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COMPARISON OF EXPORT FINANCING PROGRAMS IN CZECH REPUBLIC AND GERMANY

Jan Pícha[1]

[1]*Department of Construction Management and Economics, Faculty of Civil Engineering, Czech Technical University in Prague,*

Abstract

This paper demonstrates increasing and necessary role of European Export Credit Agencies (ECAs) and development banks for reaching success of European exporters in developing markets. Construction and engineering industries have been heavily affected by recent economic conditions and debt crises on national levels. Such a situation resulted in shortage of construction bids in the whole Europe. Taking advantage of national export credits and guarantee programs can result in significant competitive advantage in company's expansion to developing markets worldwide. The markets of Eastern Europe, Middle East and Asia are specific with neglected infrastructure and represent a huge potential for European firms possessing necessary exporting know-how and technologies. In order to withstand the pressure resulting from increasing market competition, exporting firms are forced to come out with tailor made solutions and high level of value added. Delivering project construction together with secured project financing proved to be the key success factor in developing markets which enables European firms to succeed in highly competitive international bids. Ambition of this paper is to introduce and compare export financing programs including availability of credit insurance in the Czech Republic and Germany.

Keywords

Export financing, Competitive advantage, Export Credit Agency, Insurance.

Introduction

The provision of subsidized credits to domestic firms is an important policy tool in many emerging markets and in particular widespread in export sectors. Export sectors are major sources of foreign currency reserves, contribute significantly to GDP growth and employ a large share of the domestic workforce [11]. Several East Asian miracle economies – Japan, Korea and Taiwan in particular – relied heavily on export credit policies and enjoyed export growth rates in excess of 20% during the later half of the 20th century [5]. The wheels of construction and engineering industry are driven by either domestic demand or export market. Prioritizing these drivers lays a solid foundation for sustainable industrial growth. The rationale behind the strategic planning is that export offsets the downsizing of European marketplace. Gunhan and Arditi [2] attributed the expansion of international construction firms to the causes of stagnating domestic markets, risk distribution and increasing competition for resources. Based on their survey of large U.S. construction firms, they concluded that long-term profitability is the key success factor of international expansion. While much research on exporting has been undertaken, researchers note that there are still significant areas that are in need to better understanding [3][7]. One of these areas is identifying the key success factors for the right execution of export financing concept. Ling-yee and Ogunmokun [7] concluded that financial resources were directly related to the development of low-cost as well as high-differentiation export competitive advantage. While the current literature is consistent on importance of access to financial resources for competitive positioning and long-term success, the limited attention has been paid to money lenders and guarantors, i.e. banks and ECAs. Government-backed ECAs were established to provide protection to exporters against possible risks in foreign markets and to assist in making export credit terms competitive with those offered by other countries [10].

Research methodology

For purposes of this research, qualitative approach was selected. The academic literature, interviews and annual reports were the main sources of data. These were analyzed in order to understand their major aspects. Qualitative analysis is an interpretative technique of data collection which is used to increase understanding of a topic. This methodology describes, translates, and otherwise comes to terms with the meaning of certain phenomena [1]. In order to get wide context and support for our arguments, several supplementary interviews were conducted with experts and insiders representing the business environment in Germany and the Czech Republic.

Research motivation

Latest development in construction sector forces construction firms to search for new ways and strategic alternatives in order to sustain their annual turnover, production capacities and specialization. European construction production index demonstrates continuing poor market conditions without significant signs of recovery. Since spring 2008, the level of total construction in the EU-28 has been on a more or less constant decline (see Figure 1).

EU countries have been suffering from the debt crises, whereas developing countries of Eastern Europe, Middle East and Asia massively invest into neglected public infrastructure, in particular into strategic sectors such as of transportation, power engineering, processing and manufacturing facilities. These are the sectors where the German as well as Czech engineering firms have traditionally held unique technological know-how and experience gained through number of infrastructure projects executed in the past. These territories thus represent alternative markets for European contractors.

Availability of export credit insurance plays a crucial role in every export-oriented economy. Especially construction industry which is specific due to large volumes exported requires guarantees issued by government controlled export credit agencies (ECAs). Increasing role of export credit insurance is represented by Figure 2. Such insurance fills in the gab among tools of commercial insurance. Without state coverage, neither contractors nor financing banks, would had enough confidence for participation in these construction projects. Ambition of this paper is to compare the extend and availability of export credit insurance in these both export oriented countries as a possible source of competitive advantage in international market. Based upon that, we would like to come out with recommendations for domestic ECA or domestic exporters.

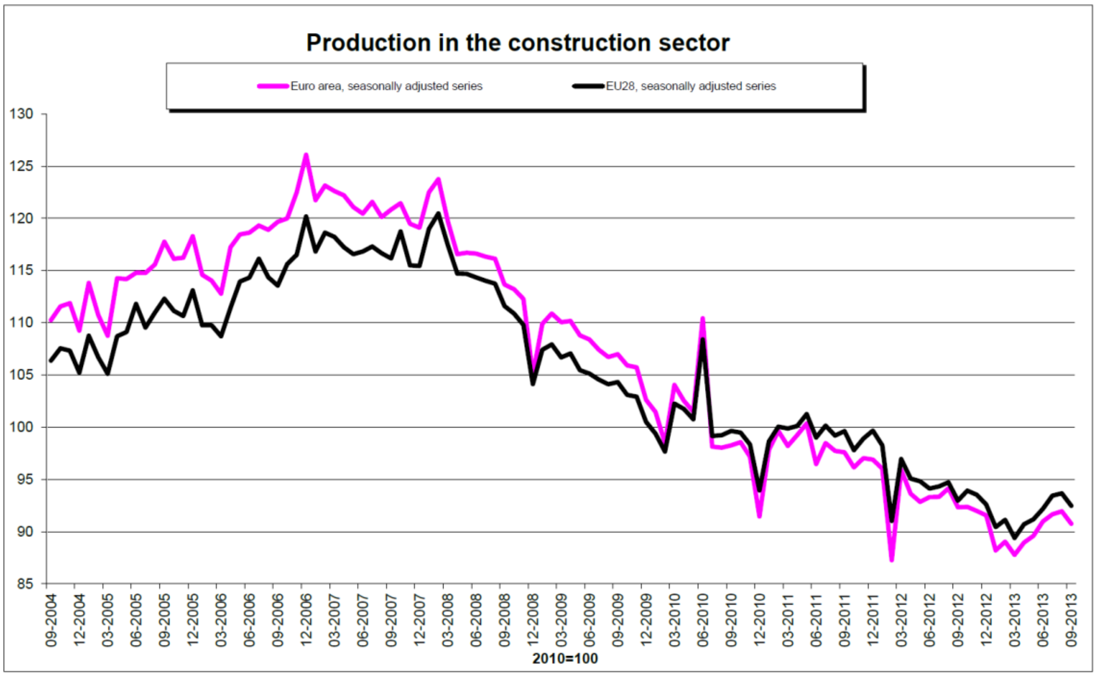

Figure 1.: EU construction production index 2004- 3Q 2013, Source: Eurostat [18]

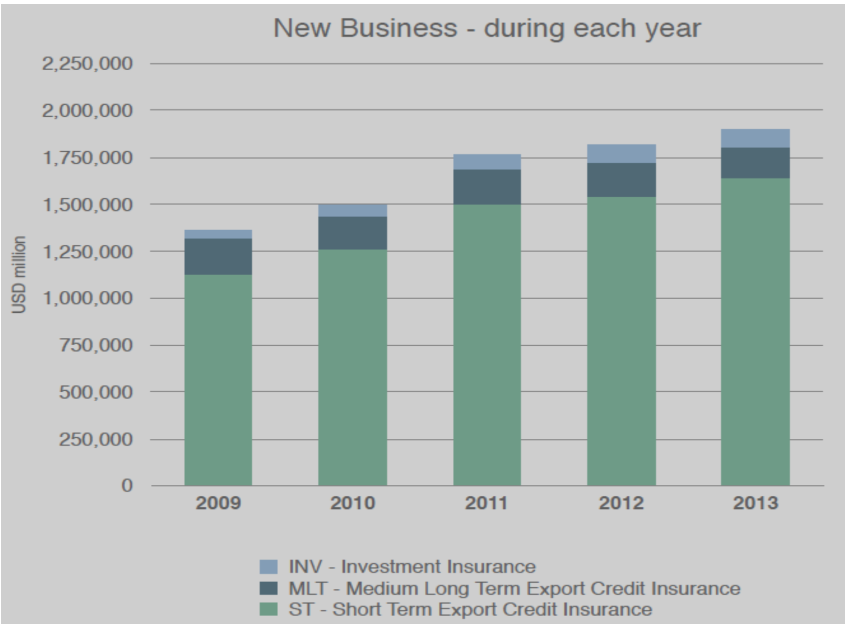

Figure 2.: Increasing volumes of all export credit insurance in the world, Source: Bern Union [12]

Export financing concept in the Czech Republic

CEB – Czech Exporting Bank

National export credit programs are offered by the governments of most industrial nations as a means of facilitating exports and stimulating their own national economies. The official domestic agency is the Czech Export Bank (CEB). CEB is a specialized state owned banking institution for the state support of export. It was set up in 1995 and is one of the main pillars of the government's pro-export oriented policy. The objective of CEB is to provide state support for exports through the provision and financing of export credits and other services connected with exporting. CEB thus supplements the services offered by the domestic banking system by financing export operations that require long-term financing at interest rates and in volumes that are not available to exporters on the banking market under the current domestic conditions. CEB primarily supports projects linked to countries with high territorial risk with high demand for Czech products or services. Export financing credits with maturities exceeding 2 years are preferred. This allows Czech exporters to compete on international markets under conditions comparable to those enjoyed by their main foreign competitors [13].

The recipient of supported financing may be an exporter (i.e. a legal entity with registered offices in the Czech Republic, or in exceptional cases a natural person with permanent residency in the Czech Republic), or their foreign customer.

EGAP – Export Credit Agency (ECA)

Exportní garanční a pojišťovací společnost (hereafter as EGAP) is a national ECA insuring credits connected with exports of goods and services from the Czech Republic against political and commercial risks uninsurable by commercial insurance. EGAP insures in particular bank loans due in over 2 years, insures exports of energy, machinery and technological systems, investment projects, transport constructions, usually to countries where political, economic and legal environment increases the risk of default. Company complements the range of commercial credit insurance products and fills the gap on the market. EGAP acts as a standard export credit insurance company in the role of a government tool to support national exports. The company provides insurance services to all exporters of Czech goods, services and investments, irrespective of their size, legal form and volume of insured exports. EGAP was found in 1992 as a joint stock company fully owned by the Czech state [16].

In line with national export strategy, EGAP provides guarantees mainly for credits to the countries of Eastern Europe and countries of former Soviet Union, where the Czech firms traditionally hold a strong position (Fig. 3).

Export financing concept in Germany

KfW IPEX-Bank

The KfW is a German government-owned development bank. It was formed in 1948 after World War II as a part of the Marshall Plan. KfW is dedicated to the sustainable improvement of economic, social and ecological living conditions. Its statutory functions are those of a promotional bank for the domestic economy and a development bank for the developing countries [6]. Nowadays, KfW banking group covers over 90 % of its borrowing needs in the capital markets, mainly through bonds that are guaranteed by the federal government.

KfW IPEX-Bank GmbH (KfW IPEX), as a largest subsidiary of KfW is in charge of project finance and corporate finance related to German or European exports. Its prime focus is on medium and long-term lending to boost the export economy, develop economic and social infrastructure and support environmental and climate protection projects. IPEX Bank's main sectors of activity are ports, airports, toll roads, bridges and tunnels, railways, ships, planes, telecommunications, energy and manufacturing. It plays a major role in fulfilling the promotional mission of KfW. In 2012 the volume of new commitments generated by KfW IPEX-Bank totaled EUR 13.4 billion [20]. KfW provides mainly export credits to European countries including Germany. Regions of Africa and Latin America still represent minor shares, due to conservative banks' policy and high territorial risks (Fig. 4.).

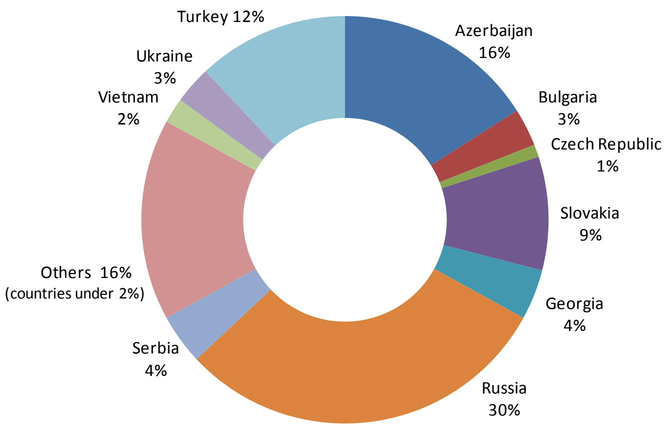

Fig. 3 Structure of credit guarantee commitments of EGAP as of 12/2012, Source: EGAP

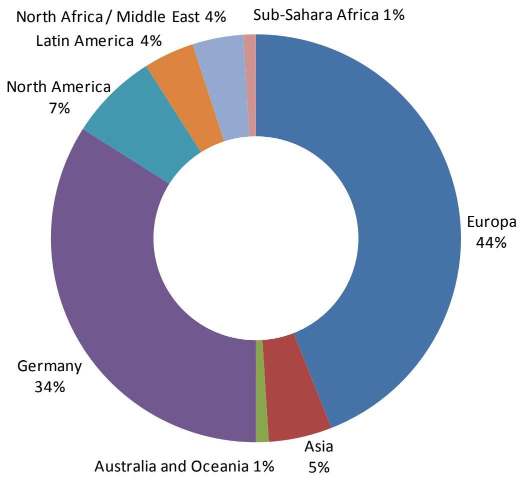

Fig. 4. Structure of credit commitments of KfW IPEX as of 12/2012

Euler Hermes – Export Credit Agency (ECA)

Euler Hermes is the world-leading credit insurer and provider of trade-related credit insurance solutions. It is the largest credit insurance underwriter in the world with 34 % of market share [17]. The Federal Government's export credit guarantee (so called Hermes Cover) protects companies from the risk of bad debt loses in connection with export transactions. These export credit guarantees are mainly targeted at exports to developing countries and emerging markets. Budgetary responsibility is borne by German state. The Federal Republic of Germany provides guarantees against commercial and political risks in connection with export transactions and against the political risks of foreign direct investments as well as political risk cover for projects which secure the supply of raw materials to Germany.

Export credit guarantees support German firms in their efforts to open difficult markets and expand in traditional markets in unfavorable times. By taking out Federal guarantees, German exporters and banks protect themselves from the country and buyer risks involved in export transactions. In addition to non-payment risks, which exist also at home such as insolvency or unwillingness to pay, political non-payment risks also loom abroad, which may result in a complete loss of the trade receivables in extreme cases. These risks include for example the confiscation of goods or the unfair calling of contract bonds. Economic or political reasons may even force an early stop during manufacture. In such a case the exporter will normally be left with the production costs incurred so far on his hands.

Availability of export insurance in Germany and the Czech Republic

Provision of export credit coverage is one of the main government tools on how to stimulate national exports and the availability of this insurance plays a crucial role for exporters when participating in international bids. Germany is an export-oriented economy on the long-term basis, having sophisticated export financing system proven by decades of its successful application. German ECA, represented by Euler Hermes, has a strong balance and offers thus enormous insurance capacity. German exporters, which are a driving force of their national economy, can therefore take advantage of this cover and compete successfully in international markets.

Insurance limits in the Czech Republic are restricted by the possibilities of the state owned ECA – EGAP. Due to the conservative approach of the Czech state, foreign or private insurers are not permitted. Czech export market thus suffers from shortage of insurance limits from territorial as well as from an industrial sector point of view, since EGAP alone is not able to cover all insurance needs. Due to this shortage we can state, that the Czech Republic doesn't fully use its export potential.

For participation in international tenders, the speed and exporters' readiness to secure export financing for foreign investor plays a crucial role. The Czech exporters are often limited by lengthy approval procedures of EGAP, which is inconsistently managed in accordance with current political interests. In contrast to that, German Euler Hermes makes prompt decisions in order to facilitate efforts of domestic exporters and boost national economy, whereas Czech firms struggle with government owned insurers, which is a time consuming process with unclear results.

In order to prove the above mentioned statements, we have compared the volumes of issued insurance coverage by both ECAs with national exports as of 2012 for both countries. The following table demonstrates volumes of state-subsidized export credits in Germany and the Czech Republic. In view of gained results, we can conclude that the proportional insurance ratio in Germany represented by 2.66 % is larger than in the Czech Republic, reaching 2.37 %.

Table 1. Export insurance cover in Germany and the Czech Republic, Source: Author

Category	Euler Hermes Germany	EGAP Czech Republic
Volume of export insurance cover*	29,1	2,9
Country national export 2012*	1095,8	122,2
Export insurance cover / Country national export	**2,66%**	**2,37%**

*in bn EUR current prices

Conclusion

Application of export financing concept and partnering with government agencies significantly contributes to formation of exporters' competitive advantage. Possession of technologies and sufficient extend of reference projects and lowest price bids doesn't necessarily have to lead to desired success in tender. For deliveries to developing countries or countries with high territorial risks securing project financing is a critical requirement.

Despite the slight differences between both financing concepts as presented by the Czech and German government, we can conclude that the idea and key principles standing behind doesn't show any significant differences. In the field of subsidized export credits, there is a strict regulation on an international level. In order to reach fair competitive environment on international markets among the countries, all subsidized financing programs are supervised by the Organization for Economic Co-operation and Development and need to comply with general conditions defined in OECD Consensus. In Germany as well as in the Czech Republic are the conditions of most export transactions set up to maximum parameters. These are strictly defined by OECD Consensus (max. 85% subsidized financing of contract value, max. 95% credit insurance, 100% financing of insurance fee, max. 50% share of foreign supplies, etc.).

Thanks to long-term experience, we can conclude, that the German national export program, implemented through institutions such as KfW IPEX and Euler Hermes, holds a pioneer position proven by decades of pooling expertise through its successful application when financing exports. However the attitude of German Euler Hermes thus still remains a pattern for all other ECAs worldwide. In the view of insured export ratio, availability of credit insurance is much higher in Germany than in the Czech Republic which consequently results in competitive advantage for German exporters.

Despite the slight differences of both presented export financing and guarantee programs, the main and common objectives are to:

- support employment in their domestic markets
- contribute to exports of advanced technologies
- offer exporters' protection from non-payment
- support domestic research and development
- maintain international competitiveness
- promote new products or penetrate new markets
- support infrastructure development
- gain significant benefits for the countries in the long term

Without state guarantees, neither contractors nor financing banks, would had enough confidence for participation in these construction projects. Construction firms gained access to international bids and entered to developing markets with high barriers to entry. National insurance programs thus contributed to infrastructure development as well as boosting construction exports from European countries.

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