Impact Measurement
–An important challenge for trade finance

Trade has been cited as a tool in supporting sustainable development; however, a key constraint to unleashing trade is access to adequate finance. Currently, 80 to 90% of world trade relies on trade finance, a form of capital that provides liquidity throughout various points in the trade cycle.[1]

Trade finance as a form of impact investment

There are three main problems within the current trade finance ecosystem:

- The gap between capital and deal flow,
- Lack of financing for Small and Medium-sized Enterprises, and,
- Trade finance is still mostly treated as a regular financial asset class, and its impact investment potential has only been exploited by a few institutional investors.[2]

These three core problems must be remedied for trade finance to succeed as a form of impact investment.

Impact investing is defined as a type of investing that intends to generate measurable social and environmental impact and financial returns via market-based solutions.[3] Trade finance is a form of impact investment and involves the financing of trade activities that generate positive environmental, social, and governance (ESG) impacts. Trade finance interventions have recently been linked to positive impacts, such as creating jobs and helping to lift people above the poverty line.[4] However, these impacts are impossible without addressing the challenges listed above.

In MEDA's Trading Up Project, Trade Finance means leases, rental contracts, investments, or loans to SMEs in ODA-eligible countries that are primarily used for short term financing but can also support financing up to 3-years in duration and primarily uses cash flows, movable assets, inventory, accounts receivable or other difficult-to-collateralize assets that are not generally used by traditional banks as a form of collateral for this financing. The purpose of this financing is to enable SMEs to trade, both domestically and across borders.

Importance of impact measurement for trade finance

Impact measurement is key to impact investing. Measuring impact is important because it demonstrates whether progress is being made towards investor's impact goals, and in cases where progress is slow, it can help to improve impact performance, as well as capture business value.[5] Sometimes, this involves re-identifying and redefining impact goals. The benefits of impact measurement can be associated with trade finance asset class when it is used as a tool for impact investments. Impact measurement is important for trade finance because it illuminates its contribution to poverty alleviation and economic growth, its causal relationship with development impact, and its potential as an evidence-based decision-making investment tool.[6]

Challenges with impact measurement for trade finance

Despite the benefits of impact measurement, in general, and for trade finance specifically, it largely remains tricky for impact investors.[7] Two of the reasons why this difficulty exists are elaborated on below:

1. Data-related challenges: a major challenge with impact measurement lies in the difficulty with collecting, analyzing, and interpreting impact data. These difficulties arise from different avenues. One of such reasons is the lack of industry-wide standards for collecting and analyzing impact data. The dominant practice within the impact investing industry is to develop impact measurement frameworks that are specific to a particular fund or institutional investor, resulting in the existence of multiple, fragmented impact measurement frameworks. This makes it difficult for impact results from different investors to be compared with one another and against other types of investments in the market.
2. Temporary nature of Trade finance: an additional challenge specifically with trade finance, arises from its short-term nature. Trade finance represents short-time transactions, ranging from three months to three years. This means that the impact is not easy to assess. However, even impact investments that have a short time period can create significant effects in terms of facilitating access to finance and creating entrepreneurial and job opportunities which otherwise might not exist.

Emerging trends in impact measurement for trade finance

Although there is a lack of industry standards for measurement and impact, new practices are emerging. Most of these efforts to develop impact measurement practice are more general in nature, and some of the challenges discussed above are still encountered in the trade finance community. Here are three examples of how new practices, resources, and tools are being mobilized to ensure standardized impact measurement in the field:

- The Global Impact Investing Network (GIIN) is working on developing a methodology that will assist investors in performing rigorous data analysis and allow for the comparison of impact performance data across the industry.[8]
- The Impact Management Project (IMP) is a platform that consolidates the efforts of the impact investing community to harmonize the measurement, management, and reporting of impacts. Members of the IMP share best practices and identify areas of impact measurement and management that need further collaboration.[9]
- The International Islamic Trade Finance Corporation (ITFC) created its Development Impact Framework (DIF), which it uses to quantify portfolio impact as well as development effectiveness.[10] This model has helped the corporation track development impact at the corporate level and has helped guide operational and strategic decisions for its trade finance portfolios.[11]

Some trade finance investors have tried to align their impact with the global Sustainable Development Goals (SDGs).[12] Despite these efforts, challenges remain to adequately measure the impact of trade finance in achieving development impacts.

MEDA's Trading Up Project works with Small and Medium Enterprises to foster growth, create employment, and strengthen market linkages through trade finance in Africa, Asia, and Latin America. This six-year global blended finance project between Mennonite Economic Development Associates (MEDA), Global Affairs Canada, Sarona Asset Management, and the University of Waterloo, aims to solve some of these challenges of the impact investing industry.

Endnotes

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5 Bass, R., Dithrich, H., Sunderji, S., & Nova, N. (2020). The state of impact measurement and management practice. 2nd Ed. GIIN Global Impact Investing Network.
6 International Islamic Trade Finance Corporation, (2019). Annual Development Effectiveness Report
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8 Bass, R., Hand, D., Sunderji, S., & Nova, N. (2020). Methodology for standardizing and comparing impact performance. GIIN Global Impact Investing Network.
9 See www.impactmanagementproject.com for more on the Impact Management Project
10 International Islamic Trade Finance Corporation, (2019). Annual Development Effectiveness Report
11 Ibid
12 https://sdgs.un.org/goals

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