

# Expanding the horizons

*Exporting companies in the US are seeing an increase in business to the emerging markets and alongside this US Ex-Im continues to play an invaluable and leading role. But it has always been the case that much more could be achieved on the US export profile if the commercial banks took a more pro-active and aggressive stance. Steve Garton explores the potential.*



Export finance can be a very low-margin business, and bank strategy is notoriously fickle. In the past, US exporters outside the top tier have seen private sector support come and go, and this cycle will likely continue in the future. But as interest in international trade is once again growing, manufacturers and exporters need financial support, and even the smaller firms have become sophisticated borrowers. Observers have noted a corresponding upturn in bank appetite for export deals, and US businesses should be looking to enjoy the renewed competition while they can.

“We have grown by 15% year-on-year in our export business alone,” says David Verhotz, senior vice president and manager of global trade services at KeyBank. “US manufacturing has picked up and exports to emerging markets are growing.”

As trade volumes increase, banks are keen to be involved. But the insurance market is also reporting strong growth. Coface North America, the private-sector arm of the French export credit agency, provides domestic and export credit insurance across the US and Canada, and expects to record double-digit growth in 2004. Says Michael Ferrante, president and chief executive officer: “There was a marked slowdown in export growth in 2002 and 2003, with less business being done in Latin America following economic crises in Argentina and Venezuela, and some concerns about Brazil. This year we have seen a tremendous improvement in interest, and the low value of the US dollar is encouraging companies to look abroad.”

The world’s largest economy will inevitably share in any growth in global trade volumes. The jurisdictions that are in particular attracting new or renewed interest, however, are concentrated in the fastest growing export

markets. “China and India have been especially hot for a while,” says Verhotz at KeyBank. “In the last six months we have seen a lot of new business into Russia, as well as the Ukraine and Kazakhstan. Turkey and Brazil continue to be strong, stable export markets.”

Private sector banks and insurers are free to cherry-pick deals and jurisdictions with which they are comfortable. On the public side, the Export-Import Bank of the United States (Ex-Im) has a different mandate to fulfil. Says Jeffrey Miller, senior vice president and head of export finance at Ex-Im in Washington: “As a lender of last resort, we have a major share of particular markets where private sector funding is not available, such as markets in sub-Saharan Africa and the former Soviet Union.”

## Product offerings on the increase

Ex-Im offers a variety of export credit facilities to US manufacturers and service providers. The government-owned bank’s short-term products are particularly popular with small and medium-sized businesses across a full range of industries, while long-term structured finance is concentrated in the transportation and energy sectors. Banks are seldom interested in the very small deals, while Ex-Im has provided guarantees on transactions worth as little as \$65,000 and insures smaller deals through the US Small Business Administration.

The bank enjoys working relationships with most US commercial banks, be they regional or international. KeyBank, the 16th largest US bank by asset size, offers Ex-Im guaranteed loans as part of a diverse export finance portfolio and has noticed increased demand for these products.

“We are making a lot of headway in Ex-Im guar- ➤

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► anteed finance for medium-term transactions in the \$250,000 to \$5 million range, as smaller firms become more comfortable with export finance,” says Verhotz at KeyBank. As comfort levels rise, these corporates become more sophisticated and are also looking for value from other financing tools.

The purchase of receivables has been identified by a number of banks as an area of great potential. Says Craig Tashjian, head of commodities and trade finance, North and Central America at Société Générale (SG): “Certainly, the North American commodity and trade finance market has evolved away from traditional letter of credit services for international commercial transactions. As a result, SG has increased its resources dedicated to the discounting of receivables, typically involving commodity tradeflows where suppliers and buyers are known to the bank.”

Supply chain and working capital management is an ever-increasing concern for corporate exporters, and this area presents a number of opportunities. UPS Capital, the financial services subsidiary of United Parcel Service (UPS), recently arranged a five-year term loan for a major Mexican company to finance the purchase of US manufacturing equipment. The company was looking to expand its manufacturing capacity, while at the same time it was faced with rising inventory levels, tying up working capital in warehoused goods. Through its supply chain solutions and staff on the ground in Mexico, UPS was able to streamline the company’s warehousing and distribution services, as well as providing a \$750,000 loan guaranteed by the US Ex-Im Bank. “This recent deal is indicative of companies looking for solutions, rather than a particular product,” says Jim Fortsch, senior vice president and head of ECA financing at UPS Capital in Hartford, Connecticut. “We were delighted to be able to help the company improve its efficiency and streamline its product solutions in this way.”

Working capital loans are very often the financial tool of choice for US exporters, and these facilities can be made more efficient once combined with other finance or insurance tools. Marcia Davis, senior vice president, specialized trade finance at Bank of America in New York, tips this as an area of interest: “Privately insured accounts receivable financing would seem a likely candidate for growth, along with bankers acceptance financing arising out of LC transactions.”

Explains David Verhotz at KeyBank: “Bankers acceptance financing is a form of working capital lending with a different price base. It can be cheaper than a plain working capital line, but on the export side this still needs to be backed with a letter of credit.”

### Old product, new label

The most sophisticated are in fact keen to avoid using up credit lines altogether. One interesting development on the import side concerns the largest and most creditworthy US corporates, who have recently begun to issue letters of credit under their own name, and interest in this tool looks set to grow. Under this arrangement the conventional substitution of credit does not occur: the corporate takes the place of the financial institution as issuer.

The bank still plays its traditional role in creating the LC and examining documents, but does not have to put its contingent guarantee of payment in place. This reduces the use of the buyer’s credit facilities and the bank’s use of capital. It still provides the buyer with the ability to control quality and timing of shipment and, in many cases, gives the seller an instrument that their bank is willing to finance. But is the private label letter of credit (PLLC) an option for smaller companies?

“There is a lot of interest from creditworthy corporates,” says Verhotz. “The vendor takes the decision as to whether the importer’s credit is acceptable and the brand trustworthy. So far this method has been limited to the largest companies, but there is no reason why it cannot be extended to smaller corporates if vendors are comfortable.”

Says Daniel Scanlan, international trade and treasury product management head at Bank of America: “It appears that the success of this instrument is directly tied to the brand recognition of the issuer and to some extent the credit standing as well. In some case, for example, smaller companies with wide brand recognition may be able to shift to the PLLC but those companies that do not have that brand recognition may have difficulty with the acceptance of an LC issued in their name. Our sense is therefore that this product will not work for all but rather for those companies who have the market clout, brand recognition and sufficient financial strength.”

Wachovia has also identified the use of this product as a potential opportunity, and the bank has the technology in place to process such transactions. Says Mike Schmittlein, managing director in Wachovia’s international division’s global trade services group: “It is a point of negotiation between the buyer and seller. The absolute size of the importer (or buying company) is not the operative factor in the ability to successfully use this kind of programme. Rather it is the credit standing of the buyer (since they are the obligor) and the relationship they have with their vendors that determines the implementation success.”

While banks are happy to work with companies in this way, the private label product will not be suitable for all. Says Cheryl Sill, global trade and treasury sales executive at Bank of America: “There is no reason why this option cannot be extended to other smaller US importers as long as the beneficiary is comfortable with the credit of the importer. However, the set-up is more involved and I would advise any company interested to talk to their bank about the pros and cons of this approach.”

### The rise of the small business

Large corporates might have better access to particular financing tools than their middle market counterparts, but there is good news for US small- and medium-sized enterprises (SMEs). Financiers have noticed room to develop this market as companies become more comfortable with export financing tools. More and more banks are looking to get involved, and this increased competition will only benefit exporters in terms of pricing.

“The large corporates insist on dealing with their►



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► relationship banks. In the middle market exporters are becoming more focused on working capital and cash management, while less banks are actively involved,” says Verhotz.

Marcia Davis, senior vice president, specialized trade finance at Bank of America in New York, agrees that take up of these products from SMEs is growing: “The needs and demands of the SME exporter are looking more like those of the top tier exporters. We are seeing more active use of export credit insurance and increased demand for value on export receivables in support of cash and liquidity management.”

UPS Capital is focused on supporting trade to and from the US and has a strong presence in emerging markets through its export credit agency activities. The company is particularly active in the small- to medium-sized enterprises (SME) sector, typically dealing with transactions from \$150,000 to \$10 million. “More than 95% of US exporters are SMEs,” says Fortsch. “Many of them do not have the financial resources, flexibility or the back-office expertise to support export transactions, so there is a need and an opportunity to support this marketplace.”

Private credit insurers may insist on minimum policy requirements, which exclude some exporters with small annual turnovers. However, insurers are also interested in the middle market and are marketing credit insurance as an alternative to expensive letter of credit facilities. Says Ferrante at Coface: “The take-up of credit insurance among US exporters has been very good. Now that middle market companies are more tuned to the world marketplace we are seeing a good reception and room for growth in this area.”

Smaller exporters are important users of short-term letter of credit facilities. Says Davies at BofA: “US SME exporters typically offer shorter terms to buyers than the financial market would normally allow, due primarily to the financing market’s more limited interest in low dollar, low yielding transactions. While a \$5 million equipment sale would be considered an attractive deal to finance for five years under ECA support, a \$500,000 sale would be less attractive to structure as an amortizing five-year loan. Therefore, SME exporters tend to offer 180-day LC terms for such transactions.”

In the middle market, however, the commercial US banks have sensed an opportunity, and US Ex-Im reports several recent approaches from even the largest trade banks. “The US financial institutions have always been involved in the large deals,” says Jeffrey Miller at Ex-Im Bank. “We do a lot of business with the regional banks but recently we have been talking to four large banks who are looking to get involved in mid-sized deals. This is very exciting and we believe that it can only help everyone involved with trade into, and out of, the US.”

### Political pressures

The US is well-known around the world for its obsession with domestic industry. Outsourcing of manufacturing jobs to low-cost countries is a regular source of political debate (and a growing contributor to the country’s trade deficit), and the World Trade Organization has attacked anti-competitive trade policies on



Jeffrey Miller at US Ex-Im in Washington DC

more than one occasion. Since the events of September 11 the country has been faced with the challenge of increasing border security without disturbing the free flow of goods and services.

“The marketplace is certainly more aware of the need to comply with trading procedures and country regulations,” says Fortsch at UPS Capital. “Focus on international logistics and customs procedures is an important part of any financial package, particularly for SMEs and those new to export.”

Homeland security aside, politics play an important role in US trade. Ex-Im is mandated by Congress to develop particular industries and jurisdictions and, while it will not break its own lending rules and criteria, the bank is putting a particular emphasis on fulfilling this political agenda. Says Jeffrey Miller: “Congress has asked Ex-Im Bank to focus on the environment, US small business exports, and exports to sub-Saharan Africa, and we are putting a great emphasis on accomplishing that, including municipal projects to develop environmental infrastructure.”

The US trade deficit is being watched keenly by financiers. Figures released for June 2004 show the monthly balance of payment deficit reached \$55.8 billion, as the surge in oil prices inflated imports to \$148.6 billion. Says Ferrante at Coface North America: “The growing deficit is obviously a cause for concern, but the low dollar value makes US goods increasingly competitive abroad and leaves a lot of room for potential growth.”

In its current state – and this shows no sign of changing in the near future – the weak currency will favour US goods over European products. This will particularly assist US companies exporting to new buyers in emerging markets, where dollar rates will compare well against the euro equivalent. Add to this the sheer volume of goods and services exported each year – at last count not far off \$700 billion – and it is not hard to see why trade banks are looking to get more involved. ■