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Review Article

The Role of Financial Institutions in International Trade

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Abstract: The importance of international trade as a source of revenue for households, businesses, and countries is indisputable, but the critical role of financial institutions in enabling and expanding international trade through financing, risk management, and regulatory support is often overlooked. Hence, this paper investigated the role of financial institutions in international trade, providing a lucid and holistic overview of how these institutions undergird global commerce. It adopted a doctrinal-library-based methodology, drawing on peer-reviewed and grey literature, as well as relevant statistics. The paper outlined the categories of financial institutions: commercial banks, export credit agencies, multilateral development banks, and international financial institutions. It examined their involvement in international trade and the instruments and mechanisms they employ for trade financing. The paper further examined the risk management and regulatory compliance roles undertaken by financial institutions. It unbiasedly assesses the impact of financial institutions on global commerce, noting strides such as expanding SMEs' access to finance and the digitization of financial services, but challenges remain. In conclusion, the paper recommends harmonizing trade standards to achieve greater equity and strengthening institutional collaboration, among other measures.
Keywords: International Trade, Financial Institutions, Trade Finance, Commercial Banks, Export Credit Agencies, Multilateral Development Banks, IMF, WTO.

1. INTRODUCTION

International trade, also known as global trade or cross-border trade, involves the exchange of goods and services across national borders (Cuong & Ten, 2022). In recent years, international trade has become increasingly ubiquitous, driven by the global uneven distribution of resources and technological advancements (Mao *et al.*, 2024). The World Trade Organization (WTO, 2024) reports that global trade amounted to US$32 trillion as of 2024. However, the success of global commerce is underpinned by financial institutions, which provide financing and payment mechanisms for cross-border trade (Abadiyah & Endraswati, 2023). These institutions range from commercial banks to central banks and development finance institutions (DFIs) at municipal, regional, and international levels.

Given the importance of financial institutions in the success of international trade, it becomes necessary to understand their role(s) clearly. Thus, this paper examines the multifaceted roles that financial institutions play in enabling, securing, and expanding international trade through financing, risk management, and regulatory support. Furthermore, it highlights the growing global finance gap, estimated at hundreds of billions of dollars, which adversely affects developing economies and small businesses. Finally, it comments on the increasing complexity of global supply chains and spotlights the crucial role of institutional support in preventing and mitigating supply chain risks, to foster international trade.

2. CLASSIFICATION OF FINANCIAL INSTITUTIONS IN TRADE

Financial institutions vary in size and function (Molyneux, 1990). In this section, we review four classes of financial institutions involved in international trade, viz, commercial banks, export credit agencies (ECAs), multilateral development banks (MDBs), and international financial institutions.

2.1 Commercial Banks

Analogous to pawns in chess, commercial banks are the pawn-like financial institutions in international trade. This attests to their greater number relative to other classes of institutions and to their primary, direct relationship with actors in international

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trade (Tulashbekovich, 2025). Commercial banks are commonly known for accepting deposits from the public (Zhylinskyi, 2024), but they also provide short- to medium-term financing instruments to importers and exporters (Tulashbekovich, 2025). Additionally, they facilitate the receipt and disbursement of payments in global trade, provide financial advice, and conduct due diligence checks for customers (Gladson & Asare, 2020). These services foster international trade, positioning commercial banks as primary financial institutions in global commerce.

2.2 Export Credit Agencies

Export credit agencies (ECAs) are government-backed financial institutions that promote national exports through financing and insurance schemes (Oramah & Dzene, 2025). As government-backed institutions, they receive funding from the public treasury and thus have a larger capital base than commercial banks (Oramah & Dzene, 2025). Moreover, as public-sector enterprises, their primary motive is service provision rather than profit maximization; thus, they can offer credit terms that commercial banks may deem too risky (Oramah & Dzene, 2025). Through their interventions, ECAs facilitate global trade, especially for SMEs, expand national export capacity in line with economic priorities, and counter competition from foreign ECAs to improve the balance of payments (Simdi, Tunahan, & Jahangir).

2.3 Multilateral Development Banks

Multilateral Development Banks (MDBs) are another form of financial institutions created by multiple countries to provide long-term financing, technical assistance, and policy advice to support national economic and social development (Bazbauers & Engel, 2021). They play a crucial role in international trade by financing infrastructure projects such as ports and energy, that are geared towards expanding global trade volumes (Endelman, 2006). They also provide technical assistance through capacity-building workshops, cross-border data collection, and research to improve access to international markets, particularly for low- and middle-income countries (Bazbauers & Engel, 2021). Common examples of MDBs are the World Bank, the African Development Bank (AfDB), and the European Bank for Reconstruction and Development (EBRD).

2.4 International Financial Institutions

The last, and most certainly not the least, class of financial institutions influencing international trade are international financial institutions (IFIs) (Leipziger, 2014). These institutions facilitate international trade from a different plane than the rest. Unlike MDBs or DFIs, they do not provide direct trade financing, instead, they provide trade rules—such as the Marrakesh Agreement Establishing the World Trade Organization, 1994 and its several annexes which include the General Agreement on Tariffs and Trade, 1994, the General Agreement on Trade in Services (GATS), 1994, and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), 1994—dispute settlements and monitoring mechanisms to ensure sound trade practices which underpin the growth of global commerce (Mohanty & Madaan, 2025). For example, the International Monetary Fund (IMF) provides balance-of-payments support to countries experiencing currency crises, thereby helping to stabilise imports and exports. Its surveillance promotes sound fiscal and monetary policies that foster a stable environment for trade.

3. TRADE FINANCE INSTRUMENTS AND MECHANISMS

Trade financing, given its complexity, is implemented through several instruments and mechanisms; four of these are reviewed below.

3.1 Letters of Credit

Letters of credit (LCs/LoCs) are among the oldest trade financing instruments, although they are primarily used in maritime trade (Oforbuike & Iloabachie, 2024). As the name implies, it is a letter that ensures the seller/exporter will be paid for the goods sold/exported. It is commonly used to finance cross-border maritime trade or to mitigate risk by shifting the obligation of payment to a financial institution ('issuing bank') (Oforbuike & Iloabachie, 2024). LCs contain terms and conditions that the seller/exporter must strictly comply with to be entitled to payment. There are various types of LCs, sight, confirmed, and revolving, each slightly varying based on the parties' commercial needs (Nwaji, 2025).

3.2 Guarantees and Standby Letters of Credit

Guarantees and standby letters of credit (SLBCs) are similar to traditional LCs, except that they take operation at different times (Naegele, 2019). Whereas conventional LCs shift the obligation of payment to the financial institution *ab initio*, Guarantees and SLBCs take effect only when the buyer fails to pay for the goods as due (Mijatović & Đorđević, 2023). Thus, Guarantees and SLBCs are conditional assurances from a financial institution, at the buyer's instruction and on the buyer's behalf, to pay for goods sold or exported if the buyer is unable to do so. Essentially, it permits the buyer to use the institution's goodwill (Naegele, 2019).

3.3 Factoring and Forfaiting

Factoring and forfaiting are trade financing instruments used by financial institutions to facilitate international trade. In factoring, exporters sell trade receivables to financial institutions to receive immediate funds, instead of waiting for buyers to pay (Marak & Pillai, 2021). These financial institutions then assume responsibility for collecting payments from the buyer and subsequently releasing the trade receivables (Dewan & Zahid, 2020). This financing arrangement provides firms with predictable working capital, enabling them to accept larger orders or expand into new markets (Dewan & Zahid, 2020). In international trade, factoring also shifts credit risk to the factoring institution, protecting exporters from non-payment, which is especially useful for small and medium-sized enterprises (Moniruzzaman *et al.,* 2023).

Forfaiting is similar to factoring but typically involves medium- to long-term receivables, often associated with capital goods or large industrial equipment (Gorton, 2014). Exporters sell these receivables to a forfaiting institution on a non-recourse basis, meaning the risk of default is fully transferred. This provides immediate liquidity and eliminates credit and political risks. Forfaiting is attractive because it simplifies balance sheets and enables exporters to offer competitive financing terms to foreign buyers. The market for forfaiting has grown steadily as global infrastructure and machinery trade expands, making it an important instrument for reducing risk in long-term cross-border transactions.

3.4 Supply Chain Finance

Supply chain finance (SCF) is a buyer-led financing approach that enhances liquidity for suppliers (Xu *et al*., 2018). Large buyers use their stronger credit ratings to secure favorable financing terms from banks, thereby enabling smaller suppliers to access funds at lower costs. SCF programs help suppliers manage working capital more effectively and ensure stable production cycles (Wuttke, Rosenzweig, & Heese, 2019). With the growth of fragmented global supply chains, SCF has become increasingly important. It strengthens relationships between buyers and suppliers and reduces disruptions (Caniato, Henke, & Zsidisin, 2019). SCF plays a significant role in enhancing the resilience of supply networks by providing predictable, cost-efficient financing linked to actual trade flows (Caniato, Henke, & Zsidisin, 2019).

Digitization has transformed SCF by automating invoice verification, payment tracking, and credit assessment (Muneeb *et al*., 2025). Fintech platforms now integrate directly with enterprise resource systems, enabling real-time visibility into supply chain transactions (Muneeb *et al*., 2025). This reduces fraud, accelerates financing, and lowers administrative costs (Tiwari and others, 2024). Digital platforms also democratize access to trade finance, enabling small businesses that lack traditional collateral to participate (Tiwari *et al*., 2024). By leveraging data analytics and artificial intelligence, fintech firms evaluate risk more accurately, expanding lending opportunities. The integration of digital tools with SCF is reshaping the efficiency and inclusiveness of global supply chains, making financing faster, more transparent, and more accessible.

3.5 Digital Infrastructure

The SWIFT network remains the backbone of secure financial communication worldwide, enabling banks to exchange payment and documentation messages reliably (Robinson *et al*., 2023). Beyond SWIFT, blockchain technology has emerged as a promising innovation for trade finance (Camargo, 2023). Blockchain pilots conducted by global banks and consortia demonstrate the potential for tamper-proof documentation, real-time tracking, and faster settlements (Camargo, 2023). Smart contracts can automate compliance checks, reducing reliance on paper-based processes. E-documentation platforms also streamline the management of bills of lading, invoices, and certificates. Digital infrastructure significantly reduces administrative burdens that have historically impeded trade, while improving transparency and reducing the risk of document fraud in global transactions.

Fintech innovations have lowered barriers to trade finance, particularly in developing economies. Digital lenders use alternative credit data, such as transaction histories, mobile payments, and logistics records, to evaluate small exporters that lack formal financial statements (Abdulai, Dary, & Domanban, 2024). This has opened new avenues for SMEs to obtain financing quickly and efficiently. Crowd-funding platforms and peer-to-peer lending networks provide additional channels for trade finance. By leveraging technology, fintech institutions increase competition, reduce costs, and enhance financial inclusion. Their role is becoming more prominent as businesses increasingly rely on digital supply chains, cross-border e-commerce, and instant payment systems for global trade operations.

4. RISK MANAGEMENT AND REGULATORY COMPLIANCE

4.1 Political and Credit Risk Insurance Overview

Political and credit risk insurance plays a vital role in protecting businesses engaged in international trade (Köseoğlu, 2024). ECAs and private insurers such as Coface, Atradius, and Euler Hermes offer policies that cover non-payment, insolvency, expropriation, and political upheaval (Oramah & Dzene, 2025). These risks often discourage firms from trading with frontier or volatile markets. By transferring risk to insurers, exporters can enter new territories with greater confidence. In addition, banks are more willing to lend when transactions are insured, effectively increasing the availability of trade finance. Risk insurance mitigates uncertainties that would otherwise hinder global commerce, thereby expanding opportunities for cross-border business.

4.2 Currency Risk Management

Fluctuations in exchange rates can significantly affect the profitability of international trade transactions. To manage this risk, financial institutions offer hedging instruments, including forwards, options, and currency swaps (Korzhegulova *et al*., 2018). These tools allow firms to lock in exchange rates or insure against adverse movements. Banks play an advisory role, helping exporters and importers develop tailored FX risk strategies. Effective currency risk management stabilizes pricing, reduces volatility, and protects margins. Without these financial instruments, many firms would avoid trading in highly volatile currency environments. Thus, currency risk management services provided by financial institutions are indispensable to sustaining cross-border commerce.

4.3 Regulatory Compliance

Anti-Money Laundering (AML) and Know-Your-Customer (KYC) regulations are critical components of global trade compliance (Howell, 2024). Financial institutions must verify clients' identities, monitor transactions, and report suspicious activities to prevent illicit financial flows. These requirements help combat money laundering, terrorism financing, and trade-based fraud. AML/KYC systems typically involve detailed documentation, screening against sanctions lists, and continuous risk assessments. Although compliance increases operational costs for banks and traders, it ensures that international trade remains transparent, legitimate, and aligned with global security standards. Strong AML/KYC frameworks also foster trust among trading partners and international regulators. Recent scholarship emphasizes the need for strategic regulatory innovation to complement compliance-based frameworks and ensure resilience in corporate financial governance (Atoye, 2025).

Basel III regulations impose stricter capital and liquidity requirements on banks, affecting the cost and availability of trade finance (Coban, 2020). Because trade finance instruments traditionally exhibit low default rates, many stakeholders argue for proportional regulation (Coban, 2020). However, Basel III aims to strengthen the financial sector by ensuring banks maintain sufficient capital buffers. This indirectly affects trade finance by increasing the cost of issuing letters of credit and guarantees for banks. Despite these challenges, Basel III enhances systemic stability and reduces the likelihood of financial crises that could disrupt global trade flows. The goal is a more resilient global banking system.

4.4 Sanctions and Embargo Enforcement

Financial institutions are central to the enforcement of international sanctions and embargoes issued by entities such as the United States' Office of Foreign Assets Control (OFAC), the United Nations, and the European Union. Banks must screen transactions and counterparties to ensure compliance, as failure to do so can result in severe penalties, reputational damage, and loss of market access. With increasingly complex trade networks, sanctions compliance has become more demanding, requiring advanced analytics and monitoring tools. In this gatekeeping role, banks ensure that global trade aligns with international security and foreign policy objectives. Similarly, tariffs impose high economic costs and can escalate international tensions, highlighting the importance of balanced regulatory approaches (Uade, Atoye, Atoye, & Omoghene, 2025).

5. DEVELOPMENTAL IMPACT AND INSTITUTIONAL CHALLENGES

5.1 Access to Finance for SMEs

Small and medium-sized enterprises (SMEs) face disproportionate challenges in accessing trade finance due to limited collateral, credit histories, and risk perceptions. The global trade finance gap, estimated at over one trillion dollars, disproportionately affects SMEs, particularly in developing regions. Financial institutions often hesitate to lend to smaller firms due to perceived risks and high compliance costs. MDBs and ECAs attempt to bridge this gap by offering guarantee schemes, risk-sharing facilities, and capacity-building programs. Expanding SME access to trade finance is crucial for inclusive economic development, as SMEs generate significant employment and contribute substantially to export diversification.

Multilateral Development Banks are increasingly prioritizing SME inclusion in global trade. Initiatives such as the IFC's Global Trade Finance Program and the Asian Development Bank's Trade Finance Program aim to strengthen local banks' ability to lend to small exporters. Through guarantees and liquidity support, MDBs reduce risk for partner banks and stimulate lending. MDBs also provide training and technology support to help financial institutions improve their trade finance operations. By empowering SMEs to participate in cross-border trade, MDBs contribute to job creation, economic diversification, and the industrial upgrading needed to integrate developing countries into global value chains.

5.2 Infrastructure Financing for Trade

Trade depends heavily on logistics infrastructure, including ports, roads, railways, and customs facilities. Financial institutions, particularly MDBs, play a vital role in financing large-scale infrastructure projects that facilitate trade. Blended finance models, which combine public and private funding, help mobilize capital for complex, capital-intensive projects. This improves supply chain efficiency, reduces transportation costs, and enhances competitiveness. Infrastructure financing also supports regional integration by connecting geographically isolated markets. Without the involvement of financial institutions in the development of modern infrastructure, many developing countries would struggle to participate effectively in global trade and attract foreign direct investment.

Public-private partnerships (PPPs) have become standard mechanisms for financing trade-related infrastructure. Financial institutions structure PPP arrangements, conduct risk assessments, and mobilize long-term capital. These partnerships help governments leverage private-sector efficiency and innovation while maintaining oversight of strategic assets. Successful PPPs have transformed ports, logistics corridors, and customs systems in many developing regions. However, they require robust regulatory frameworks to balance risks and ensure accountability. Financial institutions play advisory and structuring roles that are essential to aligning public and private interests. PPPs illustrate how coordinated financial mechanisms can facilitate sustainable infrastructure development that supports international trade.

5.3 Financial Inclusion and Digitization

Digitization enhances financial inclusion by lowering barriers to accessing trade finance. Mobile banking, digital identity systems, and e-KYC procedures enable businesses in remote or underserved areas to access financial services. Fintech platforms offer alternative credit-scoring models based on transaction data, enabling SMEs without formal credit histories to obtain financing. Digital payment systems improve cross-border efficiency and reduce reliance on intermediaries. By expanding financial inclusion, digitization empowers more firms to participate in global markets. This is particularly transformative in Africa and Asia, where mobile banking has risen rapidly, creating opportunities for millions of small enterprises. Inclusive trade frameworks are also essential for poverty alleviation and sustainable integration into global markets (Atoye, Uade, Atoye, & Oke, 2025).

Digital identity systems are essential for streamlining onboarding processes in cross-border finance. E-KYC solutions allow banks to verify clients remotely, reducing documentation burdens and improving compliance efficiency. These systems leverage biometric data, national identity databases, and blockchain technology to ensure secure verification. In developing regions, digital identity initiatives supported by MDBs and governments have improved access to trade-related financial services. They also reduce fraud and enhance trust between institutions. As more trade processes move online, digital identity and e-KYC will become foundational elements of global commerce, further integrating developing countries into international financial networks.

5.4 Case Studies

Afreximbank and PAPSS Case Study

Afreximbank's Pan-African Payment and Settlement System (PAPSS) is a significant innovation aimed at boosting intra-African trade. PAPSS enables real-time, cross-border payments in local currencies, reducing reliance on external settlement currencies such as the US dollar. This decreases transaction costs, shortens settlement times, and improves liquidity for African businesses. PAPSS is particularly valuable for SMEs that face high foreign exchange and banking costs. By integrating African payment systems, the platform supports the objectives of the African Continental Free Trade Area. Afreximbank's leadership in developing PAPSS demonstrates the transformative role of regional financial institutions in trade facilitation.

IFC Global Trade Finance Program Case Study

The IFC's Global Trade Finance Program (GTFP) has had a substantial impact on trade in frontier and high-risk markets. By providing guarantees to international and local banks, the IFC increases their willingness to finance trade transactions that would otherwise be deemed too risky. The program supports thousands of small exporters and importers, enabling trade flows that contribute to economic stability and job creation. It also provides technical assistance to partner banks, supporting their adoption of best practices in trade finance operations. The GTFP highlights how multilateral institutions can use targeted interventions to unlock trade potential in underdeveloped regions.

6. CONCLUSION AND POLICY RECOMMENDATIONS

6.1 Summary of Findings

This paper has demonstrated that financial institutions are indispensable to the functioning and expansion of international trade. Their roles span financing, risk mitigation, infrastructure development, regulatory enforcement, and technological innovation. Commercial banks facilitate payment security, liquidity, and foreign exchange stability. Export Credit Agencies absorb political and commercial risks, enabling firms to enter new markets. Multilateral Development Banks invest in infrastructure and support SME participation. International financial institutions provide macroeconomic and regulatory frameworks that underpin global trade stability. Together, these institutions create the financial architecture that enables secure, efficient, and inclusive cross-border economic activity.

6.2 Challenges

Despite their importance, financial institutions face several challenges in fulfilling their trade-related roles. The global trade finance gap remains significant, particularly in low-income countries where SMEs struggle to access credit. Regulatory fragmentation and complex compliance requirements increase operational costs and reduce banks' willingness to support high-risk markets. Limited digital infrastructure in developing regions constrains the adoption of modern trade finance tools. Additionally, geopolitical tensions, shifting sanctions regimes, and tariff measures create uncertainty and elevate compliance risks. Addressing these systemic challenges is essential for creating a more equitable and resilient global trade environment that benefits all participants (Uade, Atoye, Atoye, & Omoghene, 2025).

6.3 Policy Recommendations

Policymakers and financial institutions should prioritize harmonizing global trade finance standards to reduce redundant regulatory requirements. Expanding SME access to finance is essential and can be achieved through guaranteed schemes, blended finance, and fintech partnerships. Governments and MDBs should invest in digital trade ecosystems, including interoperable platforms for e-KYC, digital identity, and electronic documentation. Strengthening collaboration between banks, ECAs, and MDBs will create more comprehensive financing solutions, particularly in high-risk markets. Enhancing transparency and reducing documentation burdens through digitization can further streamline trade finance processes and promote inclusive participation in global commerce.

6.4 Future Outlook

Emerging trends, including ESG-linked financing, green bonds, and sustainability-focused lending, will shape the future of international trade finance. As global supply chains pursue decarbonization, financial institutions will increasingly integrate environmental criteria into trade financing decisions. Blockchain and artificial intelligence will revolutionize trade documentation, risk scoring, and compliance monitoring, significantly reducing transaction times and fraud risks. Regional financial institutions are expected to play greater roles in facilitating South-South trade and diversifying global trade relationships. Overall, technological advancement and sustainability will define the next era of trade finance, fostering greater efficiency, resilience, and inclusivity.

In conclusion, financial institutions remain foundational to the success of international trade. They provide financial structures, risk management tools, and regulatory frameworks that enable firms to operate confidently across borders. As global supply chains evolve and digital technologies reshape commerce, the role of financial institutions will expand further. Addressing persistent challenges, particularly the trade finance gap, regulatory inefficiencies, and infrastructure constraints, will unlock new opportunities for developing economies and SMEs. With coordinated policy action and continued innovation, financial institutions can help build a more equitable, efficient, and sustainable global trading system.

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