INTERNATIONAL JOURNAL OF RESEARCH AND INNOVATION IN SOCIAL SCIENCE (IJRISS)
ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VII Issue VII July 2023

Influence of Supply Chain and Receivable Finance on Trade Finance Income among Commercial Banks in Kenya

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DOI: https://dx.doi.org/10.47772/IJRISS.2023.70837

Received: 05 May 2023; Accepted: 12 May 2023; Published: 20 August 2023

ABSTRACT

The paper aims to determine the influence of supply chain and receivable finance on trade finance income among commercial banks in Kenya. The study employed a descriptive survey research approach and the targeted population was 39 commercial banks licensed and regulated by Kenya's Central Bank in the year 2021. Census method was used to select all the 39 commercial banks in Kenya. The research targeted 39 managerial employees working in the banks' Trade Finance departments, one from each commercial bank. The rationale of selecting a respondent from each bank was based on the assumptions that, Trade Finance department of each bank is managed by a Trade Finance policy and hence one response from each department would be adequate representation. Twenty-Seven questionnaires were filled yielding to a response rate of 77% of the total number of licensed commercial banks in Kenya. Descriptive statistics, such as mean, frequency, percentages, and standard deviations, were employed as quantitative tools. The data was analysed using the Statistical Package for Social Sciences (SPSS). The study used a correlation analysis to determine how closely the independent and dependent variables were related. The study deduced that the supply chain and receivable finance affect Trade Finance income but at varying degrees.

Keywords: Supply Chain Finance, Receivable Finance, Trade Finance Income

BACKGROUND OF THE STUDY

The London G-20 trade financing initiative was created expressly to provide a thorough and adaptable framework capable of acting swiftly and effectively in response to market gaps affecting both global and regional trade flows. The coordinated strategy chosen in London took into account lessons learned from previous financial crisis experiences, such as the need to restrict risk and have a variety of instruments available to deliver financing wherever in the trade finance chain it is most needed . Even during the crisis, it occurred that the perceived risk of extending trade credit was larger than the actual level of risk (W.T.O., 2013).

Therefore, the majority of the G-20 trade finance package was made up of guarantees from multilateral and export credit agencies against the commercial and political risk of trade transactions. Despite the fact that only a tiny percentage of these guarantees have been used, the package mostly succeeded in regaining confidence and immediately stabilising the trade financing markets. The availability of trade financing is a critical issue for developing countries as the bulk of international trade flows involve some form of credit, typically short-term (World Bank, 2021).

The expansion of North-South and South-South trade requires a sufficient flow of readily available credit offered at reasonable interest rates. In the wake of the Asian crisis, which appeared to be a brutal interruption of credit at the end of the 1990s, the WTO Group on Trade, Debt and Finance identified concerns about the lack of trade finance for poor countries as an issue for examination (W.T.O., 2007). Experts from partner organizations, such as the IMF, World Bank, regional development banks, export

credit and insurance organizations, and international banks collaborated on this project.

Trade is a key engine of economic development and progress. Kenyan trade accounts for almost two-thirds of the country's gross domestic product (GDP). The country's export and import flows have development ramifications. Exports enable Kenyan businesses to tap into bigger markets and innovate as a result of increased competition, resulting in increased productivity and growth. Imports of consumer items are necessary for consumers, but imports of machinery and other intermediate products enable manufacturing enterprises to increase production and exports, resulting in more jobs (World Bank, 2021).

When bank financing is unavailable, enterprises often opt into inter-firm credit arrangements such as cash-in-advance and open account transactions, according to Malouche (2009). Both systems are fraught with danger, and businesses are compelled to use them due to a lack of alternatives. Liquidity limits are imposed by cash-in-advance arrangements, limiting profitability and growth. Similarly, open-account transactions are frequently inaccessible because sellers have a strong risk aversion toward buyers and will not ship goods until full payment is received. As a result, businesses seek trade funding from financial intermediaries such as commercial or development banks, as well as export promotion organizations. Documentary, commercial, or standby letters of credit, promissory notes, bills of exchange, and guarantees are examples of bank-intermediated trade finance that can be given "off-balance sheet."

Commercial banks in Kenya are businesses that fall under Kenyan law's chapter 488, the Banking Act. In this Act, a bank means a firm carrying or intends to carry on banking business in Kenya but not including the Central Bank of Kenya. The year 2021 had 39 commercial banks licensed in Kenya. Eight major banks account for 65.32 percent, ten medium banks for 25.90 percent, and 21 minor banks for 8.77 percent, according to the weighted composite index analysis (CBK, 2020). Furthermore, Foreign exchange management, international trade facilitation, financial counseling, and investment services are among the other services provided by commercial banks. To facilitate economic growth, the banking sector must play its role of being a mediator between customers and finances and ensure that individuals and firms gain access to financing that can help in facilitating domestic and international trade.

Beard and Thomas (2016) in their Trade Finance Handbook wrote, Trade financing, should ideally be self-securing and self-liquidating through the cash flow of the underlying transactions. Classically, it will be secured by inventory, receivables or trade instruments giving the lender the assurance that cash flow from these items will first be utilised to liquidate the exposure before borrower can access the balance. Scope of trade financing begins from point of acquisition of raw materials up until the sale and thereafter receipt of proceeds from buyer for repayment of the advanced credit from the bank.

Trade finance covers both funded facilities where bank advances cash to enable financing of a trade activity, and non-funded facilities where a bank commits its word to pay upon fulfillment of certain conditions as outlined by the Bank. Trade Finance cuts across both imports and exports. For exports, it enables firms which would have otherwise been considered too risky to tap into the global value chain thereby leading to growth and increased productivity suffice to note increased employment. Imports on the other hand expand the range of goods and services that consumers can access and also machinery equipment and intermediate goods/raw materials needed for manufacturing (Beard and Thomas, 2016).

According to OECD (2015), lending from banks is the most common source of external finance to businesses and especially Small and Medium Enterprises. Interest and non-interest income are the two sources of income for commercial banks, however, annual supervision reports by Central Bank of Kenya indicate a steady reduction in interest income from a high of seventy one percent in 2016, to sixty seven percent in 2020, this was caused by introduction of lending rate cap by the CBK in September 2016. On the flip side, percentage of non-interest income that comprises trade finance fee has been steadily increasing year on year from twenty nine percent in 2016 to thirty three percent in 2020. (CBK reports 2016; 2017;

2018; 2019 & 2020).

Despite the CBK's interest lending rate regulation requirement, the banking sector's performance has remained resilient, with pre-tax profit rising by 4.2 percent from Ksh.152.7 billion in December 2018 to Ksh.159.1 billion in December 2019. The rise in profitability in 2019 was due to a higher increase in total income of 6.6% versus a 4.8% increase in total expenses (CBK Report, 2020). Of the net increase of 1.8% in the income, the larger contribution was attributable to non-interest income. Commercial banks rely on non-interest income streams such as foreign exchange income, trade finance income from issuance and or handling of trade finance instruments, and other fees to achieve risk diversification from the traditional interest income.

Commercial banks in Kenya are increasingly focusing on innovative products on trade finance in order to boost the overall trade finance income. Commercial banks need to focus more on trade finance incomes since they are less susceptible to recessions, helps in offsetting losses brought by interest income thereby creating diversification of revenue (Kahuthu, 2016). It's on the bedrock of this that led to the study being focused on investigating the influence of selected funded bank products on trade finance income of commercial banks in Kenya.

LITERATURE REVIEW

Commercial banks in Kenya generally offer both funded and non-funded trade finance solutions. Absa Bank Kenya Trade finance solutions are Letters of Credit, Guarantees, documentary collections, pre and post shipment loans, forfaiting, supply chain finance, invoice & bills discounting (Absa Bank Kenya, 2021). KCB Bank Kenya trade finance products are guarantees, letters of credit, documentary collections, certificate discounting, supply chain finance, invoice discounting, Bills discounting, LPO financing, pre-shipment or pre-export finance and stock financing (KCB Bank Kenya, 2021). Equity Bank Kenya trade finance products are guarantees, import & export collections, invoice discounting, LPO finance, letters of credit, pre-shipment and post-import finance (Equity Bank, 2021).

Commercial banks do extend trade loan facilities to their borrowers to facilitate a trade transaction guided by the underlying borrowing need and transaction. These trade loans facilities include Pre-shipment finance, post-shipment finance, Bills discounting, Invoice discounting, supply chain finance, forfaiting, certificate discounting and stock financing. In these instances, banks do levy both non- interest income in terms of arrangement or negotiation fee, over and above interest income since these are booked as direct loans. This paper discusses empirical literature on the following funded bank products: supply chain finance and receivable finance.

Supply Chain Finance

Supply Chain Finance, according to Hofmann and Zumsteg (2015), is a method for two or more companies in a supply chain, including external service providers, to work together to generate value by planning, guiding, and managing the flow of financial resources at the inter-organizational level. Supply Chain Finance, according to Kritofk (2012), is a combination of trade financing provided by a financial institution, a third-party vendor, or a corporation, and a technology platform that electronically connects trading partners and financial institutions and triggers financing based on the occurrence of one or more supply chain events. According to Martin and Hofmann (2017), this product is offered to the supplier based on the buyer's creditworthiness. As a result, credit can be supplied at a lower rate of financing than the supplier could negotiate on their own.

As a result, Supply Chain Finance (SCF) can refer to a variety of ways for funding individual goods or products as they move from point of origin to point of destination along the supply chain. The Supply Chain

Finance, which is also known as supplier finance, is primarily used to address financial concerns On supply-side value chain management (Camerinelli, 2016). According to Kristofk (2012), Supply Chain Finance is a true win-win situation for all parties involved because it is one of the most appealing instruments for businesses to .diversify funding sources, deepen and solidify connections with their trade partners. Supply Chain Finance's impact on corporate performance is seen in increased supply chain efficiency in terms of cost-cutting payable processes and payment term extensions.

Gomm (2010) investigated how finance theory may be applied to supply chain management to improve the financial aspects of Supply Chain Management (SCM). In addition to enhancing revenues, cost of sales, and invested capital, SCM was found to have the potential to raise the capital cost rate, a long-ignored supply chain driver of shareholder value. Wei and Liu (2020) on their research review of SCF at home and abroad pointed out that supply chain finance should be established on the basis of analysis of the internal transaction structure of the supply chain and use core enterprise credit ratings to provide credit financing for upstream and downstream enterprises.

Receivable Finance

Invoice discounting, Letters of Credit discounting, factoring, forfaiting and bills discounting are some of the receivables finance solutions offered by banks. Banks can generate both interest and non-interest income by giving immediate value against these receivables with a future maturity date. Kalaivani (2013) conducted an analysis of factoring service providers' performance. The study used statistical tools such as the T test, F test, multiple regression, and correlation analysis to identify the relationship between multiple variables where the sample size was seven companies. Secondary data was gathered from publications and financial statements for the years 1998 to 2007. The study concluded that factoring income is increasing at a slower rate than own funds, and that the ratio of own funds to factoring income is decreasing.

Farag (2013) developed and tested hypotheses about a linear relationship between a company's decision to factor its receivables and its size, exposure to international trade, financial strength, and whether the factoring decision is regarded as a basic or primary source of finance or an alternative source of finance using an inductive content analysis approach. The study showed no correlation between a company's financial status and its decision to factor its receivables. The study's findings also revealed that factoring is not always a product used by SMEs in Egypt, but rather a funding alternative available to anyone who can generate a surplus profit to meet the financing charges. A linear relationship was also discovered between a company's decision to factor its receivables and its liquidity, according to the study.

RESEARCH METHODOLOGY

This study was carried out utilizing a descriptive research design. A descriptive study design is a method of conducting research that involves observing and summarizing a subject's behaviour without altering it in any way (Bajpai, 2015). Descriptive research design aids in answering the who, what, when, where, and how questions associated with a given study problem (Cooper and Schindler, 2014; Creswell, 2018). The study focused on managers of Kenyan commercial banks' Trade Finance departments. The unit of analysis was Kenyan commercial banks, while the unit of observation or responders was Trade Finance managers working in the Trade Finance departments of commercial banks. Each commercial bank had at least one trade finance manager in charge of this specialized department. The intended respondents were expected to consist of 39 managers in trade finance departments, one from each of the 39 commercial banks licensed in Kenya. This justified the use of a target population of 39 with a corresponding to 39 respondents, hence the use of census sampling as discussed later. A respondent from each bank, in this case, the Trade Finance Manager, sufficed for the study since the expected feedback would be the same for the entire department.

Since the research population was small and commercial banks were freely accessible, a census sample was

used (Flick, 2018).

Table 1.0: Sampling Frame

Category	Trade finance management employees	Percent
Tier 1 Banks	8	20
Tier 2 Banks	10	26
Tier 3 Banks	21	54
Total	**39**	**100**

Source: CBK Bank supervision annual report (2020).

Table 2.0: Sample Size

Category	Target Population	Sample Size
Tier 1 Banks	8	8
Tier 2 Banks	10	10
Tier 3 Banks	21	21
Total	**39**	**39**

The questionnaires were sent to the respondents through email by the researcher. This guaranteed that the researcher and respondents didn't interact. Three participants who weren't going to participate in the final study were given the questionnaire to pre-test it. 10% of the overall sample size came from the pilot research.

Correlation analysis was used in the study to determine how closely the independent and dependent variables are related (Kothari, 2014; Mugenda and Mugenda, 2019). To identify the contributing elements to Kenyan commercial banks' trade financing revenue, multiple regression analysis was performed.

RESULTS AND FINDINGS

Frequency Distribution of Selected Funded Bank Products

According to the findings in table 4.6, 59 percent of respondents strongly agreed that bills and LCs discounting loans are offered based on the creditworthiness of the borrower's buyer's bank, and 52 percent of respondents strongly agreed that the bank offers supply chain finance on the basis of the creditworthiness of the borrower's buyer while invoice discounting and factoring/forfaiting are advanced on the basis of the creditworthiness of the borrower's buyer, according to 52 percent of respondents.

Furthermore, the results of the study revealed that majority of the respondents who strongly agreed with the other statements were less than 50% of the total respondents. For example, 48% of the respondents strongly agreed that the bank offers supply chain finance to its clients as a product in trade finance, 48% of the respondents strongly agreed that the bank extends receivable financing as product in trade finance, 37% of the respondents strongly agreed that income earned from supply chain finance is recognized as a trade finance income, and 35% of the respondents strongly agreed that fees earned from swift payments done on the back of trade finance transactions is recognized as trade finance income.

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VII Issue VII July 2023

These findings show that majority of commercial banks have different ways of earning interest and non-interest income from trade loans.

Table 3.0: Frequency Distribution of Selected Funded Bank Products

Selected Funded Bank Products						
	SD	D	M	A	SA	Total
The bank offers supply chain finance to its clients as a product in trade finance	7%	4%	11%	30%	48%	100%
The bank offers supply chain finance facility on the basis of the creditworthiness of the buyer	4%	%	7%	37%	52%	100%
The banks supply chain finance is offered through a platform	23%	12%	27%	19%	19%	100%
Income earned from supply chain finance is recognized as a trade finance income	18%	4%	15%	26%	37%	100%
The bank extends receivable financing as product in trade finance	7%	%	15%	30%	48%	100%
Invoice discounting and factoring/forfaiting are advanced on the basis of creditworthiness of the borrower's buyer	4%	%	11%	33%	52%	100%
Bills and LCs discounting loans are offered on the creditworthiness of the borrower's buyer's bank	11%	4%	7%	19%	59%	100%

Descriptive Statistics of Selected Funded Bank Products

The study also sought to analyse the views of the respondents on selected funded bank products in the Trade Finance space. The bank offers supply chain finance facility on the basis of the creditworthiness of the buyer *(M= 4.33, SD= 0.920)*; invoice discounting and factoring/forfaiting are advanced on the basis of creditworthiness of the borrower's buyer *(M= 4.30, SD= 0.953)*; the bank extends receivable financing as product in trade finance *(M= 4.11, SD= 1.155)*; bills and LCs discounting loans are offered on the creditworthiness of the borrower's buyer's bank*(M= 4.11, SD= 1.368)*; and, the bank offers supply chain finance to its clients as a product in trade finance *(M= 4.07, SD= 1.207).*

Table 4.0: Descriptive Statistics of Selected Funded Bank Products

	N	**Mean**	**Std. Deviation**
The bank offers supply chain finance to its clients as a product in trade finance	27	4.07	1.207
The bank offers supply chain finance facility on the basis of the creditworthiness of the buyer	27	4.33	.920
The banks supply chain finance is offered through a platform	26	3.00	1.442
Income earned from supply chain finance is recognized as a trade finance income	27	3.59	1.500
The bank extends receivable financing as product in trade finance	27	4.11	1.155
Invoice discounting and factoring/forfaiting are advanced on the basis of creditworthiness of the borrower's buyer	27	4.30	.953
Bills and LCs discounting loans are offered on the creditworthiness of the borrower's buyer's bank	27	4.11	1.368

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4. 3 Correlations and Regression

.1 Correlation Analysis

Correlation analysis was used in the study to examine the relationship between income earned from advancing or offering selected funded bank products and trade finance income. The study established that facilitation of selected funded products and trade finance income had a very strong positive linear statistical significance at r 0.764: p ? 0.01.

Table 7.0: Correlation Matrix

Correlations						
Variables			1	2	3	4
3	Selected Funded bank products	Pearson Correlation	.768**	.747**	1	.764**
		Sig. (2-tailed)	.000	.000		.000
4	Trade Finance Income	Pearson Correlation.	.765**	.865**	.764**	1
		Sig. (2-tailed)	.000	.000	.000	
	**. Correlation is significant at the 0.01 level (2-tailed).					

Table 9.0: Multiple Regression Coefficients

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.528	.385		1.371	.184
	Income earned from facilitation of the selected funded bank products	.049	.131	.060	.371	.714
a. Dependent Variable: Trade Finance Income						

DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

Discussion

According to the findings of the study, 52% of respondents strongly agreed and 33% of respondents agreed that Supply Chain Finance and Receivable Finance are advanced on the basis of creditworthiness of the borrower's buyer. OCC (2018) confirms that when a bank purchases domestic invoices from a foreign exporter, the bank should thoroughly assess the foreign country's risk, and the export company's financial condition and reputation. The credit standing of the foreign bank should be analyzed. One of the problems that exporters experience, is getting adequate capital to meet their client's demand for goods especially if the exporter is experiencing significant growth. Factoring enables organizations to reduce their cash cycle by selling their accounts receivables to a third party known as a factor. However, OCC (2018) further argues that, most factoring is done by non-banks or other organizations although banks can still be factors. Additionally, banks can act as forfeiters. Forfaiting is similar to factoring but a forfaiting bank buys notes that are medium to long-term receivables.

The bank gets the notes at a considerable discount for cash and in most cases, these transactions receive an "aval" or guarantee from a foreign bank.

The findings of the study showed that 48% of respondents strongly agreed and 30% of respondents agreed that the bank extends receivable financing as a Trade Finance product. OCC (2018) confirms that banks may enter into accounts receivables financing with exporters based on their existing relationship. In this type of trade transaction, the exporter is usually a small supplier and the importer a large organization. This type of transaction enables the exporter to get an early payment from the bank at an interest that is equivalent to the importer's credit standing.

The study established that, 52% of respondents strongly agreed and 37% of respondents agreed that the bank offers Supply Chain Finance on the basis of the creditworthiness of the buyer. Additionally, the findings revealed that 48% of respondents strongly agreed and 30% of respondents agreed that the bank offers Supply Chain Finance to its clients as a product in Trade Finance. Martin and Hofmann (2017) agree that Supply Chain Finance is offered as a product in Trade Finance to suppliers on the basis of credit worthiness of the buyer. Therefore, credits can be given at a lower rate than the supplier would be able to negotiate on his own as the banks assume the rates extended to the buyer. Furthermore, the study found that 37% of respondents strongly agreed and 26% of respondents agreed that income earned from Supply Chain Finance is recognized as a Trade Finance income. Previous research has shown that Supply Chain Management can enhance not only sales, cost of sales, and invested capital, but also the capital cost rate, which has been a long-overlooked supply chain driver of shareholder value (Gomm, 2010).

Conclusion

The goal of the study was to examine the effect of supply chain and receivable finance on trade finance income among commercial banks in Kenya. The study found a substantial association between these products and Trade Finance income using inferential analysis, which included correlation analysis and regression analysis. According to the study, a unit increase in funding of these products namely supply chain finance and receivable finance, results in a 0.049 increase in income from Trade Finance, indicating a positive impact of these products on Trade Finance income. The study thus concludes that although receivable finance and supply chain finance, supported by an underlying trade activity affects trade finance income, the impact is minimal.

Recommendations

The study's findings show that Supply Chain Finance and Receivable Finance affects the Trade Finance income of most commercial banks. However, the study's descriptive analysis found that most commercial banks offer a limited number of these trade finance products, with the majority of them favoring rapid transactions above alternative trade financing options. Based on these facts, the study urges commercial banks to consider a move towards more funded trade financing options in order to boost their trade finance revenues whilst meeting their clients emerging needs along the trade value chain system. For instance, under open account terms, one of trade finance payment terms, Receivable and Supply Chain Finance on the strength of well – rated anchor clients, is one such quick way to create value by effecting early payment to the suppliers.

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