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Global Journal of Economics and Trade
ISSN 2958 - 406X (Online)
Vol.1, Issue 1, pp 38 – 51, 2022

Financial Trade's Impact on Banks' Financial Performance: A Case of Equity Bank Limited

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Article's History

Submitted: 2nd September 2022
Accepted: 28th September 2022
Published: 1st October 2022

Abstract

Aim: The purpose of this study is to examine the impact of trade financing on banks' financial performance. In this study, Equity Bank Limited was used as a case study.

Methods: In this case study, a descriptive research design was used. The intended audience consisted of 66 Equity Bank Limited credit supervisors, one from each branch. Out of the total of sixty-six credit supervisors, at least thirty-three were selected using the stratified selection approach to handle 50% of the population. Used were both primary and secondary data from financial statements that were released. Sorting, cleaning, and organizing the data from the completed surveys were all parts of the data analysis process. The data was coded, put into a spreadsheet, then put through an SPSS analysis. Tables, graphs, and pie charts were then used to show the data.

Results: The research revealed that the bank's supply of trade financing products had an impact on its financial performance through the revenues generated as a result of such service, according to the analysis, presentation, and interpretation of the data.

Conclusion: The provision of trade finance by banks has an impact on their financial performance.

Recommendation: The study suggested that the bank train its employees to increase their skill levels, create more complex and welcoming trade finance procedures to encourage more clients to participate, and capitalize on less common items. It was advised to conduct further research on how trade financing affects banks' overall performance.

Keywords: *Trade finance, letter of credit, bill of exchange, equity bank, financial performance.*

Global Journal of Economics and Trade
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1.0 INTRODUCTION

Trade finance is the science that addresses the administration of money, banking, credit, investments, and assets for global trade transactions, according to Moffat (2009). The majority of research on trade finance focused on how a country's economy benefited from the availability of trade finance. A research by Beck (2002) and Summers (2000) shown that trade finance significantly contributed to the expansion of the economy. Even though it featured other professionals including importers, exporters, and insurers, banks accounted for the majority of the trade finance financiers.

In Kenya, the rules and regulations governing trade were oppressive. The banks that produced the minimal documents needed for trade financing were given control of them. Since they created additional offices in Uganda, Tanzania, Rwanda, and even southern Sudan. They significantly expanded their regional network and saw the need of developing regional commerce (Financial sector deepening report, 2009). At the end of December 2011, Kenya's banking sector had forty-four registered banks. The Kenyan central bank oversaw the industry. As a supervisory body, the central bank took the initiative to disclose the astounding bank charges. Increased competition in the banking industry and greater transparency helped it achieve its goal of bringing borrowers' attention to the cost issue by lowering fees, especially those for trade financing products (CBK Bank supervision annual report 2011).

Due to rising competition, more structured trade finance products, such as local purchase order financing, have begun to replace conventional trade finance products including letters of credit, trade credits, and documentary collection. The major functions of banks were lending, investing, and accepting deposits. Instead of using the conventional lending techniques of loans and overdrafts, trade finance offered a significant route for financing. Equity Bank began operations in 1984 as a building society before changing its name to Equity Bank Ltd. on May 1, 2007. Since then, the bank has continued to develop and widen its clientele base. The institution was a member of the Deposit Protection Fund and was overseen by the Central Bank of Kenya (CBK), which operated under the Banking Act (DPF). The organization obtained favorable ratings from Kenya's central bank in the categories of capital and assets throughout its profitable years.

The bank's mission statement is "Transforming people's lives by providing microfinance and other financial services through quality and reputational services". While its vision is “Becoming the financial institution that leads to a positive change in people's lives. The bank has a network of 66 branches. All of them are connected to each other through a WAN connection and transactions are carried out online in real time. Banking operations are fully automated. It offers a wide range of financial products and services including account, credit and trade finance products to its customers, Equity Bank is ranked as the best tier 2 bank for banks with high net worth. Assets from 5 to 15 billion, 3rd finalist in the best bank in microfinance and 5th out of 46 banks, compared to 11th place in the last central bank survey of (2011).

The primary goal of selecting Equity Bank and conducting a case study was to enable focus on specifics and comprehensive work. Due to the fact that Equity Bank had evolved over the years from a building society to a bank, her clientele was diversified and spanned the whole financial services industry, which was reflected in the products that were offered. Three primary trade financing items were taken into consideration for this study: letters of credit, guarantees, and

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collections. This was due to the fact that they dominated the bank's financial reporting as the primary trade finance products.

Giving merchants money to support their daily trading activity is known as trade financing. Trade financing had been moving away from the time-consuming ways of doing business, according to Moffet (2009). At the time of the investigation, 80010 of worldwide commerce was carried out using a purchase now, pay later open account basis. Since the merchants were from different regions and it was not always possible to trust someone from another area, there may have been concerns that the commodities provided to them would not be paid for in a timely manner. While the customer wants to make payment after the items are delivered, the seller wants to get payment before sending the goods. The banks, who acted as mediators, provided the solution to this conundrum. The majority of research on trade finance focused on how a country's economy benefited from the availability of trade finance. A research by Ephraim (2002) and Summers L.H. (2000) shown that trade finance significantly contributed to the expansion of the economy. The World Bank (2008) and Financial Sector Deepening (2009) both conducted studies that looked at how banks may contribute to better trade financing service.

The above researches had been done on how the banks could help improve trade finance in order to develop a country's economic standing. It was therefore important to find out how the banks benefited from offering trade finance by determining the effects of the trade finance on their financial performance of banks, hence the need for the study to fill in the gap. Against this backdrop, this study sought to determine the consequences of trade financing on the financial performance of the banks.

2.0 LITERATURE REVIEW

2.1 Theoretical Literature

According to Econstor (2002), he created a theory of trade finance in his work that accounted for the coexistence of various financing methods in light of the various trade finance costs. He identified three different payment forms, including cash in advance, open accounts, and bank-mediated transactions, that may be used to finance commercial activities. He said that businesses were increasingly turning to letters of credit as the most secure method of payment for contracts due to the growing level of uncertainty. Due to frequent transactions and connections inside the supply chain, he promoted the adoption of bank-intermediated transactions.

Documentary techniques, cash in advance, and open accounts are the three basic ways to make overseas payments, according to Clark (2002). Letters of credit and documentary drafts were used in documentary credit. Payments for items are made in cash in advance prior to shipment. The most reliable customers utilized open accounts, which required sending the products to the importer, billing him, and relying on him to pay within the agreed upon parameters.

John (2012) investigated the best payment contract option and its effects on the trade equilibrium. According to his argument, both the source and the destination countries' financial market traits and contracting conditions have a role in this. Schmidt acknowledged that there were three primary forms of payment, including cash in advance, open accounts, and bank-mediated transactions, much like Econstor and Clark had done before him. The utilization of bank-intermediated transactions and its implications on banks' financial performance were investigated by the researcher.

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2.2 Empirical Review

According to Marc (2007), the World Trade Organization (WTO) was established with the goal of promoting global trade in a fair manner and was tasked with facilitating trade by lowering trade barriers, negotiating and implementing international trade agreements, and resolving disputes according to the rule of law. It was also interested in expanding developing nations' supply sides so that they could take advantage of emerging market possibilities. He made the case that trade finance is the lifeblood of commerce since 90% of commercial transactions include some kind of credit, insurance, or guarantee.

Manufacturers and traders in developing and least developed countries need access to reasonable lines of trade finance and insurance in order to be able to import and export and thus integrate into global trade. . From this point of view, an efficient financial system is crucial to allowing trade to flourish. Since the WTO is not a financial institution, it has supported "regional agencies, major banks and development banks". In recent years, members have called on the WTO to consider the availability of trade finance as a critical infrastructure needed for the development of "least developed countries to integrate into trade." Paragraph 36 of the Doha Ministerial Declaration calls on members to consider and, if necessary, make recommendations on measures the WTO should take to mitigate the impact of financial uncertainties on their trading opportunities.

In the United States, commerce and industry tend to converge around similar services. Major financial institutions have hired industry supply chain managers to assist with reservation services for open account transactions in specific industries, while business management software services teams and supplies. Network of suppliers working together to obtain trade finance (arranging credit, discounting supplier payments, financing debts, with or without bank assistance). This can only be done in a fully depreciated financial system in which non-financial corporations can be allowed to provide financial services (Mark, 2007).

2.3 Conceptual Framework

This framework tried to analyze and clarify the impacts of trade financing on banks' financial performance. Through capital adequacy, asset quality, profits, liquidity, and management quality, which depended on trade finance as a commodity offered by banks, the financial performance of banks was evaluated. For instance, the bank relied on loans to increase its assets, some of which were provided through trade finance and were subsequently provided via bank guarantees, bid bonds, performance bonds, documentary credits, letters of credit, and local purchase order financing of bank drafts. Owing to more people using the services and leaving with account deposits and potential business partners, this also resulted in a growth in market share, which in turn improved profitability due to charges and fees paid for the supply of the services. The key trade finance products that showed in the financial statements when banks prepared their financial reports, known as off balance sheet financing, were taken into consideration by the researcher as they researched the impacts of trade finance on the bank's financial performance. These comprised guarantees, collections, and letters of credit.

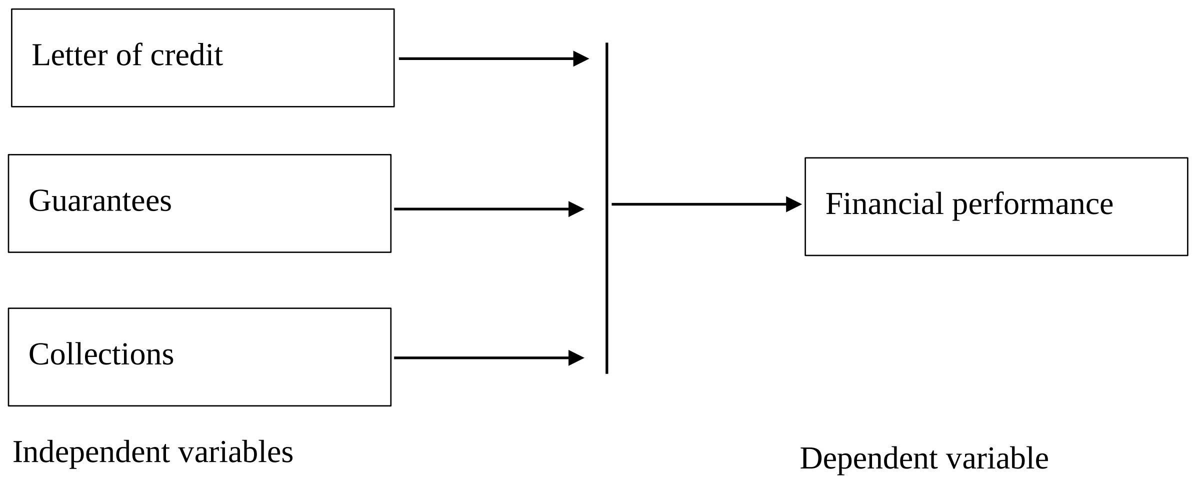

Figure 1: Financial performance of banks as a result of trade performance

Source: Researcher (2022)

3.0 METHODOLOGY

This chapter included the study's research methodology, target population, sample process, data gathering process, and data analysis process.

3.1 Research Methodology

A descriptive study design was used by the researcher. Finding out who, what, where, when, or how much is what descriptive research is concerned with, according to Cooper and Schindler (2000). The purpose of the study was to ascertain how trade financing affected the bank's bottom line.

3.2 Target Population

A population is the entire set of components from which conclusions are to be drawn (Cooper et al., 2000). The researcher specifically sought a supervisor from each of Equity Bank's sixty-six branches.

3.3 Sample Process

Sampling involves selecting certain elements of a population so that conclusions can be drawn about the population. The study applied stratified sampling technique in which the branches are classified by area. This has allowed to better understand the impact of trade finance in different industries due to the diversity of economic activities in different regions of our country. The researcher targeted a sample of thirty-three credit supervisors to make up half the population. They were randomly sampled from each of the three regions according to the Equity bank's classification as coastal, central and western regions. Equity bank has 4 branches in the coastal region, 18 branches in the West and 44 branches in the Central region. The tributaries were sampled as follows: 2 from the coast, 9 from the west and 22 from the central region. According to Mugenda and Mugenda (2009) for a descriptive study > a sample of ten percent of the population is well representative of the population and thus thirty-three clades out of sixty-six ranges are large enough to be representative of the whole population.

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3.4 Data Gathering Process

Primary data were gathered by the researcher via questionnaires from branches that were mailed to A questionnaire is a research tool that collects data from a big sample and has a number of benefits, including the ability to obtain data from a wide range of geographic areas, improved anonymity, and time savings (Kombo & Tromp, 2000). Therefore, using a questionnaire was recommended since it would allow for quick and thorough population coverage. To validate the information gathered, secondary data from the findings that were released was employed.

3.5 Validity and Dependability of the Tools Used to Obtain the Data.

Finding evidence to support the degree to which test performance correlates to the actual behavior or knowledge that the test user intends to evaluate was necessary for establishing validity in research. Reliability and validity are markers of relevance and accuracy, claim Mugenda et al., (2003). In order to determine whether the questionnaire answered the research questions planned for the study and that the respondents would provide consistent input, the researcher conducted a pilot study on six potential respondents.

3.6 Data Analysis Process

Data from the completed questionnaires were identified, sorted, cleaned, and organized during the data analysis process. The data was coded, put into a spreadsheet, and subjected to descriptive statistics model on SPSS analysis. According to the research aims and queries, the codes were divided. Themes were later formed from the data, and inferences were taken from them. The results of the analysis were then displayed using tables, pie charts, and frequency distribution charts.

4.0 DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

Data gathered from Equity Bank Limited was examined for accuracy and consistency, as well as completeness. The information was then coded and divided into themes in accordance with the categories listed in the questionnaire. The Statistical Package for Social Scientists (SPSS frequency)'s tool was used to analyze the data, and the results were then presented in graphical and tabular form.

4.2 Age of Respondents

The figure below displays the responses we received on the respondent's age. It was observed that none of the supervisors were beyond the age of 40. The majority of the supervisors were very young, between the ages of 20 and 30. This suggested that the institution was being helped by a youthful, dynamic set of employees who were eager to advance their careers and who were also giving their all to the company.

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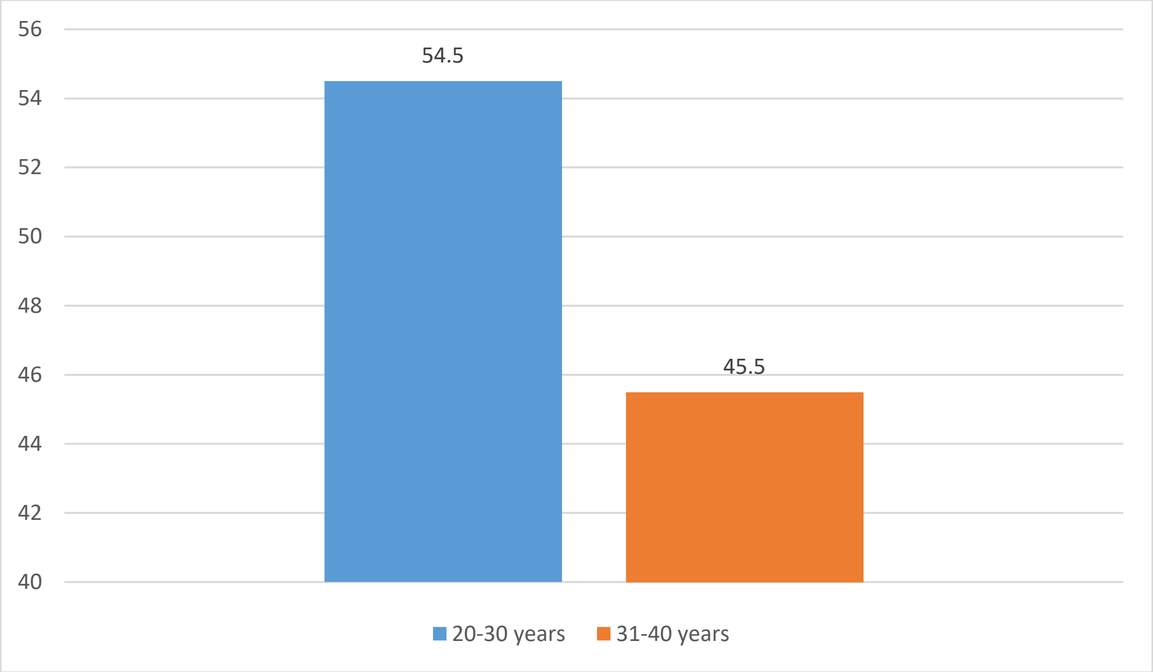

Figure 2: Age of respondents

Source: Research data

4.3 Level of Education of Respondents

The following pie chart displays the responses from respondents regarding their level of education. It shows that the highest level of education for the respondents was a master's degree, which was represented by 36.4%, followed by a first degree, which was represented by 54.5%, and the lowest level of education was a diploma, which was represented by 9.1%. Since the majority were first degree holders, it represented a very-potential group of human resources.

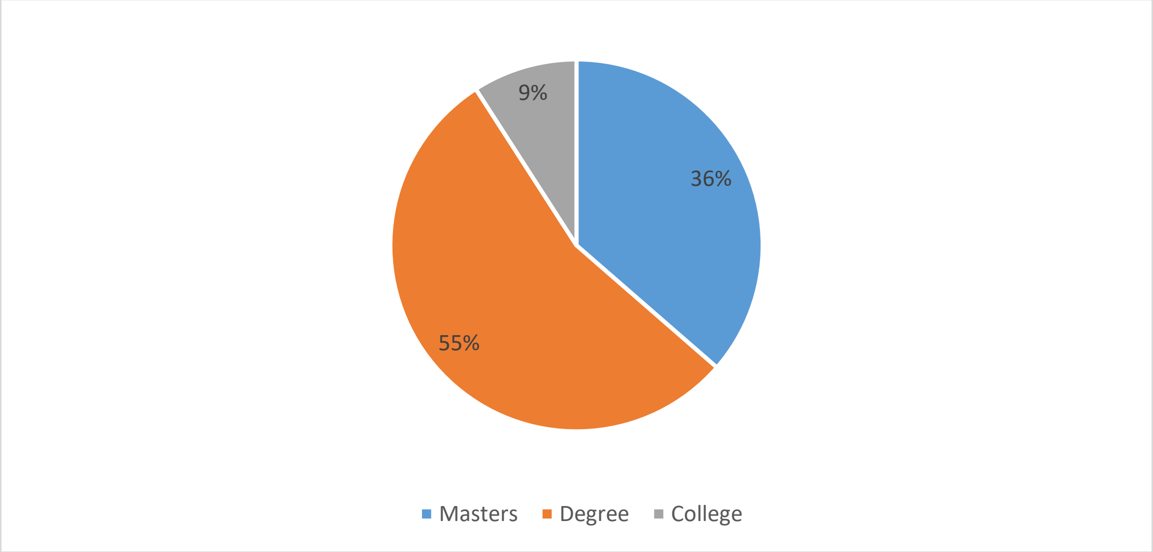

Figure 3: Level of education of the respondents

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4.4 Length of Service of Respondents

The following replies are from the respondents, who were asked to specify how long they had worked for Equity Bank. The respondents had to select their age group from one of four categories. The following possibilities are discussed: seven supervisors had served for less than three years, or 31.82%; fourteen had served for three to five years, or 63.64; one had served for five to ten years, or 4.55%; and none had served for more than ten years. Since the majority of the supervisors had worked for the company for at least three years, they were familiar with its trade finance policies and practices, making the information they provided accurate.

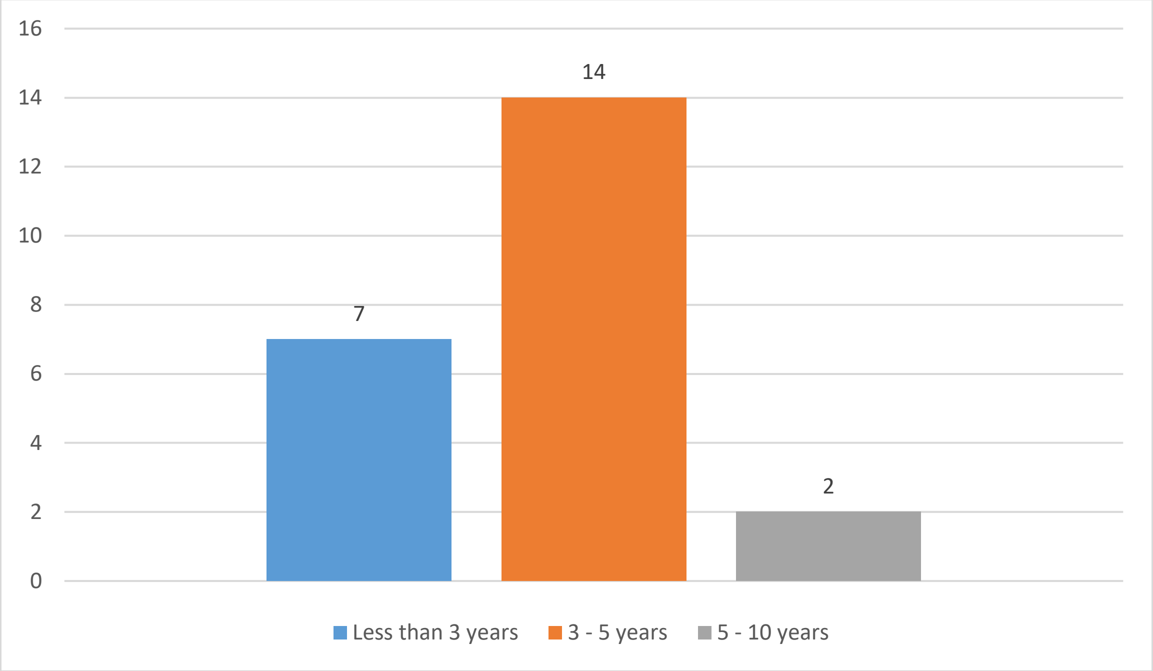

Figure 4: Length of service

4.5 Products Frequently Offered for Trade Finance.

Table 1: Products frequently offered for trade finance

Product	Frequency	Percentage
Bid bond	20	90.91
Performance bond	21	95.45
Letters of credit	21	95.45
Documentary collection	16	72.73
Invoice/ bill discounting	19	86.36
LPO financing	22	100
Inventory/ stock financing	11	50

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ISSN 2958 - 406X (Online)
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90.91% of goods often supplied for trade finance offered bid bonds, 95.45% offered performance bonds, 95.45% gave letters of credit, 72.73% offered documentary collection, and 86.36% offered invoices. Bill discounting, 100% LPO finance, and 50% provided stock/inventory financing are all available. According to the aforementioned data, all respondents offered LPO finance, although inventory and stock taking were the least common. The researcher suggests that trainings and marketing be stepped up to capitalize on the items given in order to have uniformity in all the branches, despite the fact that inventory/stock taking was the least offered but the easiest to execute.

4.6 Effects of Guarantees on Equity Bank's Financial Performance

The graph below depicts the responses obtained when respondents were asked to rank the effects of guarantees on the financial performance of banks. Guarantees were evaluated as highly significant to all metrics of a bank's financial success, with 59.09% ranking for capital adequacy, 81.2% ranking for asset value, 68.18% ranking for liquidity, and 59.09% ranking for profitability. According to the findings, the rank for asset worth received the greatest number of individuals who rated it as very important. This was due to the fact that trade finance, particularly through guarantees, provides the bank with an avenue for short-term lending, resulting in an increase in the bank's assets. Liquidity comes in second place in terms of importance. Off-balance-sheet items are classified as contingent liabilities when reporting a bank's performance, and thus have a significant impact on the bank's financial performance via the liquidity ratio.

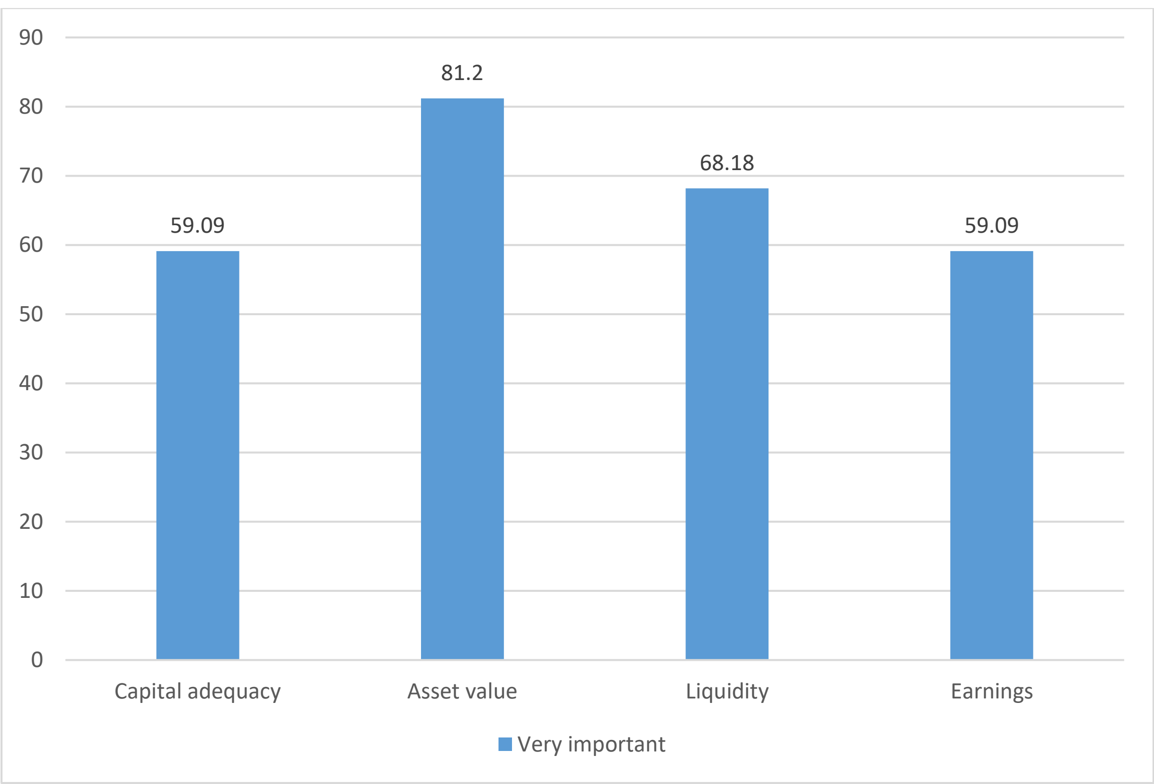

Figure 6: Effects of guarantees

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4.7 Branch Revenues from Offering Guarantees

The respondents were required to give the branches revenues from offering guarantees. Out of the twenty-two respondents 9.09% obtained less than one million, 59.09% between one million to five million and 31.82% between five million to ten million. Guarantees offer an avenue for I' the bank to make clean revenues on fees charged up front and very few risks since most of the clients offered guarantees are well known business customers. It is therefore for this reason that the bank should establish business link and memorandum of understanding with many corporate organizations to utilize the chance and offer more of guarantees. The bank should aim at having revenues on the third group which had a rank of 31.82%. Its improvement on the same line would mean an improvement in its financial performance. The same information is represented in the graph below.

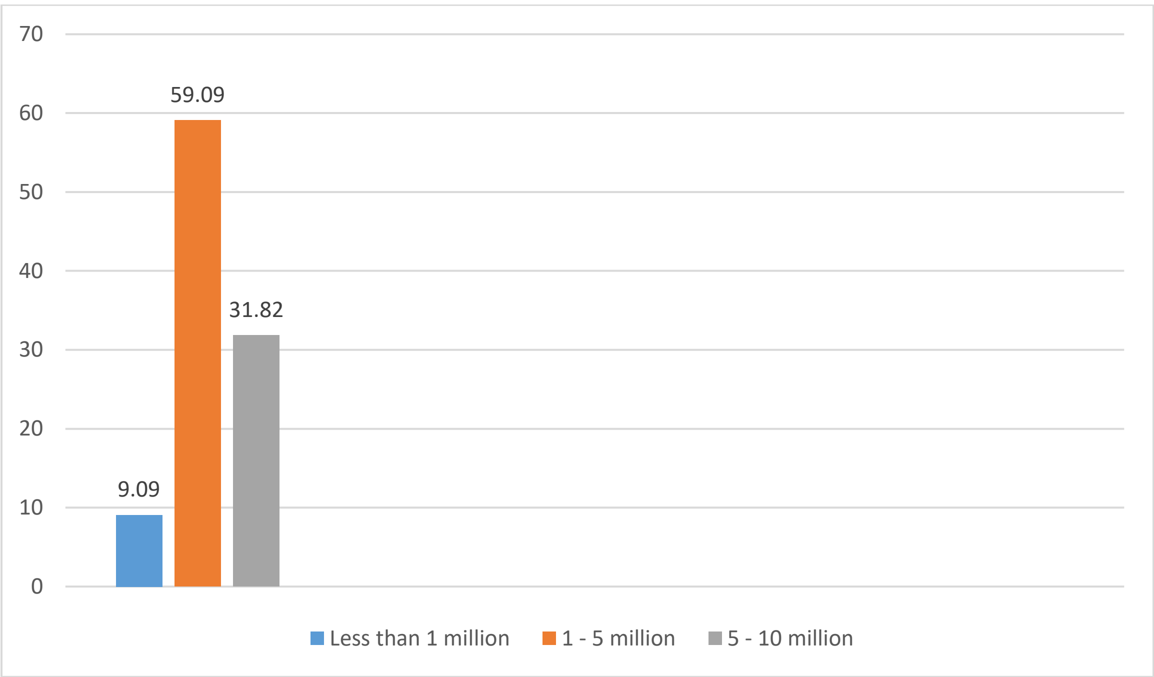

Figure 7: Revenues from guarantees

4.8 The Impact of Collections on the Financial Performance of Banks

Collections had a significant impact on capital adequacy, liquidity, and earnings, with asset value posting the greatest proportion of 59.1%. Collections is a nearly risk-free avenue. This product's revenues are mostly determined by volume. According to the respondents, collections had no effect on asset value, although earnings, capital adequacy, and liquidity did. Collections have no effect on the bank's assets because they are a liability because they are either customer deposits or money held in route to the corresponding payee. They only have an impact on earnings. Capital sufficiency and liquidity as a result of collected revenues, availability of cash to reimburse respective customers on collections, and lastly those not yet claimed are classified as contingent liabilities.

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4.9 Branch Revenues from Collections per Quarter

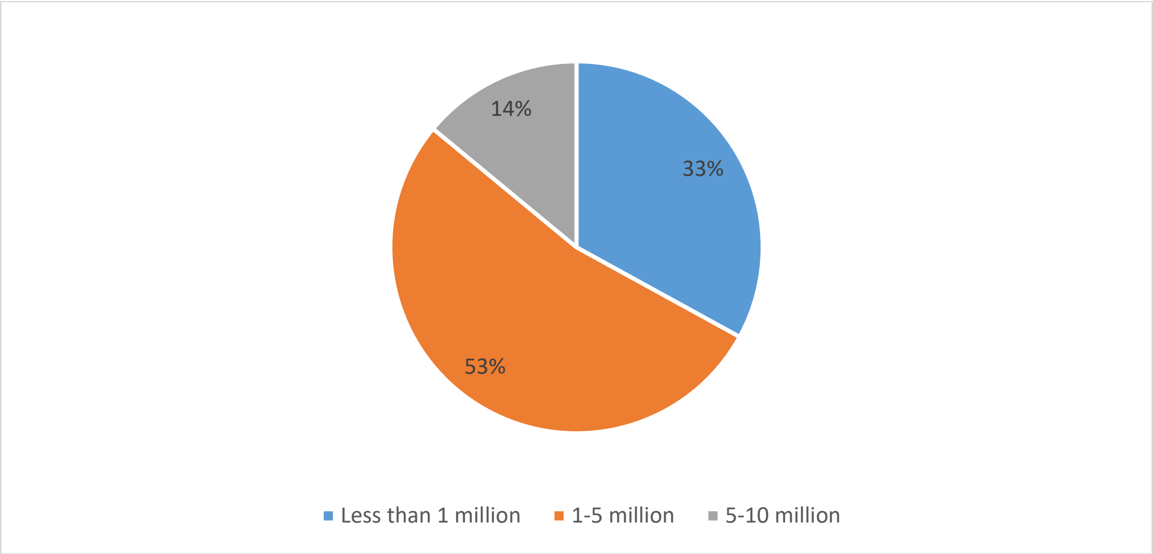

Figure 8: Revenues from collections

Revenues from collections per quarter were recorded as 53% between one million and five million, 33% less than a million, and 14% between five million and ten million in the figure above. According to the figures above, collections had the lowest revenue, with high ranks for revenues between one million and five million and less than one million. This suggested that additional work needed to be done, particularly in marketing and sensitization, to encourage customers to use the product on a regular basis and therefore tap the market for the bank to make more profits.

4.10 Factors Influencing the Ability to Provide Letters of Credit, Guarantees, and Collections

Respondents were asked to list the variables influencing their ability to provide the aforementioned trade finance products. There were the following responses: customer account operation, security offered, Jack of insufficient talents, insufficient clients, Jack of well-established structures, and low business volumes. Among all of the foregoing concerns, the greatest impediment was the lack of security given, particularly for guarantees and letters of credit, because even customers with a strong account history but without the requisite security were not offered the product.

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The main objective of the study was to find out the effects of trade finance on the bank's financial performance. This was measured through use of a questionnaire were the respondents were required to give ranks on given measures of a bank's financial performance. On the effects of letters of credit on the banks financial performance it was evident that they affected the banks performance since most of the respondents ranked effects of letters of on capital adequacy as very important. It was also noted that the effects of letters of credit on the following measure were very important as reflected by the ranks for asset value, liquidity and earnings being highest. This was also reflected on the revenues that the bank was making from offering letters of credit. It was evident that the effects of guarantees on bank performance were quite important, given that they were ranked as such for the various financial performance criteria. According to the analysis, the majority of respondents evaluated the effects of capital sufficiency, asset value, liquidity, and profitability as highly important. The study also discovered that the factors influencing the offering of various trade finance products were found to be the same for everyone. According to the research, the lack of additional collateral/security was a major barrier to accessing most trade finance instruments. This meant that improving in this area would result in higher sales and thus greater financial performance.

5.2 Conclusions

The provision of trade finance by banks has an impact on their financial performance. According to the research responses, the various trade finance products supplied had an impact on the bank's financial performance. As previously stated, the income from offering letters of credit, guarantees, and collections affected the bank's financial performance, as did the different ranks used for rating their effects on financial performance measures. It follows then that so as to improve on financial performance of the banks the factors that affected the provision of trade finance products had to be streamlined to make it easy for the bank to offer more of the products and hence increase on their revenue

5.3 Recommendations

Use of alternative securities and collaterals to gain access to the products; the study revealed that the security required to gain access to the facilities should have been either a log book or a title deed. Given that not all customers had tangible security in the form of title deeds and log books, the use of chattels as alternative securities is advised. This would even result in increasing levels of trade finance revenue due to increased customer volumes. The creation of a memorandum of agreement with the majority of the respected firms that produced or demanded guarantees and letters of credit would be extremely beneficial since clients would only be required to produce the agreed-upon evidence and would have easy access to the products.

The time required for appraisals would also be greatly reduced. Payments would be made through their accounts, reducing risk exposure and providing assurance that the transaction would be completed within the agreed-upon time frame and under the terms and conditions that were satisfactory for both the customer and the bank. Marketing was also essential, as it had been shown that a large number of clients did not use trade finance products simply because they were unaware that such goods existed. It was highly advised that branches should focus on the provision of trade finance products, as only LPO financing was reported to be offered by all branches, with other products such as inventory/stock financing and documentation collections stated to be the least offered. This would result in increasing customer volumes and, as a result, increased revenue.

Funding Sources

The authors received no financial support for the research, authorship, and publication of this article.

Conflict of Interest

The authors declare no conflict of interest.

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