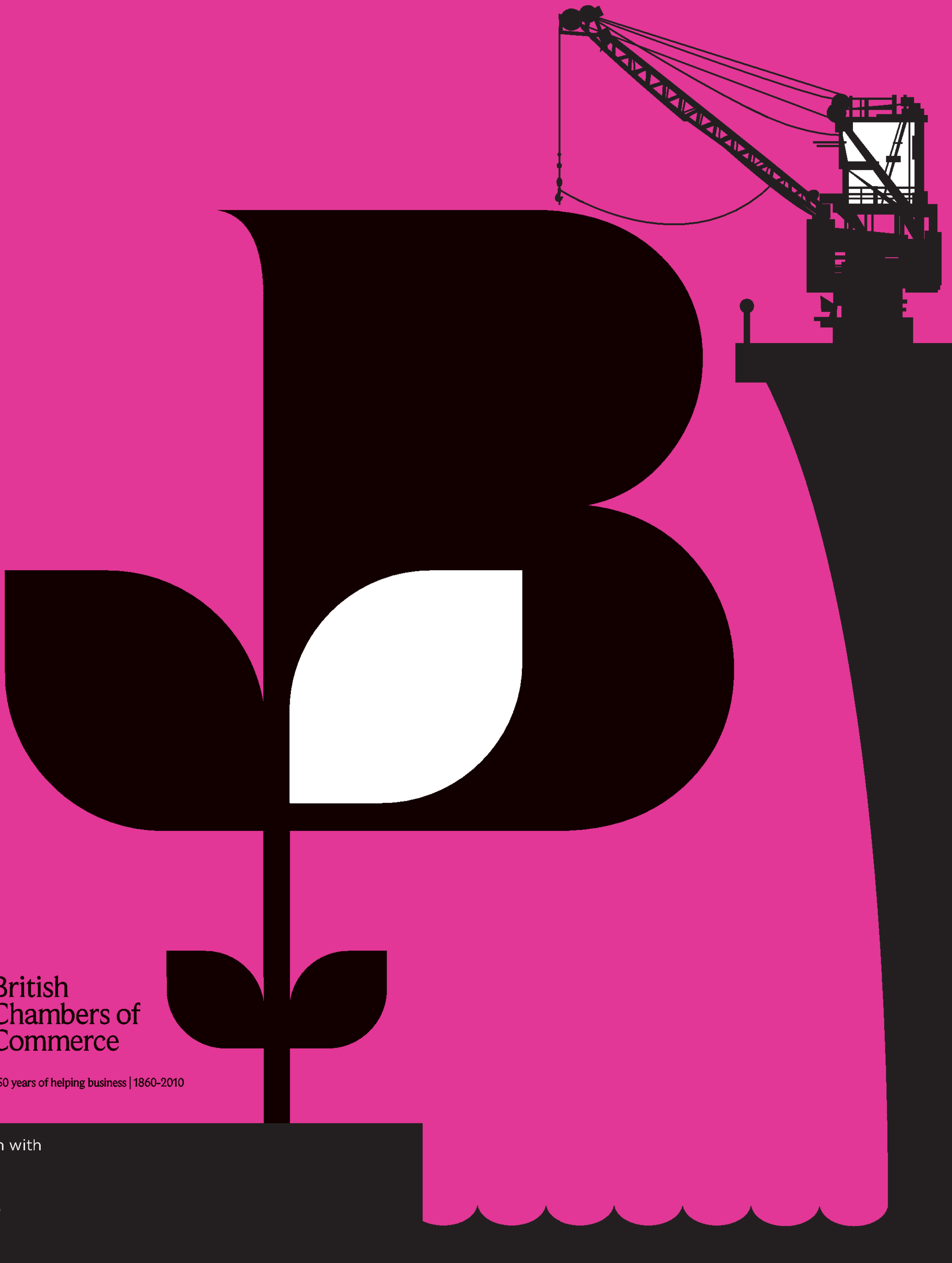
EXPORTING BRITAIN:
TRADE FINANCE



British Chambers of Commerce

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In association with

Greater Manchester Chamber of Commerce

ABOUT US

The British Chambers of Commerce is the national body for a powerful and influential Network of Accredited Chambers of Commerce across the UK; a Network that directly serves not only its member businesses, but the wider business community.

Representing 100,000 businesses who together employ more than 5 million employees, the British Chambers of Commerce is The Ultimate Business Network. Every Chamber sits at the very heart of its local community working with businesses to grow and develop by sharing opportunities, knowledge and know-how.

No other business organisation has the geographical spread across extensive multi-sectoral, multi-sized businesses achieved through local Chambers of Commerce. Lying at the heart of their local community, Chambers reach and serve all businesses, with special emphasis on providing services to their members.

Editorial note:
The opinions expressed in this report are those of the authors and may not necessarily represent those of the British Chambers of Commerce.

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CONTENTS

FOREWORD

Global trade is vital to the UK. If we are to retain our place at the economic top table, we must create more goods and services that the rest of the world wants to buy, and export more of what we already produce. Gone are the days where we could rely on the financial services industry, property, or the public sector to be the main drivers of employment, wealth and tax receipts.

Although this is widely acknowledged among policy makers, many of the financial schemes that underpin trade have been withdrawn, undermined, or are not fit for purpose. For example, we believe that the Government needs to do more to ensure exporters access to trade finance, which in many cases has put British exporters at a disadvantage compared to their main rivals during the past ten years.

Some form of trade financing underpins around 90% of all exports, easing the flow of international trade by moderating its risks. Yet despite this, British exporters have experienced severe difficulties when accessing the trade finance products that are essential to their businesses. While the Government has implemented a Letters of Credit Guarantee Scheme, serious issues remain around access to export trade credit insurance. Unlike other comparable trading nations, the British Government sold its short-term export credit business and refuses to intervene in the export credit market, putting British exporters at a comparative disadvantage during times of economic uncertainty.

While there is some evidence that the problem is diminishing in its scale, the Government needs to support those exporters who are still struggling, and prepare for future market shocks to ensure that there is a state-backed solution ready when needed. While we welcome the October 2009 Letters of Credit Guarantee Scheme, we believe there is still work to do to ensure that British exporters are protected during any subsequent economic shocks, and are able to compete in difficult markets.

If the Government is serious about encouraging British exports as a driver of employment, economic growth and prosperity, it must seek to resolve what we believe are market failures and lack of provision in the trade finance industry. This would help British exporters to be able to compete more effectively with competitors from other comparable trading nations who are better supported during difficult times, and help put Britain on a stable path to full recovery. As *Exporting out of recession*, the latest report from the Business, Innovation and Skills Select Committee suggests, Chambers of Commerce across the country are well placed to help businesses grow through exporting.

David Frost
Director General
British Chambers of Commerce

EXECUTIVE SUMMARY

1. There is now a general consensus that the economy must move away from a reliance on financial services and the public sector, towards the production of innovative goods and services that the rest of the world wants to buy, and the more effective exporting of what we already produce. However international trade is highly risky for many businesses, especially SMEs, and they require some sort of trade finance facility to mitigate against this problem. Recently, trade finance has been hit by the global banking crisis, like many other financial services. The true impact of this has not yet been felt, but a lack of liquidity risks harming British exporters as global trade increases alongside economic recovery. The BCC believes that the Government must act to ensure that British exporting businesses are effectively supported.

2. A comparison with other major trading nations demonstrates that they offer a much greater degree of short-term trade finance support to their exporters than that provided by the UK Government. While the UK's Export Credit Agency arrangements were broken up and the market liberalised, our competitors such as Germany and France, continued to provide a significant level of state support and guarantee for their exporters. This was re-enforced by the EU's suspension of State Aid rules during the recession, which enabled many European countries to offer greater trade finance support for their exporters through the provision of short-term export trade credit insurance on non-capital goods to developed markets. No such support has been forthcoming from the British Government, leaving UK exporters unable to offer the same payment conditions to customers as their foreign competitors.

3. This situation has put British exporters at a disadvantage when accessing difficult markets during normal economic conditions, and in all markets during the present recession. According to a BCC survey with Greater Manchester Chamber of Commerce one in eight companies have experienced severe difficulties when accessing trade finance. Chamber members have also reported examples of export credit being arbitrarily withdrawn, restricted, or reduced or have experienced prohibitive rises in their premiums. This has resulted in lost contracts, the scaling back of exports, and an inability to access certain markets.

4. The British Government's measures to address the problems associated with trade finance have failed to adequately address this issue. Measures to bolster domestic export credit insurance and the creation of a Letters of Credit Guarantee Scheme have been beset by problems and underutilised, and the Government's single intervention into the short-term export credit market has not been duplicated as yet. The BCC believes a much more comprehensive approach is needed if British exporters are to be able to take play their full role in driving the UK towards short-term recovery.

5. The BCC therefore recommends that the following actions are taken by the government, trade insurers, and businesses themselves:
   - The Government should consider funding a state-backed export trade credit insurance scheme run through a private company, who would share the risk and the profits. Both France and Germany have successfully applied this model.
   - The Government needs to remain vigilant to ensure that other countries are not extending support to their exporters that would infringe upon state-aid rules.
   - Trade finance professionals in general, and insurance companies in particular, must ensure that risk is properly priced, and make their decisions on a case-by-case basis, rather than applying a blanket approach as has been the case during this recession.
   - Businesses themselves must become more proactive in looking at the different finance options available to them. The BCC and the Chamber Network stand ready to help exporters do this.

1. During the past decade, the importance of exports to the UK economy as a source of growth, prosperity, employment and tax receipts has declined. This is borne out by the Government's own figures, which show that, while exports accounted for 28% of national wealth in 1995, these had shrunk to 25% in 2008,[1] with further falls expected for the recessional year of 2009.

2. The financial problems of the past two years have shown that the economic model pursued by successive governments since the early 1980s is an unsustainable one. There is now a general consensus that the economy must move away from a reliance on financial services and the public sector, towards the production of innovative goods and services that the rest of the world wants to buy, and the more effective exporting of what we already produce. As Professor Peter Spencer, chief economic advisor to the Ernst & Young ITEM Club stated in January 2009, "it is vital the UK rejuvenates its overseas investment model and starts selling into countries such as China, where we have an exceptionally low market share compared to our leading competitors. The UK's recovery is reliant on a roaring trade with the tiger economies".[2]

3. However, international trade is highly risky for many businesses, especially small and medium sized firms. Many of the problems inherent in domestic trade are also evident when trading abroad, but are harder to predict and much more difficult to resolve once they occur. These can include: buyer insolvency; non-acceptance of goods; credit risks caused by allowing the buyer to take possession of goods prior to payment; regulatory risks, where differences in rules prevent transactions; interventions, where governmental action prevents transaction being completed; political risks, where leadership changes interfere with transactions or prices; war; and, 'Acts of God'. In addition, international trade also faces the risk of unfavourable exchange rate movements.

4. International trade is also more damaging to cash-flow than domestic trade, because of the longer lines of credit that it demands. Many businesses choose to use trade finance options such as forfeiting[3] and factoring,[4] as well as letters of credit[5] in some instances, in order to free up cash. International customers also often require longer payment terms than are customary for UK trade. Furthermore, during an economic downturn, customers are likely to ask for the longest payment terms possible.[6]

5. Because of the risks associated with international trade, the World Trade Organisation (WTO) calculates that 90% of the $14 trillion value of world trade is financed by some form of trade finance facility designed to mitigate risk, such as letters of credit, or covering trade with insurance when operating on an open account basis.[7] Regarded in this context, it is trade finance that makes the UK's global trade viable, especially for British SMEs which make up the backbone of the economy. Without finance, trading globally would simply be too risky for

[1] Source - ONS.

[2] Ernst & Young - www.ey.com/UK/en/Newsroom/News-releases/Item---10-01-18---ITEM-Club-Winter-2010-forecast.

[3] Factoring is a financial transaction whereby a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount, in exchange for immediate money with which to finance continued business.

[4] Forfaiting involves the purchasing of receivables from exporters. The forfaiter will take on all the risks involved with the receivables. It is different from the factoring operation in the sense that forfaiting is a transaction-based operation while factoring is a fir- based operation, meaning, in factoring, that a firm sells all its receivables while in forfaiting, the firm sells one of its transactions.

[5] A letter of credit is a method of payment underpinned by a bank's undertaking to make a payment to a named beneficiary, against the presentation of documents which comply strictly with the terms of the letter. Its main advantage is in providing security to both the exporter and the importer, but the security offered comes at a price.

[6] BExA Guide to Exporting (2009), p.5.

[7] WTO - www.wto.org/english/news_e/news08_e/trade_finance_12nov08_e.htm.

many companies to make it a realistic option for business growth.

6. In the short and medium-term, exports have the potential to help the British economy move from recession to growth. The competitive price of sterling creates a golden opportunity for exporters to sell their products abroad. However, until recently the trade figures have been less than encouraging. Rather than being bolstered by a fall in Sterling as many commentators predicted when the currency depreciated in 2008,[8] the November 2009 trade deficit in goods and services was £2.9 billion, compared with a revised deficit of £2.2 billion in August 2009. The deficit in goods alone was £7.1 billion, compared with £6.1 billion during the preceding August. Likewise, the trade gap with the rest of the EU widened to £3.5 billion during November 2009 compared with a deficit of £3.0 billion in August.[9]

7. One of the reasons for the UK's continuing poor trade performance is that in line with many other financial facilities, trade finance has become less readily available during the recession. While this has been a global phenomenon, it has been particularly acute in the UK. Banks have been less willing to participate in letters of credit transactions, insurers have withdrawn export trade credit insurance[10] from many businesses and industries, and many companies have had their risk ratings downgraded resulting in their suppliers withdrawing credit lines (see Chapter 5).

8. In the short-term, there are difficulties associated with taking advantage of the drop in the value of the currency. The economic slowdown is global and demand is therefore weaker in the UK's main export markets; history tells us that depreciation of the currency has led to exporters raising their sterling prices in the short-term to boost profits; and, it inevitably takes time for exporters, or potential exporters, to identify opportunity and exploit it.

9. Further to the benefits to exporters, a weaker pound will benefit UK producers as businesses substitute their consumption away from imports and towards domestic goods. However, this is not necessarily an instant win and the benefits will take time to filter through to the economy.

10. As the volume of global trade increases, poor trade finance availability could further strangle the potential growth that exporters could offer the British economy, especially from high growth emerging markets. This is especially true of short-term export credit insurance, where withdrawal or prohibitively higher pricing mean that many SMEs are not able to trade even if there is strong demand for their products.

8 Telegraph - 17 Dec 08 - Sterling fall is a life-saver for UK economy.

9 ONS – Trade figures - 10 Nov 09 - www.statistics.gov.uk/cci/nugget.asp?id=199.

10 The purpose of Export Trade Credit Insurance is to offer protection to exporters of goods or services who sell their products on credit terms. The exporter is insured against losses arising from a wide range of risks, which may be conveniently categorised into either commercial risks or political risks, although many private export credit insurers offer cover for commercial risks only. In order to protect the insurers in the private sector against adverse selection, an exporter is usually required to insure its entire book of export orders filled on credit terms, rather than being allowed to seek coverage in respect of countries where the peril is perceived to be the greatest.

CHAPTER ONE: A COMPARISON WITH OTHER COUNTRIES

1. A COMPARISON WITH OTHER COUNTRIES

1.1. British exporters receive poor levels of state support in comparison to other major trading nations. Because of the importance of trade finance to global trade, the governments of many developed economies have traditionally provided trade finance facilities through their own Export Credit Agencies (ECAs). This is because they believe that exporters must be supported both in difficult but profitable markets (that private financing is adverse to), and during economic downturns when the private market fails to provide.

1.2. Up until the 1990s, the British Government's Export Credit Guarantee Department (ECGD) had a virtual monopoly over export trade credit insurance on large, small, short-term and long-term contracts. However, in 1991 the short-term credit insurance business was split from longer-term capital financing, privatised, and sold to the Dutch credit insurance group NCM (now called Atradius).

1.3. After 1991, ECGD became a re-insurer of last resort, supporting capital (or semi-capital) exports of goods and services usually sold on two or more years' credit, often for high value transactions on capital goods and projects.[11] The ending of ECGD's virtual monopoly on short-term credit insurance and subsequent liberalisation of the market meant that British exporters found export credit insurance became both cheap and readily available until the current global financial problems. Some businesses still found it difficult to access short-term finance for non-capital consumer goods into high-growth emerging markets, however.

1.4. All comparable trading nations offer a much greater degree of state support and guarantee to their exporters than is available to British companies. This is especially true of exporters seeking trade finance for short-term non-capital goods and service exports, as shown in Table 1. The stated purpose of nearly all ECAs is to help their country's exporters in difficult markets which the private sector will not cover, and during market difficulties to ensure a continued ability to trade.

Table 1. Comparable state supported trade finance services

Country	ECA Name	Export Trade Credit insurance	Letters of Credit Guarantee	Assistance for short-term non-capital goods	Pre-Export Financing	Export working capital	Buyer financing
Canada	Export Development Canada (EDC)	Yes	No	Yes	Yes	Yes	Yes
France	Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE)	Yes	No	Yes	Yes	Yes	Yes
Germany	Hermes Kreditversicherungs-AG PwC Aktiengesellschaft Wirtschaftsprüfungsgesellschaft	Yes	No	Yes	Yes	Yes	Yes
Italy	Servizi Assicurativi del Commercio Estero (SACE)	Yes	No	Yes	Yes	Yes	Yes
Japan	Nippon Export and Investment Insurance (NEXI)	Yes	No	Yes	Yes	Yes	Yes
UK	Export Credit Guarantee Department (ECGD)	No	Yes	No	No	No	Yes
USA	Export-Import Bank of the United States (EXIP)	Yes	No	Yes	Yes	Yes	Yes

[11] House of Commons Trade and Industry Select Committee - Third Report - January 2000 - www.publications.parliament.uk/pa/cm199900/cmselect/cmtrdind/52/5208.htm

1.5. For example, in Germany there is a federally sponsored ECA that helps German companies with export trade credit insurance, which is run by Euler Hermes Kreditversicherungs-AG and PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft. Widely known as Hermes Cover the scheme itself states that 'Federal export credit guarantees support German enterprises in their efforts to open difficult markets and expand traditional markets in unfavourable times'.[12] As the scheme itself states, 'the export credit cover available from private insurers is severely restricted over a wide area of business'. The Federal Government thus 'steps into the breach when the privately owned insurance industry does not provide sufficient cover'. Because nearly all other major exporting economies do this, such support 'provides a level playing field for German exporters in the international competitive arena'.[13]

1.6. Although French state support is administered through Coface, which is a private firm, much of the short-term export insurance is still state-backed, especially for trade with emerging markets. The state-owned insurer of last resort, Caisse Centrale de Reassurance, has also been providing French companies with export credit insurance to ensure that they remain covered should their customers potentially fail to pay their bills throughout the recession.[14] Likewise, in the Netherlands support is managed through private firm Atradius, but much of the risk is underwritten by the Dutch state.[15]

1.7. Thus as Table 1 shows, in stark comparison to other major trading nations, the British Government offers comparatively little trade credit support for the majority of its exporters. ECGD concentrates on supplying medium-term finance spread over two or more years for capital or semi-capital projects, e.g. for a power plant upgrade involving five years credit, or on an aircraft where payment is spread between ten and fifteen years.[16] Projects requiring short-term finance, or non-capital goods or services, such as those for the consumer market, are unlikely to receive help from the ECGD. For example, unlike its counterpart ECAs, ECGD does not have an export trade credit insurance scheme for exporters who wish to access markets which the private sector is uneasy about. In a normally functioning market, this might not be such a problem. However, during a recession, this severely compromises the ability of British exporters to compete with their rivals.

1.8. A 2009 report from Goldman Sachs has suggested that key drivers for export growth during 2010 will be demand from the growing middle classes of BRIC countries and other emerging markets.[17] However, it is precisely when exporting into these markets that businesses find difficulty in accessing trade finance. For example, in Case Study 1, Graham and Brown's business to Russia is limited by not being able to offer open account trading supported by export trade credit insurance.[18] Conversely their German competitors can offer full lines of credit over extended periods to the Russian wallpaper market – the world's largest – because of state backed guarantees on consumer items.

1.9. As can be seen from Case Study 1, UK support for trade finance has been far behind that of our main trading rivals. This has meant that British businesses have often been disadvantaged when seeking to trade with high-growth emerging markets because of the better payment conditions that many foreign exporters are able to offer their customers.

12 http://www.agaportal.de/en/aga/grundzuege.html

13 Ibid.

14 BBC News - France to offer credit insurance - Thursday, 27 November 2008 - http://news.bbc.co.uk/1/hi/business/7752175.stm.

15 http://www.atradius dutchstatebusiness.nl/dsben/index.html.

16 BExA Guide to Exporting (2009), p. 38.

17 *Goldman Sachs BRICs Monthly* Issue No 09/07, August 2009, p3.

18 **Open account trading** is where exporters receive payment once the good have been received.

Case Study 1

Graham & Brown are the leading wallpaper manufacturer in the UK and third largest globally. Based in Blackburn, they employ over 400 people with a turnover of around £80m of which 30% is exported, selling internationally via divisions based in France, the Netherlands, Germany, the USA, Canada, China and Russia.

Despite the size and undeniable success of the company, they are being hamstrung by the British Government's own trade finance policies. This can be seen in their relationship with Russia, which is the world's largest market for wallpaper. The market works on 90 day terms and as a private family business Graham and Brown cannot afford to expose themselves to more than €2million euro aggregate debt. This of course limits their sales potential.

The availability of export credit insurance would mean they could target sales of €20million annually in the Russian market, which would feed through to the local and national UK economy through the creation of jobs and tax revenue. However, private export credit insurers will not currently work in the Russian market, and the Government does not provide short-term export credit facilities.

Regrettably, this places Graham & Brown at a serious disadvantage against their main German competitors, who can use state-backed export credit insurance to leverage much larger sales into difficult markets where risk coverage is highly priced privately, or unavailable.

Graham & Brown believe that a scheme similar to that in Germany would help create a level playing field with their European competitors, and enable them to take better advantage of the demand for their products.

2. THE RECESSION

2.1. During the global economic crisis, some British exporting companies have found that their access to export trade credit, insurance and guarantees has been severely limited. Businesses have had their cover withdrawn for certain customers and markets, while in other cases it has been re-priced to the extent that it has become unaffordable. Some businesses have had their own ratings downgraded by insurers, which has hampered their production lines as their suppliers have had to withdraw credit lines.

2.2. By the Department for Business, Innovation and Skills' own estimate, about 5% of total exports (£9.2bn) are being put at risk due to lack of finance,[19] while the International Chamber of Commerce reports that pricing of trade instruments have increased between 50 and 100 basis points during the past year.[20] This situation was further underlined by Pascal Lamy, director-general of the WTO, when he commented that "trade finance is being offered at 300 basis points above the London Interbank Offered Rate and even at this high price, it has been difficult for developing countries to obtain."[21]

2.3. As part of the BCC's work on trade finance, in conjunction with Greater Manchester Chamber, we surveyed 250 exporting businesses from the Manchester city-region. Greater Manchester was chosen because it offers a good selection of exporting firms of various sizes, from different manufacturing and service industries.[22] The survey found that 57% of businesses (143) used some form of trade finance to insure or fund their exports, the vast majority of which (93.8%, 121) used letters of credit, with a smaller number (22.5%, 29) using export trade credit insurance.

2.4. Of those businesses that used trade finance, 12.7% (31), or around one in eight, reported that they had experienced problems with trade finance during the previous twelve months. This suggests that the economy is losing out on possible export-led growth, as significant numbers of businesses are being hampered as they try to export. Over half (56.7%) said that they had reduced exports to existing customers, while just under half were unable to exploit new export opportunities (48.3%), stopped exporting to certain markets (46.7%), lost business to exporters from other countries with state backed schemes (46.7%), or had increased business exposure to risk (44.4%). These problems seriously hamper the ability of some exporters to take full advantage of trading opportunities, and also act as a deterrent to businesses thinking about exporting more of their products, or those trading internationally for the first time.

2.5. As illustrated by Case Study 2, some businesses within the Chamber Network have reported that export credit cover for certain companies, markets and even countries has been withdrawn, often at very short notice. One business, which derives 90% of its turnover from exporting, reported having cover withdrawn on credit lines to many of its customers rendering their policy nearly worthless, despite having held cover for 25 years. Another company found that its cover for credit lines to the United States was restricted to £10,000 per annum, which naturally has severely limited the possibility of exports into a large market.

2.6. Another company found that despite having been with the same insurer for some years, more than £1,000,000 of cover on their credit lines to their customers was withdrawn one month after they renewed their policy. In many instances, cover has been limited due to unfair risk assessments on markets and countries, rather than on an individual company's credit worthiness.

2.7. In many cases, withdrawal of cover has been arbitrary, and damaging to business. For example, in Case Study 3, Conveyor Units was halfway through the largest project they had ever undertaken with a successful Spanish company. This has permanently jeopardised Conveyor Units' relationship with their customer, who has taken their business to another European company offering better payment terms.

2.8. Businesses have also reported prohibitive rises in the costs of their premium

[19] Telegraph - 05 Oct 09 - Government expands export credit guarantee role.

[20] Source – International Chamber of Commerce.

[21] Quoted in The Times – 03 Nov 08 - Commerce becalmed over letters of credit.

[22] 253 businesses from the Greater Manchester city-region were surveyed by telephone in conjunction with Greater Manchester Chamber of Commerce between 15 and 22 January 2010.

Case Study 2

Metallisation Ltd is a manufacturer of metallic coating spraying systems, based in the West Midlands, which had been in business since 1922. The company currently employs over 30 people and has an annual turnover of around £7 million. An experienced exporter, over 70% of the firm's business is based on exporting to over 54 different countries.

Over the last year and a half, the company has found the export insurance situation much more precarious, with export insurance harder to come by. Also, rather than merely raising premiums as a result of increased risks, there have been instances of insurance being withdrawn completely at short notice. Left with the option of either losing the business or taking on the credit risk of their customers, the company has used the bank balance it has built up to do the latter.

As an experienced exporter, the company argues they should not have to bear this additional risk, but more importantly believe that such a situation four or five years ago would have put their business in a perilous position and are concerned for businesses that are not in as strong a position as themselves. As Financial Director Rob Hill states,"the current export insurance model is broken and we urgently need both a short term fix to protect businesses that are basically sound and profitable but find themselves exposed and vulnerable at this time".

payments, as seen in Case Study 4. One company found that its premiums had increased by 30%, while their insurers had withdrawn cover for some markets. There was also an 840% increase in the cost of one company's premium, which grew from just under £1,000 per month to £8,000 - a figure which would prove prohibitive for many SMEs. Some companies have also found that the amount insurers are willing to cover has been severely cut. One company sought to renew their premiums, but cover had been cut to 50% of its original rate.[23]

2.9. As seen in Case Study 4, some companies have found that they have been down-rated by their suppliers' export credit insurers even if they are still in rude financial health. In line with the experience of businesses that have had lines of finance cut, decisions have usually been based on arbitrary classifications such as which particular industry the firms operate in. This has caused serious cashflow problems for businesses who are now having to pay upfront for their supplies, while for those who re-export it has impaired their ability to do work for their customers without payment up-front themselves. This shows that export credit insurers and banks also need to take a more objective view of risk

23 From interviews with Chamber of Commerce members.

Case Study 3

Conveyor Units are a Midlands based SME that produces complete material handling units, as well as having a separate arm which distributes bearings and components for conveyer systems. Approximately 40% of the business's £11million turnover is dependent on exports, mainly to European markets. The company has held export trade credit insurance with the same insurer for the past eight years, and have had similar policies for the past 27 years. Around 90% of the exporting turnover of the company is covered by the insurance.

Since the recession began, their insurer has continuously stripped down levels of cover on Conveyor Units' export customers, usually with no notice period given. This occurred most seriously when Euler pulled credit line cover on a customer in the material handling industry, which promised to be the biggest job they had ever won. The customer was linked to another financially healthy company operating in the Spanish construction industry, but their insurer took a blanket decision to withdraw credit cover on any businesses connected to that sector. Conveyor Units had taken "Continuation Cover Insurance", but because the insurer required supplementary information on the customer, the working relationship was ruined, and no subsequent orders have been placed despite work having been put out to tender. Conveyor Units has also had to turn down other potential export sales because of reduced or withdrew export trade credit insurance.

Conveyor Units believes that the problems of the export trade credit insurance market are not easing, despite the Government's claims to the contrary. This is because initiatives from insurance companies which are superficially designed to address the problems in the market are ineffective in reality. For example, the insurance company has asked customers to supply the names of three key customers for whom they will try and push through the underwriters in order to secure decent credit cover. Even though Conveyor Units supplied six names for consideration, no further communication has been received. They have also promised to give a 14 day notice period for withdrawal of policy cover, but this is too little, too late as such policies did not exist during the most difficult days of the recession.

Case Study 4

Team Leyland is a company in the North West of England which operates in the automotive sector. With 90% of their £3 million annual turnover based around export sales, international trade is the life-blood of the business. They have customers in places as diverse as Malta, Kazakhstan and the Caribbean. While the vehicle side of the business is generally based around payment upfront, their component sales are supported by trade finance facilities in the form of export trade credit insurance. This has been provided by the same incurrence company since the company was founded in 1993.

During the past year and a half, Team Leyland's export business has been severely undermined by its credit insurer. Firstly, insurance on lines of credit from Team Leyland to their main supplier have been withdrawn, despite the fact that the suppliers insurer was the same company who covered Team Leyland's own lines of credit. They were told that any company in the UK automotive sector was considered as a high risk. As a result, Team Leyland now has to pay their supplier upfront, seriously limiting the business's cash-flow.

Secondly, Team Leyland's own lines of credit to their customers have been significantly curtailed, hampering the business' operation. Premiums have increased by over 20%, but far more detrimental to the business is their insurers insistence upon the reduction of cover on some key customers, and total withdrawal on others. Before the economic crisis began, the company had insurance cover of up to £2 million on lines of credit to its customers, but this cover has been reduced by £700,000. The result of this is that business with customers is curtailed, undertaken with full exposure to credit risks, or lost to competitors from other countries where the export credit insurance market is functioning better and who can therefore offer full credit.

Export trade credit insurance is vital to Team Leyland's business. Withdrawal has meant the reduction of its trade with some markets, or in some cases losing customers to rivals from other countries. At a time when the competitive value of the pound should mean that British exporters are in a ideal position to drive economic recovery, businesses are being hamstrung by an ineffective and overly cautious trade finance industry.

when assessing exporters, their customers, and foreign markets.

2.10. Despite the Government's claims to understand the gravity of the situation, it has repeatedly stated in public that the situation is improving for many companies. However, the BCC survey with Greater Manchester Chamber revealed that 92.9% (17) of those who had experienced problems with trade finance thought that they had stayed the same or had got worse during the past three months. Looking ahead 82.2% (19) thought that the situation would stay the same, or improve during the next three months. The majority of businesses (53.6%, 15) who use trade finance are typically covering less of their exports with such products than they were three years ago, meaning that many are working on an open account basis and taking on the risks of trade wholesale. This is confirmed by the Business and Innovation Select Committee that stated that "neither we, nor any of the businesses who we have spoken to, have seen evidence that this situation is improving and therefore the Government's decision to merely 'monitor the market' is inadequate".[24]

2.11. As our research has shown, a significant number of British exporters has experienced serious difficulties accessing short-term trade finance. As seen in Chapter 4, exporters from the UK's key trading rivals already have schemes in place which many have broadened during the recession to ensure that exporters are still able to access vital lines of trade finance. Conversely, the British Government has been slow to act, and exporters have missed out on opportunities, cut back on their trade, or have lost key clients. British exporters' experience shows that help from the Government must be forthcoming now, and also for when there are subsequent shocks to the market to ensure that the experiences described here are not repeated.

[24] www.publications.parliament.uk/pa/cm200910/cmselect/cmbis/266/266i.pdf

3. GOVERNMENT INITIATIVES

3.1. The British Government has been concerned about the problems associated with trade finance. While a fully backed export trade credit insurance scheme has not been forthcoming, a number of actions have been taken, as outlined below.

Domestic trade credit insurance scheme

3.2. Domestically, the Government has attempted to shore up domestic trade credit insurance with a £5 billion scheme but it has been taken up by only 52 companies, with a mere £7 million guaranteed. There are several factors contributing to its poor performance: many businesses have suffered complete withdrawal of policies and are not eligible for the scheme; the communication of the existence of the scheme has been poor; and, businesses have altered their management of risk to adapt to the changing market.

3.3. These lessons should be taken into account when designing any schemes for exporters. Potential users need to know of a schemes existence and their eligibility, and the application process for a scheme must be as straightforward as possible.

Letters of Credit Guarantee Scheme

3.4. In October 2009, the Government announced a Letters of Credit Guarantee Scheme covering 282 banks in 36 developing markets (see *Appendix 1 - Glossary* for explanation of Letters of Credit), which will run until 31 March 2011. Exporters requiring a confirmation of a letter of credit will approach a participating bank in the UK. If the UK bank is not able to take the full risk on the overseas issuing bank, it can access the guarantee offered by ECGD and share up to 90% of the risk with the UK Government.[25] Developed markets are generally excluded from the scheme because of EU State Aid rules, however key emerging markers such as Brazil, India, Russia and China are covered. Profits from the scheme will be split equally between the issuing bank and the Government.

3.5. While the BCC welcomes the Letters of Credit Guarantee Scheme, it must be remembered that letters of credit are only used in some 10% of trade deals, and therefore they will not meet the total needs of exporters to covered markets. The Government must also ensure that the scheme is set at the right price for SME exporters as one of the major problems of trade finance is not just a lack of availability, but a prohibitive price rise.

3.6. As of January 2010, only one letter of credit has been issued under the remit of the scheme during the first three months of its life. This can be seen from the results of the BCC's survey with Greater Manchester Chamber of Commerce, which revealed that 83.3% of businesses who had experienced difficulties in obtaining letters of credit had not been informed of the Government's scheme. While some banks report that the market has improved slightly compared to the outset of 2009, some sources within banks who have been tasked with running the scheme have reported that they consider it to be overly bureaucratic, which has acted as a bar to banks offering this to their customers.`

Short-term credit lines

3.7. Until 2009, the Export Credit Guarantee Department (ECGD) hadn't operated in the small firms market since 1991. However, in September 2009, ECGD insured a short-term $14.4m (£9m) contract secured by Cleveland Potash Limited with Brazilian fertiliser conglomerate, Fertipar. Cleveland Potash's parent company, Israel Chemicals Limited, had its group credit insurance limit reduced at the height of the credit crunch. Without intervention from ECGD, the deal would have fallen through, with job losses among the company's 1000

25 www.ecgd.gov.uk/index/products-and-services/overview.htm

employees, and the 4000 employees who are part of the extended supply chain.[26]

3.8. No further interventions into the short-term market have been made, and at the time of writing ECGD reports that there are no plans to do so in the future. However, as the Cleveland Potash case demonstrates, there is no legislative bar to such interventions by ECGD into the short-term market.

[26] www.ecgd.gov.uk/news.htm?id=9057

4. RECOMMENDATIONS

4.1. The BCC believes that action needs to be taken by the Government, the export trade credit insurance companies, and by exporters themselves in order to help address trade finance issues.

Recommendations for Government

4.2. The BCC believes that unless the Government intervenes to support SMEs' access to sources of trade finance, British businesses will not benefit from the predicted rise in global trade flows over the coming year. There has been a market failure in the trade finance industry, especially around short-term export trade credit insurance. The Government must therefore intervene to rectify this by providing a publicly-backed scheme. Without such action, it is unlikely that British businesses will benefit from the likely rise in demand for consumer goods to BRIC countries and other emerging markets. This is reflected by the Business, Innovation and Skills Select Committee who "strongly recommend[ed] that the Government reassess its decision not to use the opportunity presented by the [European] Commission's decision to re-enter the short-term trade credit market until the financial situation improves".[27]

4.3. While there is some evidence to suggest that the problems of the past year are easing, the Government needs to establish support in this area to ensure that British businesses can access short-term financing for non-capital goods during any subsequent economic downturns that might disrupt finance flows.

4.4. Currently the Government believes that the export credit insurance market is rectifying itself, but our members have not found any greater liquidity within the market and are still being hamstrung by insurance being withdrawn from credit lines both to and from their companies. Furthermore, the Government must ensure that British exporters are able to access trade finance for high-growth developing markets in the same manner that all other comparable trading nations provide for their exporters.

4.5. **The BCC believes that the Government should consider funding a state-backed export trade credit insurance scheme run through a private company, who would share the risk and the profits. Both France and Germany have successfully applied this model.**

4.6. The application of such a model would mean that exporters would not be dependent on the private market for exporting into emerging markets, or during periods of recession or economic uncertainly. While in times of economic growth developed markets in the EU, North American and Australasia would not be allowed to be covered by such a scheme under EU State Aid rules, the European Commission relaxed the rules which govern this during the economic crisis. EU countries that already had such schemes were able to take full and immediate advantage by widening the scope of their cover. The British Government was unable to help its' exporters in such a way, but should have a scheme ready to help exporters both in the short-term and when the market fails again.

4.7. **We also believe that the Government needs to remain vigilant to ensure that other countries are not extending support to their exporters that would infringe upon state-aid rules.**

Recommendation for trade financiers

4.8. **Trade finance professionals in general, and insurance companies in particular, must ensure that risk is properly priced, and must make their decisions on a case-by-case basis, rather than applying a blanket approach as has been the case during this recession.** Too many successful companies with healthy balance-sheets and order books are finding themselves blacklisted merely because of connections to particular industries and markets.

Recommendations for exporters

4.9. **Businesses must become more proactive in looking at the different finance options available to them.** For example, because

[27] www.publications.parliament.uk/pa/cm200910/cmselect/cmbis/266/266i.pdf

ECGD offers a greater range of medium-term and long-term financing for capital and semi-capital goods, eligible companies should look at such options with closer attention than they would in normal conditions.

4.10. In the BCC survey with Greater Manchester Chamber of Commerce, it was revealed that only 57% of exporters used any form of trade finance at all. This means that it is likely that other firms conduct their trade on an open account basis, supplying ordered goods, and extending un-guaranteed lines of credit to their overseas customers. Trade financing is often designed to mitigate risk, and as such, provides a spur and encouragement to potential exporters. It enables current SME exporters to export more with confidence and greater leverage into BRIC countries and other emerging markets. While this would obviously be encouraged by a state-backed short-term trade finance scheme, SME exporters should be more proactive in sourcing trade finance, and understanding the options available to them. **The BCC and the Chamber Network stand ready to help exporters do this.**

5. CONCLUSION

5.1. Trade finance oils the wheels of global trade. Without recourse to products such as export trade credit insurance, businesses are often unable or unwilling to export their products. The economic problems of the previous two years have seriously impacted upon the availability of trade finance, particularly short-term credit insurance. Because other countries are supporting their export credit insurance markets, British businesses are being placed at a real disadvantage. As the global upturn comes, UK Government action is required – or else British exporters will be unable to play their full role in driving the UK towards short-term recovery and longer-term growth.

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