

A Study on Supply Chain Finance (SCF) in Yemen



Done by :

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- **Objectives:**

This study on Supply Chain Finance provides an overview of the SCF current state in Yemen. The specific objectives are:

1. To provide an overview of the financial situation in Yemen;
2. To provide an overview of the Supply Chain Finance situation in Yemen;
3. To map existing barriers and market nature that hinder growth and the cross-border expansion.

- **Approach:**

The three objectives are translated into the following tasks and activities:

- Task 1, provides an overview of Yemen financial situation based on research and previous reports.
- Task 2, provides an overview of the Yemen supply chain finance market based on desk research and interviews.
- Task 3, the analysis of the market barriers based on research.

- **The current imports financing situation in Yemen:**

Since 2015, Yemeni importers have faced a growing number of financial and institutional constraints imposed by the war's physical and economical dimensions. The major financial constraints faced by importers include:

- Reduced access to foreign currency and letters of credit from the Central Bank of Yemen (CBY), owing to decreased foreign currency supplies ;
- Reduced access to correspondent accounts as a result of classification of Yemeni banks as 'high-risk' ;
- Reduced access to credit – a problem that permeates the food supply chain.

After Saudi Arabia intervened in the conflict in March 2015, hydrocarbon exports from Yemen were gradually suspended (and are still yet to recover to pre-conflict levels), resulting in the loss of the country's biggest source of revenue – foreign currency – and primary means

of maintaining a fragile monetary, fiscal, and economic stability. In 2014, hydrocarbon exports accounted for approximately USD 6.4 billion and 36% of foreign currency inflows. The loss of foreign currency from hydrocarbon exports led to the CBY using Yemen's foreign currency reserves to preserve a letters of credit system that demonstrates traders have access to foreign currency inside the country. This was used to facilitate the import of essential food and fuel commodities, and to protect the value of the riyal, and maintain exchange rate stability. As foreign currency reserves dwindled – CBY foreign currency reserves fell from USD 4.7 billion in December 2014 to less than USD 1 billion in September 2016 – CBY reduced the scope of letters of credit to cover select food commodities (e.g. wheat) after eliminating coverage for fuel and sugar. CBY also responded by limiting the ability of foreign currency account holders to withdraw funds as well as Yemeni banks' ability to sell foreign currency to fuel importers. In 2015, Yemeni food importers also found their access to key correspondent accounts in Western Europe and Canada restricted following additional de-risking measures taken against Yemeni banks. De-risking policies implemented in relation to Yemeni banks in 2015 left Yemeni banks and traders more dependent on correspondent accounts held at Lebanese banks, which would later prove costly following the onset of the Lebanese banking and financial crises in November 2019. President Abdrabbu Mansour Hadi and the Government of Yemen (GOY) used the pretext of reduced foreign currency reserves to stoke claims that Ansar Allah was dipping into state coffers to fund its war effort. This line of argument was used to justify the order that President Hadi made in September 2016 to relocate the CBY headquarters from Sana'a to Aden. The transfer of the CBY headquarters led to the division of the CBY and left Yemen with two competing central banks, CBY Aden and CBY Sana'a. It also marked the onset of economic warfare that continues to escalate – encompassing competing monetary, fiscal, and economic policies and regulations – prompting a fragmentation of the economy, the local currency, and the domestic market. From 2015 through to November 2018, the CBY and the formal banking system as whole became a less reliable option for Yemeni food merchants looking to secure foreign currency and transfer money to external actors (e.g. exporters, shipping agents, and insurers) in order to facilitate their import activity. Since 2015, food importers came to rely more on informal financial networks in which money exchangers and hawala agents operate –by transferring a 100% of the goods value -to help importers secure foreign currency and to pay external actors. These networks helped food importers tap into remittance flows, as remittances have replaced

hydrocarbon revenues as the primary source of foreign currency for Yemen during the conflict. The problem, however, is that with the CBY unable to regulate the demand for foreign currency via a letter of credit system, the increased importance and use of informal financial networks brought with it added pressure on the riyal as importers competed with one another to access foreign currency. With the GOY and CBY Aden unable to regulate the demand for foreign currency among importers because of insufficient foreign currency flows and the weak institutional capacity of CBY Aden, the market was left to its own devices and the value of the riyal depreciated in 2017 and 2018. The injection of foreign currency from Saudi Arabia and the rolling out of a new letters of credit system from CBY Aden to cover the import of essential food commodities helped stem the rapid depreciation of the riyal between July and October 2018.(1)

According to key informants, all future rounds of Yemen's letter of credit (L/C) import financing mechanism have been put on hold due to insufficient government revenue, depletion of Saudi financial support, and the rapidly depreciating local currency. Though currency is typically issued to traders quarterly, the most recent L/C distribution occurred in January 2021. As a result, traders have been accessing foreign currency at increased costs, likely contributing to more rapid food price increases via increased costs of importing both food and fuel. This is driving further reductions in household purchasing power due to the expected inability of most households to expand income-earning. As of the last week of May 2021, the cost of the minimum food basket at the national level was 20 percent higher than the already significantly above-average levels recorded at the beginning of January 2021. Further price increases are expected throughout the coming period. (2)

As for the currency instability, according to the World Food Program WFP market monitoring, consumer prices of many imported staple foods increased by more than 100% between 2014 and 2019 – notably rice (248%), wheat (110%), and wheat flour (98%). These price rises largely reflect changes in the YER-USD exchange rate during the conflict. The rising level of food insecurity in Yemen does not stem from a lack of food on the local market, but rather people's decreased ability to purchase food items. Reduced purchasing power is a result of a variety of factors: local currency depreciation, reduced income, and less employment as well as a lack of salary, pension, and social welfare payments. Financial constraints faced by food merchants and the various techniques employed to circumvent such

constraints have had a direct impact on the value of the riyal and, as a result, on food prices and consumer purchasing power. Of note is the close correlation between the value of the riyal and food prices. The correlation is particularly noticeable during periods when the riyal has depreciated and the market then adjusts to new, higher rates. From 2015 onwards, importers came to rely more on informal financial networks to secure foreign currency and pay exporters. The (unregulated) demand for foreign currency put huge downward pressure on the riyal. As importers looked to protect themselves against its depreciation and political uncertainty, they bought up and essentially sucked out foreign currency from the market. This led to a further depreciation of the riyal in 2017 and 2018. When considering the concentration of food imports within the hands of a relatively small group of importers, the impact is magnified. (1)

- **Supply Chain Finance in Yemen:**

Supply Chain Finance is " the use of financing and risk mitigation practices and techniques to optimize the management of the working capital and liquidity invested in supply chain processes and transactions. SCF is typically applied to open account trade and is triggered by supply chain events"(3).

The SCF portfolio includes at least nine techniques acknowledged and defined by the Global Supply Chain Finance Forum which are:

- Receivables purchase SCF techniques include receivables discounting, factoring, forfaiting, payables finance and dynamic discounting.
- Loan or advance-based SCF techniques includes loan or advance against receivables, distributor finance, loan or advance against inventory and pre-shipment finance.

SCF is seen as an effective solution to combat cash flow issues and improve working capital. Recent developments in supply chain finance have been driven by the emergence of global supply chains and the growth of open account trade (4).

Banks in Yemen play a vital role in trade, domestically and internationally, by providing traditional trade finance instruments such as letter of credits and documentary collections. However, the SCF market is dominated by traditional finance providers (banks), which provides typical SCF service (loans). Moreover, Islamic banks in Yemen provide financing

through murabaha. Microfinance banks only finance in accordance to chapter two article no. 3 of the microfinance bank's law no. 15 issued in 2009 which says the aim of establishing such banks is to "provide the suitable financing for the targeted segments by offering financial facilities for poor which contributes in reducing poverty and unemployment by focusing on the poor segments to reach self-dependence"(5).

According to Haqlan the General Manager of Correspondent Banks Account at the Central Bank of Yemen Sana'a, when asked about the role of the Central Bank in financing trade " what normally offered are; loans, exchange rates , and credit facilities. As far as I know there are no banks or financial institutions that offers debt buy-back in Yemen . Accordingly, SCF in Yemen are separate operations and not a chain ."(6)

Some interviews were conducted with bankers from different banks in Yemen as follows:

- Amer Alsaqaf from Yemen Bank for Rec., and Dev. Indicated that only traditional ways of financing trade are applied in his bank (7).
- Ashjan Alqadasi from Alamal Microfinance Bank indicated that the bank she works in only provides microfinancing for local trade only while the bank deals with such financing as in Islamic banks. They buy the products for the customers (8).
- Eram Essam from Altadhamon Bank indicated that the bank finance trade through murabaha(9).
- Dalham Alfadhly from Alahli Bank indicated that his bank only offers loans to finance foreign trade besides letters of credits and other traditional trade financing ways (10).
- In other interviews with other bankers from several banks in the republic, they indicated the same information as to say; Islamic banks in Yemen provides financing through murabaha while commercial banks provide loans and the traditional instruments of financing trade.

- **Market barriers:**

- 1. Digitalization**

The National Information Center (NIC) was established in 1995 in order to contribute in the field of information policies in Yemen. Moreover, when thinking of digitalization, we put in mind the following:

a- Internet connectivity

Since 1995 the Yemen Republic connection to the external world was enabled via fiber optic network through a sea cable extending 226 km to Djibouti and to other Arab countries, South East Asia and Europe. However, the next year internet service was provided by a sole provider (Teleyemen) a company possessed by British Cable Company and the Yemeni government and then the ownership transferred into the government to become the Public Telecommunication Corporation. ISDN was introduced in 2001 by which internet users increased. Moreover, the Ministry of Telecommunication and IT finalized the technical study for establishing the wireless internet project(WIMAX) (11).

b- Legal and regulation environment

The legal and regulatory environment in Yemen is unsatisfactory for the activation of the Information and Communication Technology ICT sector role. The role of telecommunication and IT bill which was concurred by the Yemeni government under resolution 393 for year 2008 and transferring it to the parliament in preparation for its concurrence. The parliament consequently transferred the bill to a committee since 2009 and it had not been concurred yet. Law no. 13 for the year 2012 regarding the right access information had already been discussed. NIC had also prepared a bill for the law of information administration which was concurred by the government and transferred under resolution 431 for the year 2008, the parliament in its turn transferred the bill to a committee since 2009 and had not been concurred yet. (12)

c- The status of trade facilitation in Yemen

In September 2014, the United Nations Regional Commissions UNRCs started a global survey to gather data and information on trade facilitation and paper-less trade implementation from their member countries. The result indicated that the level of trade facilitation measures implementation in Yemen is 44.1 % which is lower than West Asia average level (12).

2-Supply Chain Management:

supply chain management barriers fall under managerial complexity or misalignments in bringing together firms' processes, structures, and culture. Moreover, Poor information systems support proves to be a critical barrier since essentially collaboration is highly dependent on information. Coordinating value-added activities across functional and organizational boundaries without shared information are considered to be next to impossible. More details are given as follows:

a- Technological Barriers

What proves to be the vital barrier to greater supply chain SC collaboration and cooperation is the inadequate information systems. Poor information systems support proves to be a critical barrier since essentially collaboration is highly dependent on information. Coordinating value-added activities across functional and organizational boundaries without shared information are considered to be next to impossible. Moreover, it is important to have the ability to communicate and the availability of accurate, timely, and relevant information to supply chain efforts to reduce inventory, boost asset productivity and customer service (13).

b- Relationship Barriers

Most companies, especially those that possess market power, find the daunting task of sharing the economic benefits of alliance relationships. Despite this, dominant supply chain members show off the desire to disseminate the risks of uncertainty with alliance partners. It is also a fact that sharing risks appears to be much more appealing proposition than sharing rewards. Moreover, even when it is decided that risks and rewards are equally shared, identifying and quantifying them can pose an exceptional challenge. Another important relationship barrier is the fact that people are not willing to share information. It also serves as a barrier that stems from the tensions that exist among channel members. Not having the trust makes it difficult to share information deemed sensitive. Many managers simply feel that they cannot afford to share proprietary information. Unfortunately, without open information sharing, strategic and tactical supply chain decisions will definitely be subculture-optimized and future collaboration efforts will be at stake (13).

c- Culture

Due to the lack of awareness and the unstable financial condition of Yemen, people may not try any untraditional instruments to finance themselves. Supply chain finance adopting different Supply chain finance instruments might be faced by a refusal due to the lack of awareness, trust issues, and culture. Nonetheless, Yemen financial circumstances during war time put Yemen traders several steps backward. Furthermore, banks only offer what is demanded (i.e. traditional instruments).

- **Suggestions and recommendations:**

In order to sort SCF situation in Yemen some suggestions might improve the situation for instance stabilizing the political situation will improve the economic status; the concerned legal authorities might work on updating the commercial law articles which are related to trade finance transactions ;the Chamber of Commerce and Industry should promote digitalization solutions among importers and exporters and their benefits; enhancing the cooperation among supply chain members; the CBY should encourage banks to provide SCF services ; the Ministry of Communication and IT must upgrade the current infrastructure in order to facilitate trade finance instruments and establishing digital standards; providing sophisticated information system for information sharing among supply chain members; increasing the awareness of open trade and SCF techniques among importers and exporters ; motivating suppliers and customers to participate in the supply chain and adapting SCF techniques; providing supply chain finance techniques training and courses in order to apply them in real life; allowing non-banking sector to provide global trade financing and legitimating their job.

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