The challenges and opportunities of trade finance in Africa

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27 Feb 2019

It's common knowledge that, while the African continent offers many exceptional economic opportunities for forward-thinking businesses and investors, doing business in Africa can be challenging. Trade finance is certainly not immune to these challenges and it adds a layer of complexity that can make transacting on the continent interesting, to say the least.

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In the first place, parties wanting to access trade finance in Africa need to satisfy the typical considerations that any lending institution would require, anywhere in the world. These include a solid and verifiable performance track record, clear regulatory policies for the region in which the target investment is situated, robust governance structures, and manageable transaction and reputational risks.

Perhaps unsurprisingly, many prospective investors or business partners who want to transact on the African continent find it difficult to tick all of the above-mentioned boxes. That said, the most significant challenge to trade in Africa is actually one of perception rather than fact. A prime example is the perception that Africa is risky because of conflict. While there have undoubtedly been, and continue to be some, conflict-driven risk issues in parts of Africa, the idea that this makes transacting on the entire continent risky is a significant misperception.

Poor sovereign credit rating

That said, many of the African countries that stand to benefit from international trade and investment are not helping themselves when it comes to attracting such investment. Apart from the investment fears created through political conflict and power struggles, the lingering uncertainty perpetuated by countries and governments sees them positioned very poorly on global investment grading standards.

And when a country has a poor sovereign credit ranking, it has massive negative implications for the borrowing power of businesses, despite many of these demonstrating consistently positive fundamentals. That's because lenders typically assign prudential limits in relation to these sovereign ratings. So the worse the rating, the lower the overall lending limit allocated to that country will be, and the higher the cost of borrowing for individual entities.

This link between low sovereign ratings and high costs of finance is particularly challenging in emerging markets, where there are relatively few large corporates with long track records, but very many emerging small- to medium-sized family-based businesses. While many of these are highly successful and offer very appealing investment return opportunities, they typically lack the mature corporate governance structures required by both investors and funding providers.

Local currency weakness

When you add, to these challenges, the funding complexity of local currency weakness that plagues most African countries, it's not difficult to see why accessing funding for international trade opportunities remains very challenging on the continent.

However, while there's no denying that there are challenges to trade finance in Africa, the potential value that could be unlocked through investment in the numerous opportunities on the continent still make many businesses highly appealing to funders, and both African and global investors.

To fully capitalise on this interest, and grow it over time, a few critical interventions are needed. Apart from greater political and policy certainty, much more visible involvement and commitment are required from development finance institutions, social development funds, and multi-lateral funding organisations.

Ghana case study

Ghana offers a prime example of the positive impact this can have. Some years back, the direct foreign investments (DFIs) in that country made the decision to partner more closely with banks and support their lending activities with a $2bn funding facility. Apart from the financial security this generated, the mere presence of the DFIs in the country addressed much of the risk misperception that existed, and created a massively positive view of, and confidence in, Ghana as a viable and compelling trade finance destination.

The willingness of DFIs to take a similar supporting stance and align themselves with funding institutions in other African countries has the potential to act as a significant catalyst for trade finance that will effectively create a virtuous circle of funding access, business growth, and long-term economic development in Africa.

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