# CAN EXPORT CREDIT AGENCIES FACILITATE CROSS BORDER TRADE TO EMERGING MARKETS AND HELP INCREASE INVESTMENTS AND INNOVATIONS IN THEIR FOOD PROCESSING INDUSTRIES?

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## Introduction

Companies that engage in cross border trade and/or investments to emerging market economies are faced with commercial risks and political/non-commercial risks. Political risks are typically higher in emerging markets than in developed high income countries. The World Bank´s Multilateral Investment Guarantee Agency (MIGA) published a report a few years ago titled World Investment and Political Risk (MIGA, 2009). This report includes an extensive literature review on foreign direct investment and political risks. The study found that while a degree of ambiguity exists when it comes to the relationship between political risk variables and foreign direct investment (FDI) based on econometric studies, findings based on surveys unequivocally support the view that companies do take into account political risk in their investment decisions (MIGA, 2009), for further discussion about the importance of political risk see also EIU (2007) and Loyd´s (2007).

In spite of the higher level of risks in emerging markets than in high income economies, companies continue tapping into these markets because of potentially high profit margins, however managing the risks is important. In order to mitigate against political and commercial risks, the use of risk mitigation instruments has become more important for companies exporting to and doing business in emerging markets. These instruments are provided mostly by national export credit agencies (ECAs), multilateral financial institutions and private insurers. Most ECAs and multilaterals are members of the Berne Union (International Union of Credit and Investment Insurers). The Berne Union (BU) was founded in 1934 in order to promote international acceptance of sound principles in export credit and investment insurance and to exchange information relating to these activities. Today, the BU has 73 members (including Prague Club members) comprising mainly export credit agencies (ECAs), multilaterals and private insurers. The BU plays an important role in bringing together the public and private insurers to enhance cooperation and information sharing. Members meet on a regular basis to discuss industry trends and challenges" (MIGA, 2009).

The demand for the services of ECAs to support trade finance increase rapidly during the economic and financial crisis that started in the fall 2008. For example, according to EKN, the Swedish Export Credit Agency, the volume of guarantees this agency issued increased from more than SEK 20 billion in 2007 to more than SEK 115 billion in 2010 (EKN, 2010). This amount is equivalent to USD 3 billion in 2007 to USD 17 billion in 2010. This evidence illustrates that risk mitigation instruments are in high demand in a country like Sweden and the same applies to many other developed countries.

The following article discusses risk mitigation instruments offered by ECAs and

at the same time discusses the preliminary findings from a research conducted by the authors in co-operation with a large Icelandic company, Marel, who is engaged in manufacturing food processing equipment. Marel has production facilities in several countries. Another case from Ukraine, provided from EKF, is also briefly discussed. The objective of this research is to answer the research question: Can export credit agencies facilitate cross border trade to emerging markets and help increase investments and innovations in their food processing industries?



**Some definitions**

There are many definitions of political risk. MIGA defines political risk as "the probability of disruption of the operations of MNEs by political forces or events, whether they occur in host countries, home country, or result from changes in the international environment. In host countries, political risk is largely determined by uncertainty over the actions of governments and political institutions, but also of minority groups, such as separatist movements. In home countries, political risk may stem from political actions directly aimed at investment destinations, such as sanctions, or from policies that restrict outward investment" (MIGA, 2009, p. 28). When discussing the reasons why a country needs to set up an ECA, Stephens states that "political risks are those relating to the actions of governments in importing countries to prevent payment being made to the foreign exporter, for instance problems with transferring foreign currency. Default by government or public sector buyers or guarantors in another example, as is civil war" (Stephens, 1996).

Beside political risk, commercial risk is also a concern of companies worldwide when they expand their business to emerging markets. The commercial risk is defined by the OECD (in the context of export credits) as "the risk of nonpayment by a non-sovereign or private sector buyer or borrower in his or her domestic currency arising from default, insolvency, and/or a failure to take up goods that have been shipped according to the supply contract" (OECD, 2003). Stephens has a quite similar definition on commercial risk "the principal commercial risks are insolvency of the buyer, default on payment by the buyer and repudiation of or refusal to accept the goods or services ordered" (Stephens, 1996). Commercial risk can be high in emerging markets where the financial system is still immature as compared to developed countries. The lack of financial information and the quality of information in these markets partly constitutes the threats of commercial risk. Credit rating agencies and the exporters themselves cannot always assess credit worthiness comprehensively and sufficiently based on the limited financial information of their buyers. As Nerouppos et. al. (2006) emphasized in a study the lack of data in emerging markets can lead to tremendous difficulties for risk management. "Another problem, equally important from a risk management point of view, is that there is a startling scarcity of available data. Often, the institutional mechanisms that lead to the plethora of data in advanced markets do not exist (e.g. derivatives exchanges, secondary markets, and even regular auctions of a standard set of government bonds). Furthermore, those data that are available are contaminated for many reasons. Since many emerging markets have gone through some period of crisis, the history of local financial variables is of questionable value in calibrating mathematical models for assessing future risks. Any current price data that are available must be viewed in light of the volumes and liquidity of local markets. All of these factors lead to tremendous difficulties for risk management (Nerouppos et. al., 2006, p. 180-181)..

**Risks mitigation instruments and ECAs**

When private companies engage in cross border trade and/or investment in emerging markets, the risks they face is a key concern. In order to meet this existing demand the political and commercial risk insurance industry has been formed. The leading association in this industry is the Berne Union (founded 1934) with 73 members including mainly ECAs, multilateral institutions, and private insurers (MIGA, 2010). ECAs are either public-sector institutions in their respective countries, established to provide support for the exports of that country, or private-sector companies that act as a channel for government support for exports from the country concerned (Yescombe, 2002).



In general, ECAs charge premium to the companies that use their products. The "OECD country ratings are designed to set guidelines to price the default risk on export credit and to set minimum premium rates charged by participating ECAs" (MIGA, 2010, p. 63). The ratings known as Knaepen Package came into effect in 1999, is a system for assessing country credit risk and classifying countries into eight risk categories, from 0 to 7 (OECD, n.d). Basically, ECAs will assess political risk and commercial risk when they issue guarantees to exporters or foreign buyers. ECAs use country ratings by OECD as platform to assess political risk or country risk while commercial risk is assessed based on each individual corporate´s information such as operation and background information, financial and audited annual reports, project feasibility studies, etc. Companies who are eligible to use products or services provided by an ECA must have operations relevant to national interest of the country where the ECA is located.

There are various products or risk mitigation instruments offered by ECAs and the products can be the same or very similar from one ECA to another. Products of ECAs include, for example: Bond Guarantee, Investment Guarantee, Project Financing Guarantee, Financing Guarantee, Project Delivery Guarantee, Working Capital Guarantee or Reinsurance.

The products that this paper focuses on and analyzes are: (i) Buyer Credit Guarantee, (ii) Supplier Credit Guarantees and (iii) Export Loans. Each individual ECA may have different names for similar products. The authors chose the three products for analysis based on their research of a large European company, Marel Food Systems, in connection to its business expansion in Vietnam. These products seem to be the most suitable in terms of risk mitigation when companies export goods or services to their buyers in emerging markets. However, companies need to find what product suits them best on a case by case basis.

A Buyer Credit Guarantee is basically a guarantee issued by an ECA to a bank that lends to a foreign importer to pay for an order of goods or services from an exporter in the country where this ECA is located (see figure 1). In emerging economic countries, both local and international banks are cautious when they decide to lend capital to companies. A research among the largest fisheries processors (ranked by Vietnam Association of Seafood Exporters and Producers (VASEP) in Vietnam conducted by the authors in November 2011 found that when companies applied for medium long term loans (up to 5 years) to invest in their processing equipment they usually only got 50 to 55 percent of the amount requested. If a company has good working experience and good relations with a local bank and the feasibility study of their project is highly as-

sessed, the amount of loan could be increased to 70 percent out the total loan requested. The companies had to use their own fund to for the rest of the investment. Some processors said that they could hardly obtain any medium or long term loan if the size of loan is up to few millions of US dollars. This has been one of the companies´ main constraints and it prevents companies from investing in more comprehensive capital intensive processing lines.



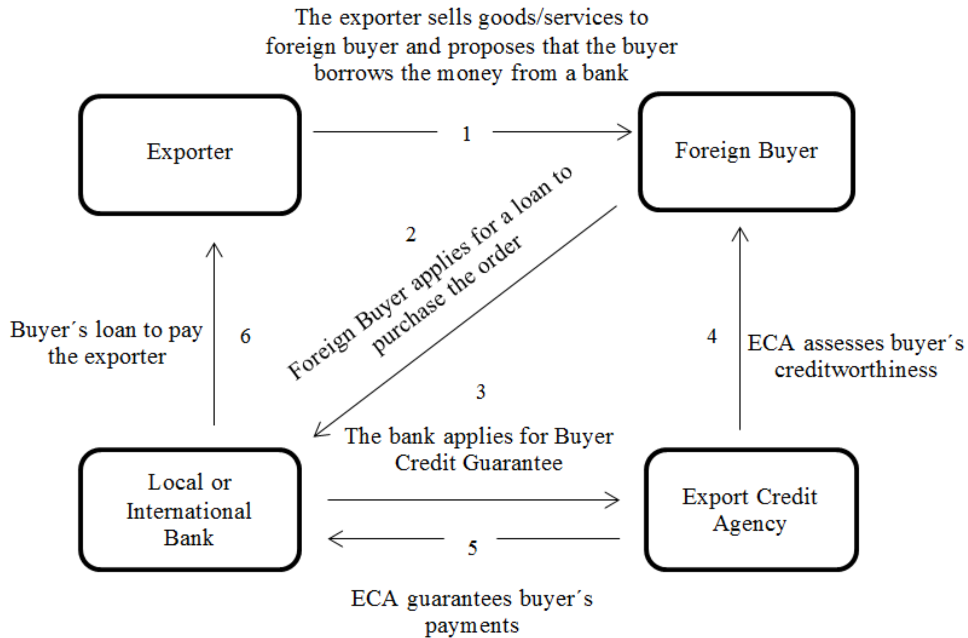


**Figure 1. Model of Buyer Credit Guarantee of Danish ECA – EKF**

A Buyer Credit Guarantee can help foreign buyers in emerging markets to obtain larger loans from international banks and with longer lending term. This can also be done through a local bank but it would normally take more time as the ECA is more likely to know the international banks. The bank will then be covered from buyer´s default in repayment due to commercial and non-commercial risks.

A Supplier Credit Guarantee is a guarantee issued by an ECA to the supplier or the exporter and this exporter can grant the foreign buyer extended credit on amounts payable for the order. The supplier or the exporter will be protected against the risk of not being paid by the buyer or the importer due to political or commercial risks.

The exporter can take advantage of supplier credit guarantee to lend the foreign buyers in an emerging market where an extended credit period may be a key incentive for the buyers to select the most competitive supplier over the others. Supplier Credit Guarantee helps the buyer or the importer repay the order in a longer period (see figure 2). This can be very advantageous for a buyer who may have limited cash flow and has difficulty in accessing to funds. In a prior research conducted by the authors among 20 largest Vietnamese fisheries processors in August 2011, a set of questionnaire was sent out. All of those who answered indicated that they have to pay the supplier within 3 to 6 months after the equipment has been fully installed and checked. This short term

repayment period for the equipment from the supplier is one of their main constraints especially for companies who lack working capital and have difficulty in obtaining loans. The research conducted by the authors in November 2011 found that these companies have not been offered an extended credit period from any supplier. They have to apply for loans from local banks with high interest rates. Most loans lent to them are both short term loans (less than 12 months) and the amount allocated is far lower than the amount they requested. This constraint is one of the reasons why Vietnamese fisheries processors could not purchase sophisticated processing equipment from European manufacturers on a large scale.



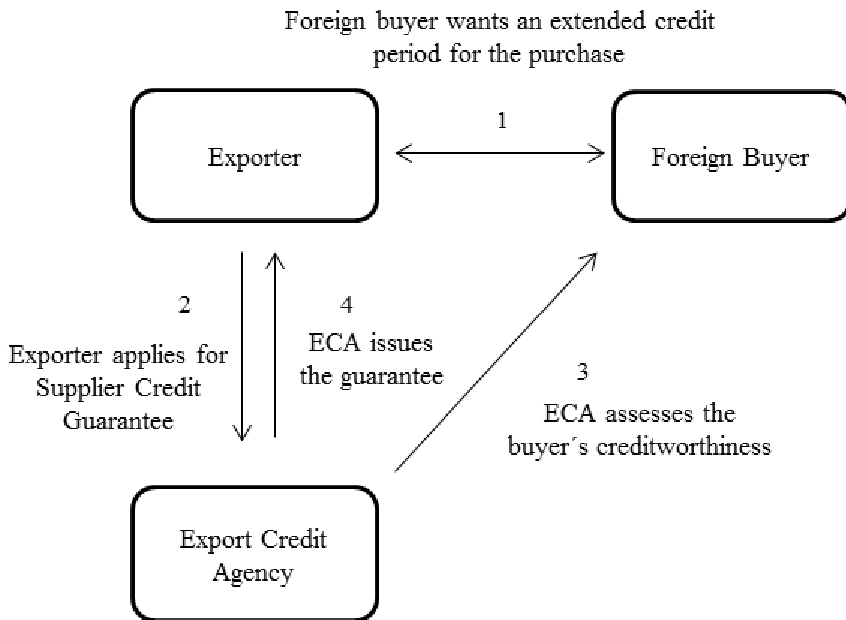


**Figure 2. Model of Supplier Credit Guarantee of Danish ECA – EKF**

They only bought a small part of the equipment needed from these manufactures and the rest of processing lines were locally made or imported from more affordable Asian manufacturers. This suggests that if buyers from an emerging market like Vietnam are offered an extended credit period, it may affect their investment decision which means that they would perhaps invest more sophisticated processing equipment on a larger scale. Some of the processors in Vietnam have indicated that if they were granted a longer repayment period from the supplier and at reasonable cost they would consider to invest and modernize their processing lines more comprehensively. See figure 2 for the description of how Supplier Credit Guarantee works.

An Export Loan is a lending scheme to help the exporter´s foreign buyer when this buyer is unable to secure credit facilities from banks for purchasing products and services from the exporter (see figure 3). In the case of EKF, the Danish Export Credit Agency, they facilitate the export loan through a bank, and the loan is based on the bank´s lending terms. It depends on each individual ECA whether or not they offer the export loan product and how long the lending term will be. But this product is very

important in the situation of financial crisis where banks are unable to provide loans to companies. The EKF offers export loans as a result of the crisis and application for export loan of EKF can be made until end of 2015. In the same research by the authors in November 2011, the Vietnamese pangasius processors shared the view that local banks can only lend them an amount not exceeding 20 percent of those banks´ totals lending capital. This reflects the limits in lending capacity of banks in Vietnam when large transactions are requested and limits the opportunities for processors in Vietnamese enterprises, if they wish to invest in intensive processing solutions. Besides that, each company may enjoy different interest rates depending on how good their relationship is with the local lending bank.



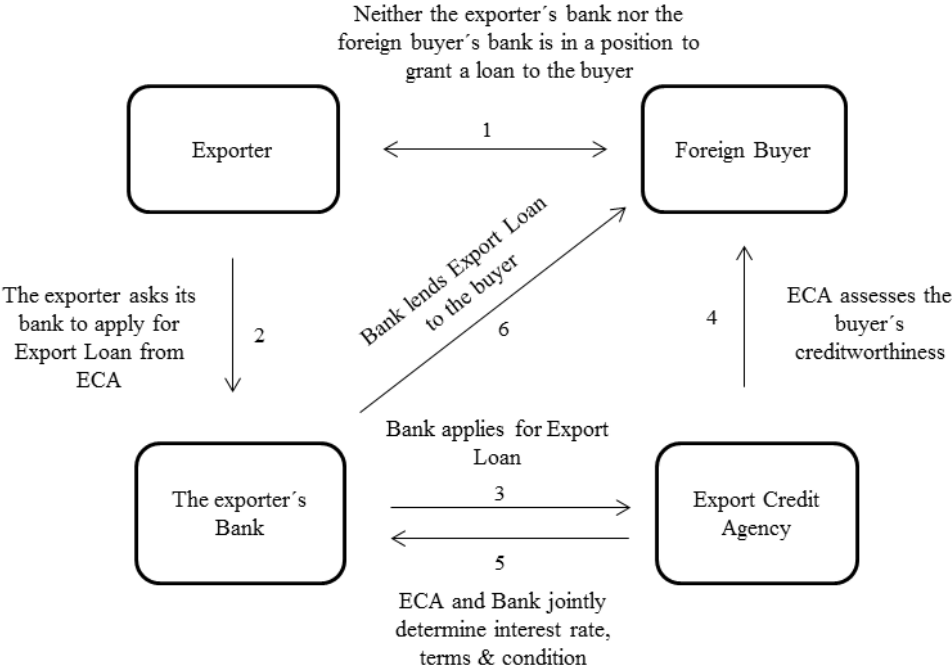


**Figure 3. Model of Export Loan of Danish ECA – EKF**

However, the associated cost and premium for this Export Loan scheme is not necessarily cheaper than other traditional lending schemes because the export loan is granted jointly by a bank (usually the exporter´s bank) and an ECA to the foreign buyer on commercial basis and market conditions. Export loan can be even more expensive but it also can be critically important in international trade especially under financial crisis time where many of banks are unable to provide funds to companies.

**Two brief cases**

*1.Grain and seed exporter Nibulon Company in Ukraine used EKF´s Buyer Credit Guarantee to secure a loan at a far lower interest rate than in Ukraine*

**Figure 4. Nibulon Company in Ukraine**

The challenge: In 2009, a Danish company, Cimbria Unigrain, received the first of two large orders worth EUR 20 million from Nibulon, Ukraine's largest grain and seed exporter and a high-growth company. This order consisted of eight silo facilities for storing, drying and loading grain and seed. And Nibulon uses this equipment to extend and standardize its storage and transportation facilities by the rivers of Ukraine and the Black Sea. However, the Ukrainian buyer´s constraint was that they had to borrow at a high interest rate in Ukraine to pay Cimbria Unigrain. And this might create uncertainty regarding the order from the Danish manufacturer.

The process: Cimbria contacted EKF and EKF agreed to assess the viability of the export order and work on the financing options via a guarantee from EKF. ”Even allowing for the premium payable to EKF, Nibulon is making a big saving," says Sales Director Henning Roslev Bukh. He adds that Nibulon regards Cimbria Unigrain and EKF as important and regular business partners.

The solution: Finally EKF offered buyer credit guarantee to Nibulon. This meant that Nibulon was able to secure a loan at a far lower interest rate than in Ukraine. ”Nibulon is very pleased that it was possible to arrange a Danish guarantee for this order. We might well have got the order anyway, as Nibulon has ordered from us for many years and is very satisfied with our products. Nibulon could perhaps have financed the purchase with equity, but it is often cheaper to borrow the money than to use equity, and equity is greatly needed in a growth-oriented company such as Nibulon," says Henning Roslev Bukh. And in 2010, Nibulon made another order for eight silo facilities – and once again, EKF provided a guarantee for the buyer's payments. Thanks to this order Cimbria Unigrain hired 30 employees in 2010 (EKF, 2009).

*2. Marel Food Systems and the possibility of the use of ECAs products in the Vietnam market*



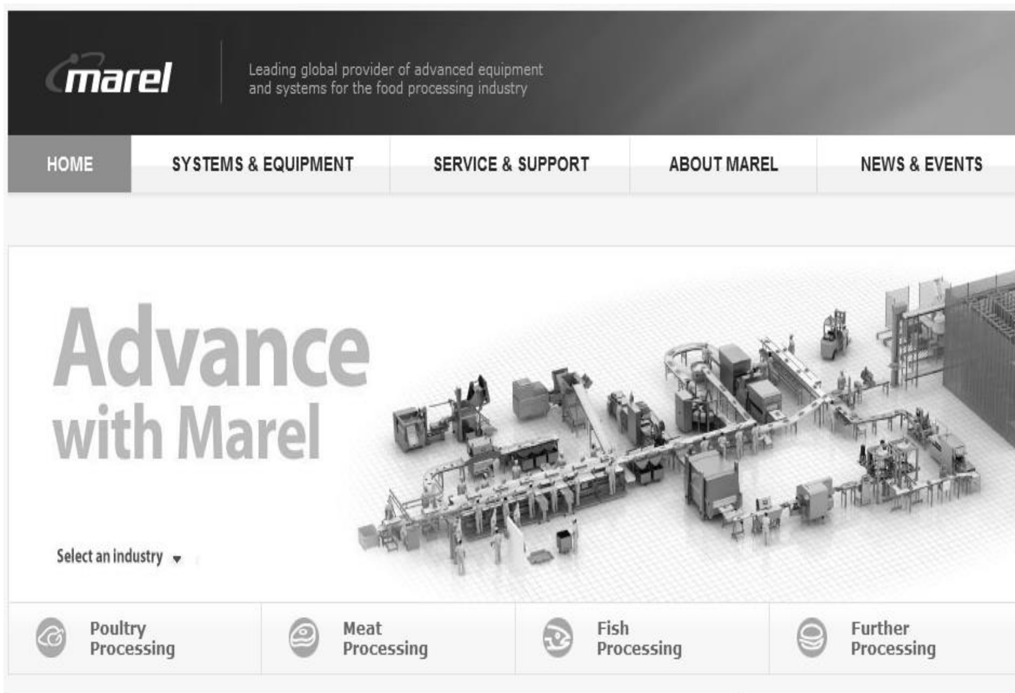


**Figure 5. Marel Food Systems**

Marel Food Systems is one of the leading manufactures in food processing equipment in the world. Marel was originally established in Iceland but has production facilities for processing lines in fish, poultry, and meat in numbers of European countries, as well as in America and Asia. Marel is ambitious to expand their business in emerging markets where food processing industry is becoming more important like, for example, in China, Thailand and Vietnam. However, the purchasing volume of buyers from those markets remains low especially in Vietnam. The research in cooperation with Marel, mentioned earlier, among largest pangasius processors in Vietnam, found that Vietnamese buyers bought some limited number of equipment rather than comprehensive processing lines. During in-depth interviews with four of the largest Vietnamese processors, the authors were told that most of equipment made by European manufacturers is sophisticated and advanced, however, this equipment is too expensive for them to purchase on a large scale. Instead, they needed to select some equipment which is most important for them. The remaining equipment they bought from more affordable manufacturers from China, Korea or Japan and some other equipment is locally made. When asked, these processors said they were aware of the fact that having advanced equipment in their processing lines would enable them to export more of their products to high income markets like USA, Europe and Japan.

A critical issues rest with funding which in many cases prevents processors from investing in capital intensive processing solutions. The issues here include low amount of loan allocation from local banks, limited availability and accessibility to long term loans especially in foreign currency like USD, high interest rate, short repayment peri-

od to the equipment suppliers etc.

The authors interviewed some ECAs in Europe like EKF (Denmark), EKN (Sweden) and ECICS (Singapore); in response to the question what products offered by ECAs they thought are most suitable for Marel and its buyers in Vietnam given the constraints mentioned above, these ECAs thought that two products should be suitable which are Buyer Credit Guarantee and Supplier Credit Guarantee. The recommended products of ECAs could help Marel achive its goal which is to expand its business in Vietnam. However, the ECAs also said that in order to be supported by ECAs´ instruments the Vietnamese buyers need to fulfill the requirement in terms of being able to provide sufficient and transparent information of their companies, especially financial information, including audited annual reports. The readiness and well done "homework" of Vietnamese buyers will help the process of ECAs in assessing their creditworthiness and making decision on their guarantee request quicker. Most of the Vietnamese fisheries processors now are working with local banks both state owned and privately, however, ECAs indicated that if foreign buyers work with international banks it will normally make the process faster because ECAs tend have more working experience with large international banks than domestic banks in a specific country.



**Conclusion**

When companies engage in cross border trade and/or investment they are likely to face higher risks than when doing business in domestic markets. These risks can be both political and commercial risks and the level of risk is also different in different markets.

In the context of emerging markets, and due to the current uncertainty in world financial markets, these risks have moved towards to the top corporate agendas.

Risks related to cross border trade can and should be managed. In order to cover the existing demand and to promote home country export, ECAs have been established in many counties, including most OECD countries. Those agencies provide various risks mitigation instruments three of which are discussed in this article.

Through the research done by the authors and the brief cases described in this article, we can see that there are real possibilities for companies to have risks mitigated if they tap into emerging markets.

For the purchaser in emerging markets the use of ECAs risk mitigation instruments can result in larger loan allocation, longer term lending and lower interest rates. For companies receiving income in foreign exchange in can be feasible to borrow wholly or partially in foreign currencies, if real rates are high and subject to large fluctuations domestically, as often in the case in emerging market economies.

Among the key issues to obtain ECA guarantees is the ability of ECAs to assess the creditworthiness of companies involved, especially the foreign buyers. In response to this issue, foreign buyers should provide full and transparent financial information to help the process move faster, including audited annual reports.

ECAs usually prefer working with international banks that they know and had a business relationship with them. Thus it would be advantage of foreign buyers to seek loans from international commercial banks. This could reduce the processing times for ECA guarantees. Cooperation with International Financial Institutions could also be feasible.

The products offered by ECAs show that the risks associated with political and

commercial risks in emerging markets can be managed, and the cases discussed in this paper are tangible evidence or their applicability, as well as an example of a recent success during a global economic and financial crisis.



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**Abstract**

Export Credit Agencies (ECAs) played an important role in cushioning the downturn in cross border trade to emerging market economies during the economic and financial crisis that started in the fall 2008. In addition to facilitating trade during times of crisis, ECAs can also help companies in emerging countries access long term funding and at lower interest rate than they could access locally. This can also help companies modernize their processing lines, especially those engaged in capital intensive activities, and enable economies in transition increase the value added of their industries. This article discusses the role of ECAs in facilitating cross border trade to emerging markets as well as the economic rationale for the existence of such agencies. It also demonstrates how selected risk mitigation instruments of ECAs, namely: (i) buyer credit guarantee, (ii) supplier credit guarantees and (iii) export loans have been applied in practice to facilitate investment and innovations in the food sector. Finally cases are presented that highlight how companies have used the service of ECAs, for example, to obtain better terms, including longer term loans and/or lower interest rates.

**Keywords:** cross border trade, emerging markets, financial crisis, export credit agencies (ECAs), commercial and non-commercial risks, risk mitigation instruments