Opening the right doors

THE UK ECONOMY DESPERATELY NEEDS MORE BUSINESSES TO EXPORT, BUT THEY WILL ONLY DO THAT IF THEY CAN GET THEIR TRADE FINANCE IN ORDER. **PETER WILLIAMS** REPORTS FROM THE RECENT ACT CONFERENCE IN MANCHESTER ON THE ISSUES.

Introducing the conference, Peter Matza, head of publishing at the ACT, suggested that while the business world could be seen as bumping along in neutral, exporting offers an opportunity to get back into gear. This government seems to be keen on encouraging exports. Look back at history and it is clear that in many ways Britain is a country that was built on trade and exports. We needed to return to that culture, Matza told the conference. But exhortation alone will not be enough: in the end it is companies that must proactively drive exports, although there are many agencies and advisers willing to help businesses achieve their export goals.

The conference – which was sponsored by Lloyds Bank Corporate Markets – heard first from one of those advisers: Martin Cook, director, business group, UK Trade & Investment (UKTI). He pointed out that in many ways the UK is a remarkably successful exporter, selling tea to China, cheese to France, chocolates to Belgium and naan bread to India. But while Cook cited these real-life examples of how British companies are exporting, he pointed out that more companies needed to do more. With personal and government spending squeezed, the only realistic way to deliver that elusive business growth is by exporting more.

Unfortunately, not enough businesses look to export markets as a realistic way to increase sales and profits. According to figures collected by UKTI, exporting is a game played only by a minority of companies. The number of UK exporters is somewhere between 200,000 and 300,000, a tiny proportion of the total number of businesses in the country, even if the one-man bands are excluded.

Yet research shows that exporting is good for companies, making them more productive and efficient. And the conditions for export

drives appear good: Cook pointed out that sterling had decreased in value by around 20% since February 2007 and had remained relatively stable for the past three years. However, with the UK economy so subdued that has not translated into an export-led recovery despite the fact that some parts of the global economy, notably the emerging nations, are still growing strongly.

Even those companies that have managed to overcome the first hurdle and do some exporting could do more. According to UKTI figures, over half of those companies that have been exporting for at least a decade export to no more than five countries.

Case study: Export strategy at INEOS ChlorVinyls

Paul Nichols, group treasurer of INEOS ChlorVinyls – which makes and sells chemicals across the world – sees a difference between selling to mainland Europe and selling further overseas. A key driver of a bulk chemical company is to shift as much of the products that the plant can produce. A typical sale to mainland Europe differs little from a sale to a UK customer, with a low value and straightforward cross-border payments.

But sales to more distant "deep sea markets" present a different set of challenges. Delivery is often by sea via a shipping company, which poses particular challenges and risks. The value of the order could be up to €2m, meaning more documentation, more credit and more FX risk. Where possible in these markets the company will use a local agent or distributor to sell to the end customer; that way there is only one customer, one credit limit and one payment process.

In deep sea markets there is always a choice of payment. They include open payment, payment in advance, a standby letter of credit (LoC) from the buyer's bank in favour of the seller, documentary collections, an irrevocable letter of credit (ILOC), and a confirmed irrevocable letter of credit. Choosing the right payment method is not straightforward as all have pros and cons and offer different advantages to the buyer or the seller.

It is also important to understand the risk with each method. Getting the paperwork right is absolutely vital. For instance, the LoC has to match up exactly with the bill of lading, otherwise the bank may refuse to accept the LoC. Often the exporter is not fully in control. For instance, with ILOC the customer chooses a bank in its territory as the issuing bank, and that bank chooses the advising bank in the UK; the exporter does not choose either although it can recommend, and if it has had a bad experience with one particular institution it can refuse future LoCs from that bank. An eye for detail is essential to stop the export turning sour.

UKTI's role is to help companies develop their export strategy. It employs people both here in the UK and in markets that account for 90% of the world's GDP. With 80% of UKTI's staff coming from the private sector, the government department knows how the commercial world works. It helps exporters connect into local networks, carries out research into markets and products, and assists existing exporters in penetrating high-growth markets.

TRADE FINANCE STRATEGY For companies that do take the plunge and export, sorting out the right trade finance will be a key determinant of success. Susan Ross, chairman of the British Exporters Association (BExA), advised the conference to bear in mind that trade finance was money management and a sales tool. It represents a vital way to smooth irregular flows of cash and convert receivables into cash. When looking at financing, she said, exporters probably needed to buy goods off every part of the trade finance shelf. The four elements she identified as key were non-bank, government support, portfolio finance and single contract.

Non-bank finance is familiar to treasurers: an equity injection or an improvement to working capital by securing longer-term payment deals from creditors or collecting from customers quicker. Ross split bank finance into two broad categories: portfolio finance, which includes factoring, invoice finance and discounting; and single contract finance, such as a letter of credit, forfeiting, leasing and supply chain finance.

Whichever option is right for the exporter, Ross warned that it was imperative to bear in mind one question: who takes the risk of non-payment? A treasurer has to be completely clear on the answer to that question.

Bank finance can be used in conjunction with government support (see below). The latter is particularly important as government finance provides stability and enables a company to leverage its borrowing lines. Both of these can turn out to be vital advantages in the uncertain world of exporting.

If non-payment is a heightened risk for exporters, then so, obviously, is currency exchange. Jeremy Adam, director, client derivative structuring, Lloyds Bank Corporate Markets, addressed the conference on currency risk implications for international trade and export.

For any exporter the foreign exchange risk will be a major part of the treasurer's life. FX risk is unavoidable for many exporters. Adam said that there was no quick win. He looked at the changes in FX risk management following the financial crisis and argued that there were three approaches:

- conventional hedging techniques using forwards and derivatives;
- recognising FX risk as an asset class; and
- looking out for Black Swan and/or illiquid risk management events.

For most exporters hedging techniques are the ones that need to be examined with most care. In this post-financial crisis world Adam suggested that risk management should complement and support the balance sheet and liquidity, and reflect the business objectives as well as the underlying market factors.

EXPORT GUARANTEES Nigel Addison Smith, finance director of the Export Credits Guarantee Department (ECGD), said his organisation aimed to provide a service and wanted to introduce new ones where there was genuine demand. But it needed to see hard evidence for this, not just rhetoric or lobbying.

ECGD had almost been shut down in 2004 when bank credit was so easy to obtain its products were not being used. Now it has £19bn exposure with £1bn of capital utilised and it is writing just under £3bn of new business this year. Deals range remarkably: ECGD has recently supported one deal worth £12,000 – where its premium will amount to tens of pounds – but it has also seen a deal worth £2.3bn.

One of ECGD's main trade finance products is the buyer credit guarantee, where the ECGD provides a guarantee to a bank that makes a loan to an overseas buyer to finance the purchase of capital goods and/or services from a UK exporter. The typical deal will be more than £5m and ECGD backs deals in sterling, dollars and euros as well as some local currencies.

ECGD can also support a line of credit to give exporters a quick way to access bank finance so an overseas customer can purchase UK exports. These lines of credit are for an individual overseas buyer or many overseas buyers, if a bank is a borrower. While ECGD wants to support exports, Addison Smith reminded the conference that it also had a duty to protect the taxpayer. The renewed need for ECGD services has sent its new business soaring from £1.8bn in 2006/07 to £2.9bn in 2010/11.

USE IT OR LOSE IT ClydeUnion Pumps led a pilot for an ECGD bonding support scheme and provided the conference with a tangible example of how to use ECGD services. The Glasgow-based manufacturer of centrifugal and reciprocating pumps had been lobbying for UK bonding support with the backing of BExA. Mairi Pattison, treasury manager of ClydeUnion, said the breakthrough came when the company went on a trade mission to China led by the prime minister, David Cameron. It won an order on that trip which needed bond support.

The ECGD scheme was announced in February 2011. ClydeUnion completed its application and issued the first bonds under the scheme in early June and now has a number of banks providing ECGD-backed bilateral bonding facilities. Major contracts across various market sectors require a variety of bonds, including bid, performance, advance (or progress) payment and warranty.

For ClydeUnion bank bonding had been a constraint on growth in terms of competitively priced facilities since the banking crisis, especially as it was a relatively new company. Under the scheme ECGD provides a counter-guarantee to the bank of up to:

- 50% of bond value for performance and warranty bonds; or
- 80% of bond value for advance payment bonds.

The main condition is that the underlying contract must involve an export with at least 20% of UK-manufactured content. All other things being equal, ECGD ranks with bank security. Pattison said that the scheme had provided access to bonding facilities needed by her company and ECGD had been flexible; for instance, it had not imposed specific requirements or constraints on the guarantee wording. She encouraged other companies that use bonds to look at the products. "If we don't use it, we will lose it," she said.

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