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Getting Started Overseas: Eximbank Working Capital Financing For Small Business Exporters

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ABSTRACT

This article focuses on pre-export financing options offered to small business exporters by the U.S. Export-Import Bank. Financing is provided in the form of guarantees on commercial bank working capital loans to small business exporters. The paper discusses the program itself as well as relevant federal statutory law governing the program's establishment and operation.

INTRODUCTION

The small business community currently faces several major economic hurdles. Shrinking domestic markets and continued consumer preferences for cheaper foreign products are pushing many companies into bankruptcy. One way in which companies can meet this challenge is to target their sales and marketing efforts overseas.

Increased exports can contribute critically to the success of the small business community and the U.S. economy as a whole. Exports can make the dollar stronger and help increase the number of available jobs domestically. In one year alone New England produced $10 billion in exports sales creating 135,000 jobs (10). Despite the essential role they play in the health of the economy, small businesses (especially companies seeking to enter the international marketplace for the first time) are often confronted with commercial banking policies which prevent them from getting the financing necessary to launch their overseas efforts.

To encourage private banks to lend to small business exporters, the federal government, through the Export-Import Bank of the United States ("Eximbank"), has developed a program that guarantees commercial bank working capital loans to small business exporters. This paper discusses Eximbank's "Working Capital Guarantee Program" (the "Program") and the extent to which it meets the needs of small business exporters. After a brief discussion of the mechanics of commercial bank working capital financing, the paper covers the Program itself. This includes a discussion of relevant statutory directives, and Program guidelines and requirements.

COMMERCIAL BANK EXPORT WORKING CAPITAL FINANCING

Companies use export working capital loans to finance the purchase of raw materials needed to produce exports or to help them market their products abroad. This type of financing is especially useful for companies trying to compete internationally for the first time. Export working capital loans are commonly set up in two ways. The commercial bank may either fund a specific export transaction (such as the sale of 100 cars) or open a revolving line of credit in favor of the exporter that can be used for several transactions over a period of time. Revolving lines provide great flexibility to the exporter because outstanding amounts already used can be paid off at any time and interest due will decrease as a result (11).

Unfortunately, it is often very difficult and expensive for small business exporters to get export working capital loans. As a recent publication by Eximbank explains, "lack of working capital financing is one of the biggest barriers small and medium-sized companies face when trying to export" (7). Banks may charge floating rates as high as three percent over prime and a two percent service charge. They also require that inventory and accounts receivable be assigned as collateral.

Banks justify these requirements by pointing to the high expenses associated with monitoring inventory and accounts receivable and the perceived poor credit worthiness of small business exporters. To make matters worse, many exporters only have their foreign receivables to offer as collateral and lenders are reluctant to assume the risks associated with these types of receivables. Risks here include war and local restrictions on the buyer's ability to get the necessary foreign exchange to pay the U.S. exporter in dollars (9).

EXIMBANK'S STATUTORY MANDATE

With the help of Eximbank, small business exporters may now be able to counter conservative commercial bank lending policies. Established in 1945 pursuant to the Export-Import Act (1), Eximbank's primary purpose has been to help U.S. exporters compete internationally. Over its 55 year history, the Bank has financed approximately $200 billion in U.S. exports (6). This was usually done by giving large loans directly to foreign buyers to purchase U.S. exports, or by guaranteeing commercial bank loans to foreign buyers (12).

Although Eximbank programs were primarily directed in the past towards helping large U.S exporters with proven international track records, the prospects for small business access to Eximbank financing has changed drastically over the past few years. As a result of increased pressure from the small business community, Congress passed legislation in 1983 directing Eximbank to also guarantee loans given by commercial banks directly to exporters. The legislation also mandated that special efforts be made to guarantee loans to small and medium-size businesses (3).

EXIMBANK'S WORKING CAPITAL GUARANTEE PROGRAM

General Purpose

In response to the 1983 statutory directives, Eximbank established the Program, whose stated purpose was to help "small companies obtain commercial financing for export-related purposes, such as production, inventory purchases or export marketing" (6, p. 33,34). By 1987 there were approximately $18.6 million working capital guarantees authorized under the Program. In 1988 authorizations jumped dramatically to $75 million (6, p. 16).

Eligible Lenders

Financial institutions and commercial banks with business lending experience are eligible to apply under the Program (7). The Bank has also given guarantees to state government agencies offering working capital financing to local exporters, including the Los Angeles Local Development Corporation and the Massachusetts Office of International Trade and Investment.

Eligible Exporters

At first, it would appear that the Program's eligibility requirements are very flexible. Small businesses applying for an Eximbank guarantee must simply show that they have "exporting potential" and need financing "to produce or market goods for sale overseas" (7). However, the actual application form for the Program implies that the Bank has more stringent eligibility requirements. It asks exporters to submit financial statements for the past three years, if they are available (4). It would thus appear that the Bank would prefer to avoid providing start up financing for brand new companies. Three years of financial statements should help Eximbank credit officers substantiate a company's claims that it has "exporting potential".

A typical applicant under the Program has already unsuccessfully tried to get a working capital loan from its commercial bank. The commercial bank's refusal to lend may be based on a hesitancy to accept the exporter's foreign receivables as collateral or the fact that lending limits with the creditor have already been reached by the exporter on prior transactions.

Eximbank's legislation was designed to provide financing alternatives to exporters facing this predicament. The law directs Eximbank to take into account the extent to which "the private credit market is not providing adequate financing to enable otherwise creditworthy ... exporters to consummate export transactions" (3). Furthermore, when "such guarantees would facilitate expansion of exports which would otherwise not occur" (3), the statute directs Eximbank to seriously consider authorizing a guarantee.

Covered Activities

Eximbank guaranteed loans can be used for a wide range of export related activities, including labor costs associated with producing goods for export, purchasing raw materials, export marketing or overseas business development activities (7, p. III-2). This would probably cover overseas travel, room, board, and the fees needed to hire a foreign consultant.

Types of Financing Covered And Lender Risk Guaranteed By Eximbank

Exporters can apply to get an Eximbank guarantee for loans covering a specific export transaction or revolving lines of credit covering a three month period. Eximbank will reimburse the lender for up to 90 percent of the exporter's outstanding loan balance plus any past due interest and principle (7. p. III-3,4).

Security

Security requirements under the Program also seem to be very flexible. The legislation states that Eximbank can guarantee working capital loans "when such loans are secured by export accounts receivable, inventories of exportable goods, accounts receivable from leases, performance contracts, grant commitments, participation fees, member dues, revenue from publications, *or such other collateral as the Board of Directors may deem appropriate...*" (my emphasis) (3).

Eximbank further requires that all collateral must be perfected on a first lien basis, and shared between it and the commercial lender on a pro rata basis (i.e., Eximbank - 90% and commercial bank - 10%) (7, p. III-2 to 4).

Costs of the Eximbank Guarantee

Although eligibility and collateral requirements may seem to be lenient, many small business exporters may find that the fees charged for using the Program are prohibitively high. Eximbank charges three different fees. Although two out of the three are charged to the lender, most commercial lenders will pass these charges on to their clients. The lender is charged a "facility fee" of one-half of one percent on the loan amount which is due within 90 days of the Eximbank formal approval of the guarantee. The lender is also charged a one-quarter of one percent "usage fee" which is payable quarterly on the outstanding balance of the loan until the loan period ends. A $100 "processing fee" is also charged to the exporter for having its application reviewed (8).

Although these fees may seem steep, Eximbank is limited by other legislative mandates which require it to charge fees in order to remain fiscally responsible. On the one hand, Eximbank must offer financing that will "neutralize the effect of ... foreign credit on international sales competition" (2). This means that if a competing foreign export finance agency (i.e., the Eximbank's counterpart in France or Britain) finances a local export by charging below market rates, Eximbank must consider offering a similar low rate on the financing for the competing U.S. export. In this way, Eximbank hopes to make product quality and price (not the financing package) the main factor influencing the foreign buyer's purchasing decision.

Congress further directs Eximbank to also consider "its average cost of money as one factor in its determination of interest rates ..." (2). Since Eximbank is not a grant-giving agency, it must thus charge fees and rates to cover its own borrowing costs. Currently the Federal Financing Bank loans Eximbank the money to finance its loans, and rates charged by Eximbank on its loans and guarantees are less than the rates charged by the Federal Financing Bank to Eximbank. Thus, there is an ongoing decline in Eximbank's reserves.

Eximbank must, therefore, try to earn money in a variety of ways to make up for the negative spread between its cost of funds and its return on loans and guarantees. It is therefore highly unlikely that processing, usage or facility fees under the Program will be reduced anytime in the near future.

CONCLUSION

While poor financial support from Eximbank and the commercial banking industry in previous decades prevented many small business exporters from getting adequate financing, Eximbank's Working Capital Program may now provide one hopeful alternative for small businesses. Although Program fees may in some instances be prohibitive, the Program still offers many companies a real chance to expand or begin developing their international marketing and sales efforts.

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