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Export Credit Arrangements
Productivity Commission
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Productivity Commission Issues Paper: Australia's Export Credit Arrangements

Introduction

The NSW Government formed the Department of Trade and Investment, Regional Infrastructure and Services (known as NSW Trade & Investment) in April 2011 to drive sustainable economic growth in NSW.

Under the NSW 2021 Plan for economic development the Department is responsible for leading delivery of three key development goals:

- Improve the performance of the economy
- Drive economic growth in regional NSW
- Increase the competitiveness of doing business in NSW.

The Department provides advice and assistance to NSW businesses of all sizes to establish or expand in metropolitan and regional NSW. It also works to enhance trade and export performance by building export capability, driving sustained (long term) export growth and by attracting international investors into priority sectors.

NSW Trade & Investment has a dedicated division, Investment and Export Services (IES) that specifically assists NSW exporters to grow their business internationally.

Export services are designed to assist companies:

- Build Export Awareness & Capability
- Facilitate Market Entry
- Leverage Existing Opportunities

Export services are delivered via a domestic and international NSW Trade & Investment footprint, including ten Export Advisers located across NSW and four international Trade & Investment offices located in Shanghai, Guangzhou, Mumbai and Abu Dhabi. Two more international Trade & Investment offices are planned for San Francisco and London in 2012.

In 2009/10 ABS statistics indicated that there were approximately 16 000 exporters in NSW. In 2010/2011, IES was able to provide export support services to over 6000 NSW exporters, up from under 5000 the previous year. This represents approximately 40% of the NSW exporter base.

NSW Trade & Investment's Relationship with EFIC

NSW Trade & Investment and EFIC have had a formal alliance agreement since 2005. It was renewed and expanded in November 2011.

The core objective of the Agreement is to outline an annual program of collaborative activities aimed at building export sustainability and capabilities of NSW exporters.

This includes a variety of collaborative activities including:

- Shared promotions using export-related websites, newsletters
- Use and promotion of EFIC's online finance tool; Export Finance Navigator
- Joint participation in trade missions, seminars and export-related workshops
- Co-operation with commercial banks to promote EFIC finance options to NSW exporters
- Access to other NSW Government agencies
- Referrals of NSW exporters to EFIC for cash flow services and financial support.

Trade Finance & Credit Insurance Issues Facing NSW Exporters

In preparing for this submission NSW Trade & Investment drew on its knowledge and experience from working with several thousand exporters each year. In addition, the Department conducted a series of informal discussions and interviews with active exporters across the state. A number of priority issues were identified, these are outlined below.

Access to Finance

While Australia has a mature capital market and sophisticated export credit insurance capabilities, NSW exporters are facing considerable pressures from deteriorating global and domestic conditions.

For example, a slowing world economy and growing economic volatility, relatively higher interest rates, high exchange rates, declining rates of productivity, negative business confidence and a tight labour market just to name a few.

Accessing finance is a key challenge for all exporters and the continued instability in the financial systems globally is reducing the level of liquidity available, while also increasing the "price" for funds.

According to a 2011 HSBC Global Trade Confidence Index approximately 35% of Australian respondents expect to self-fund their own trade financing needs, with around 55% nominating commercial banks as the avenue they expect to assist the most to meet their trade financing needs.

When combined with the remaining 10%, this survey indicates over 65% of respondents are likely to be vulnerable to the lack of liquidity in the commercial banking sector and ever increasing prices.

This puts at risk economic growth and jobs.

In Australia, DFAT sources advise that 1 in every 5 jobs is dependent on international trade. In NSW, goods & services exports generate around $52 billion in revenues each year. When compared to Australia's total exports of goods & services, NSW exports represent approximately 16% of goods exports and 39% of services exports.

The risk is even greater amongst small to medium sized enterprises which typically lack the resources to self-fund their trade financing requirements.

Under its current operations, EFIC has been able to assist some exporters to gain access to working capital. The following two case studies provide some additional insight:

Example 1: A successful NSW lighting specialist currently exports 60% of its output. From late 2008 until the end of 2010 the company had a multi-million USD contract to supply high tech LED handrails plus other lighting to the United Arab Emirates. The contract was with an Asian construction firm supplying the main client, a Middle Eastern government department. The deal required a 40% advance bond. The company had worked successfully on three previous occasions with this construction firm but the nature of this large contract meant the Australian banks could not assist. EFIC stepped in to successfully help complete this very profitable and lucrative export.

Example 2: A NSW firm which provides online video services utilised EFIC’s products in 2010 through a working capital guarantee which enabled them to obtain an overdraft with ANZ Bank. This facility had previously been refused. The firm had won a contract with a Malaysian client and there were significant upfront costs in the initial stages of the project. EFIC assessed and then implemented the required support which enabled the exporter to secure an overdraft facility and assisted in the successful implementation of the project. EFIC's professional approach was a key feature in the important early stages of the project.

However, EFIC’s overall penetration /reach into the exporting community is fairly low, especially when it comes to their actual financial instruments. This is because many of their current instruments designed for complex projects, supply chain proponents or individual companies can be more suited to the big-end-of-town than to an SME. This is especially true in many of their target sectors such as defence, engineering, resources, infrastructure and agriculture.

Excessive Lending Requirements

In the face of increasing financial uncertainty, commercial trade finance and credit insurance providers are reducing their risk tolerance levels and requiring considerably more documentation and security from exporters seeking finance.

As such, even “secure” options such as Letters of Credit are becoming more difficult to source, especially amongst the small to medium exporters.

While political or country risk has always been a feature of developing markets, exporters are now finding traditional markets such as the US or Europe are also considered to be high-risk. When compounded with risk assessments on large-scale projects, consortia, banking partners or individual buyers, access to credit can be extremely difficult.

Reliable Risk Assessment

Related to the issue outlined above, is the expectation that individual exporters are able to easily, access information on and make assessments of, the level of risk inherent in any new commercial transaction.

For most NSW exporters this is unrealistic. Sophisticated economic, political and corporate risk analysis on deals that often involve multiple players in numerous different jurisdictions is simply beyond the resources available to most exporters.

The “purchase” of these assessment capabilities is then either built into commercial trade finance service fees and the cost of credit or available for a fee-for-service from other commercial specialists such as Dun & Bradstreet.

In these circumstances, the cost of credit or a reliable risk assessment may end up being simply too high for the exporter to afford.

As such, the exporter may self-fund a potentially lucrative project with little understanding of the real commercial risk.

EFIC provides exporters with free access to a range of timely, reliable and comprehensive risk information which helps to counter some of the negative pressures outlined above.

Other Issues For Comment

1. Benchmarking

The role and operations of Export Credit Agencies (ECAs) vary considerably around the globe. As such, we would recommend a brief benchmarking study may provide some insight into the changing role ECAs can and are playing in mature markets like Australia.

For example, the Export-Import Bank (EIB) of the United States, has aligned its goals for increasing small business export financing with President Obama's objective, announced at his 2009 State of the Union Address, to double US exports in five years.

This is requiring a significant change in the range of services, financial instruments and operational practices of the EIB.

By benchmarking with the current activities of other international ECAs , EFIC may be able to both increase the nature and reach of their services, while also helping to “level the playing field” for NSW exporters often competing with exporters of other mature nations in third markets.

2. Reforming EFIC Guidelines

<u>Guideline Reform for non-traditional export models</u>
The globalisation of the world economy has meant that Australian exporters conduct their exporting activities with significant difference to 10 years ago. EFIC guidelines need to ensure they are able to reflect the growing complexities of working within global supply chains.

Anecdotal evidence from clients suggests that current EFIC guidelines appear to be more suited to traditional models of direct exports, rather than the more complex globalisation practices of modern exporters.

<u>Guideline Reform for Developing Markets</u>: As EFIC reviews its current guidelines it should also consider increasing its tolerance for risk in emerging markets. As exporters start to move away from a focus on traditional markets and develop business opportunities with China, India, Brazil, Russia and Sub-Saharan Africa, political, country and company risks have increased. Exporters now need to work with these markets and require more support to capitalise on opportunities and secure business growth.

> **Example 1:** One such example relates to the BRIC (Brazil, Russia, India, China) countries, which are very rich in natural resources. Many of the largest mining companies are headquartered in BRIC countries and are developing new mining projects. These companies are looking for innovative mining technology, and have the financial means to afford the best equipment, technology and services in the world. Australian technologies developed in response to our own resources boom are suitable for these export markets.
>
> Brazil is the largest iron ore producer in the world with large gold and copper production. Australian exporters find that barriers such as high tariffs, complicated logistics and

bureaucratic red tape make the country very difficult to deal with. In particular, performance bonds to the large mining companies are prohibitive. EFIC assistance in these cases could help OEM suppliers with contracts to mining projects.

Example 2: Another direct example relates to dealing with country risk. A NSW exporter of medical equipment had difficulty getting funding for his sale of medical equipment to the Sri Lankan Ministry of Health. EFIC, while initially indicating an interest in funding the deal subsequently pulled back due to the credit risk around Sri Lanka at that time.

From the perspective of the NSW exporter the critical issue was keeping the Sri Lankan Ministry interested in buying from Australia. A competitor from the USA is likely to win this business if the Australian supplier can't get the financing deal together.

Guideline Reform for Application and Approval Processes: Feedback from NSW exporters is that the EFIC application and approval process is cumbersome. Many NSW exporters consider the level of detail required prohibitive. A suggestion made from one client was to change the definition of SMEs from $150 million in turnover to a level more appropriate to small business and introduce less onerous application and approval processes. This could be achieved by creating two divisions within the SME category; a small enterprise division defined at a more realistic level of between $5-$50 million in turnover; and a medium enterprise division for businesses with turnover of between $50-$150 million.

Processing for the small enterprise division could then be simplified - thus reducing compliance and business costs for small companies breaking into export markets. NSW's (more modest) export grants program has reduced the number of application forms required from five pages to one, only collects essential data and provides an automated submission and processing approach – this is more user friendly and cuts time and red tape.

3. Government service and programs for exporters

In response to questions on pages 33 & 34 of the Issues Paper, the products and services EFIC provide complement but do not overlap those provided by the NSW State Government.

4. Export Finance Navigator

The Export Advisers team for NSW Trade & Investment regularly refer new and existing exporters to the 'Export Finance Navigator' tool developed by EFIC. This is an excellent initiative providing guidance for exporters in many financial solutions along their export journey.

Summary

- As liquidity levels and risk tolerance in the global financial sector decrease, Australian and NSW exporters of all sizes are finding it increasingly difficult to access trade finance and credit insurance.
- This is having a dampening effect on exports in many sectors and is a potential threat to economic growth and jobs.
- NSW Trade & Investment is keen to work closely with EFIC and the commercial banks to help exporters understand and utilise the full range of financial instruments available to them, including those provided by EFIC.
- However, education will not be enough.

- As the trade finance and credit insurance industry contracts, there is a strong potential argument for the role of ECAs, especially in mature economies like Australia to be re-assessed.

- The review of EFIC's operations is thus well timed.

Recommendation

- We would recommend the review primarily consider how EFIC can provide a much needed counter-balance to the tightening trade finance and credit insurance market for exporters.

- This should include consideration for ways in which the total number of exporters assisted can be significantly increased.

- In addition we would recommend, EFIC:

  - continue to enhance the quality of its analysis and assessment programs and perhaps contribute to global debate on best practice methodology.
  - ensure its guidelines are flexible enough to meet the changing market entry models and globalisation practices of modern exporters
  - consider increasing its tolerance for risk in emerging markets
  - consider developing an easier application and approval process, especially for the small business sector

- Lastly, we would recommend some limited international benchmarking with other ECAs in mature economies such as the US, Canada, Israel, Japan, New Zealand could provide useful insight into the reach, range and effectiveness of other ECAs facing similar economic pressures.

Kylie Hargreaves
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