Trade credit insurance – a finance solution for Africa's investment challenges

With African businesses facing issues as global credit rating agencies downgrade key economies in the continent amid a post-COVID context, Alexis Delamaire of Credit Guarantee Insurance Co Ltd explains how trade credit insurance can stimulate investment flows and promote economic development in the region.

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In the aftermath of the pandemic, arguably many African countries, including Mauritius, showed resilience and stayed ahead of the economic curve with great success.

However, in 2023, the Africa Sovereign Credit Rating Review of the Economic Commission for Africa (ECA)[1], Standard & Poor's, Moody's Investors Service and the Fitch Group[2] downgraded a number of African countries – namely Ghana, Nigeria, Kenya, Egypt and Morocco – citing 'increasing government financing needs and pressures from the upcoming wall of Eurobond maturities combined with poorly structured terms of international bonds.'

Global credit rating agencies rationalised their respective downgrades primarily on the back of 'weakening external liquidity position due to unfavourable foreign exchange trajectory, the growth of debt service cost and the high yields on the Eurobond financial markets.'

Poor ratings affect investment in Africa

Poor credit ratings in Africa are often attributed to various factors including political instability, economic volatility, weak governance, and inadequate infrastructure. These factors contribute to a lack of investor confidence, limited access to capital, and high borrowing costs for businesses and governments across the country.

Political instability, characterised by frequent changes in leadership, civil unrest, and conflict, creates an uncertain business environment, leading to increased perceived risk by lenders and investors. Economic volatility, driven by fluctuations in commodity prices, currency devaluation, and inflation, further exacerbates the challenges faced by businesses and governments in managing their finances and servicing debt obligations. These challenges contribute to poor credit ratings for African countries, ultimately restricting access to financing on international markets.

Whilst on the one hand, some financial experts argue that Africa should develop regulatory mechanisms to supervise international credit rating agencies (CRAs) to avoid erroneous assessments that discourage investment on the continent, noting that: "African regulators need to develop regulatory mechanisms to supervise the work of international CRAs operating within their respective jurisdictions to ensure proper conduct of business and enforcement. It is imperative for regulators to ensure accountability on inaccurate rating opinions issued in Africa" [3].

It is, however, undeniable that political instability, economic volatility, weak governance, and inadequate infrastructure continue to worsen operational risk scores for African countries. In the medium- and long-term horizon, major institutional reforms and economic strengthening coupled with social reforms are needed to address political and economic challenges to create a stable environment that fosters intra-African trade as well as international trade.

Credit Insurance to stimulate economies and secure investments

In the short term, amidst the turbulent economic environment, trade credit insurance (also known as export credit insurance[4]) offers a financial instrument that has the potential to help businesses export and trade with African countries despite poor credit ratings. Trade credit insurance allows domestic companies to extend credit terms to existing customers or pursue trade with new, larger customers.

Credit insurance, in essence, transfers the business' risk of non-payment or default of their debtors to the Insurer, allowing businesses to trade with confidence. In addition to peace of mind, by transferring the risk of non-payment of debtors, businesses' enhance their ability to access finance. Lenders are more willing to extend facilities and provide financing to businesses that have credit insurance coverage, as it mitigates the risk associated with lending. This increased access to finance enables businesses to invest in expansion, innovation, and growth, thereby stimulating economic activity at a national level.

> Investors are more likely to allocate capital where credit insurance coverage is available

Trade credit insurance further facilitates trade by providing assurance to exporters that they will receive payment for goods or services delivered to their customers, even in the event of the customer being in default and/or in an insolvent position. Such assurance provides exporters the incentive to discover new markets and expand their international trade relationships, leading to increased export volumes and economic growth. It is noteworthy to highlight that investors are more likely to allocate capital to regions or industries where credit insurance coverage is available, as it provides a layer of protection against potential losses, thereby stimulating investment inflows and economic development.

Pressing need for growth in Africa's credit insurance market

In Africa, credit insurance is offered by both the private sectors, through dedicated credit insurers, as well as by Government Credit Agencies or semi-governmental bodies like the African Trade Insurance Agency (ATI) and the African Export-Import Bank (Afreximbank) which provide trade insurance products across the continent, largely through financial intermediaries such as commercial banks. However, there is still a large gap in the provision of trade credit insurance in Africa.

Indeed, the credit insurance market in Sub Saharan Africa is mainly confined to South Africa due to the general higher level of financial literacy and financial market sophistication. In Mauritius, Credit Guarantee Insurance Co. Ltd offers a local, concrete credit insurance solution to address Africa's trade credit insurance challenge for domestic exporters through its network of partners and associates in Africa and Europe, thereby acting as a solid partner in Mauritius' expansion of trade to African countries[5].

The need of the hour is to expand the presence of credit insurance providers to different parts of the continent and allow more African economies to benefit from the enhanced ability this innovative product offers to covered businesses to attract finance and build their trade books towards stimulating economic development.

Sources:

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