and lower the sensitivity of trade finance revenues to global shocks.

[9] https://iccwbo.org/content/uploads/sites/3/2020/10/wto-plurilateral-negotiations-on-trade-related-aspects-of-ecommerce-icc-issues-paper-n3.pdf.

- Boost SME trade finance by easing the requirements, for instance, collaterals (this will also widen the customer base of banks and boost revenues).
- Improve compliance infrastructures to meet global regulatory and correspondent banks' requirements.
- Invest in digital transformation, which will lower transaction costs and speed processing.

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