

PRACTICAL INFORMATION



HERMES COVER SPECIAL NOVEMBER 2008

Combined use of Export Credit and Investment Guarantees

EXPORT CREDIT GUARANTEES OF THE
FEDERAL REPUBLIC OF GERMANY

► **Hermes Cover**

► HERMES COVER SPECIAL

Combined use of Export Credit and Investment Guarantees

COMBINED USE OF EXPORT CREDIT AND INVESTMENT GUARANTEES

The German economy is focussed to a high degree on the export of goods and services. Companies who want to establish themselves over the long term in foreign markets normally not only have to adapt themselves to foreign standards and legal systems, but need to take account of local competitors and consumer behaviour which may differ from that on the German market. In many cases this means that the German exporter automatically becomes an investor over time: as a measure to support the sale of his products it is often necessary not only to set up marketing and service companies, but also production lines in the importing country.

The **EXPORT CREDIT GUARANTEES** and the **INVESTMENT GUARANTEES** are export promotion schemes of the German Government which have proved themselves to be successful over the years and can provide support precisely tailored to the individual project for German companies which want to go abroad. The two forms of guarantees can be deployed either alone or in combination.

While export credit guarantees cover export transactions against the (commercial) buyer risks and/or (political) country risks, investment guarantees protect direct investments abroad exclusively against political risks. The OECD Consensus does not apply to investment guarantees and, in contrast to the export credit guarantees,

the premium is normally independent of the country and buyer risk in the individual case, and is a uniform 0,5% p.a.

There is a whole range of options for using the two instruments. The following pages illustrate a number of practical examples.

PRACTICAL EXAMPLES

A. MARKETING COMPANIES

Small and medium-sized enterprises which in the past delivered their products directly to foreign buyers have frequently moved on to establish their own marketing and service companies in their key foreign markets in the developing and emerging countries. Today, selling only from Germany is as a rule an inadequate solution to meet the demands placed on a company faced with global competition. There are many reasons for this. On the one hand, it is worth mentioning here the numerous local regulations concerning imported foreign goods which the exporter constantly needs to monitor and apply to his own product range. On the other hand, long-term customer loyalty is of outstanding importance in the case of high-value industrial and consumer goods, in order to be able to optimise planning in procurement and manufacture. Over the long term, this can only be secured with a local presence. The German exporter who does not establish a local marketing and service company in most cases loses market shares in the long run. In the worst case this can lead to being completely squeezed out of the market, which in the end has consequences not only for German exports, but for the economic viability of the German exporter and the jobs he provides.

Federal Government guarantees support German companies in the situation described above and provide cover commensurate with the risks for the different phases of opening up a new market:

In the initial phase of a foreign business venture, the German exporter delivers goods directly to foreign buyers whose financial strength he is only partially able to assess. He is therefore exposed to both commercial and political risks. In this situation export credit guarantees help to reduce both types of risk.

In a second phase the German enterprise establishes a marketing company locally, in order to open up the market for the long haul. Some time has already passed since the first deliveries were made from Germany, and in the meantime enough experience has been gained with regard to potential customers and the requirements they have as to the features, design and quality of the products. As a result, the commercial risks of the market have usually become more easily calculable. The political risks, however, are still beyond the power of the German company to influence. For this phase, too, the Federal Government makes individually tailored cover available to German companies in the form of export credit guarantees for goods and services as well as investment guarantees for the business commitment in the foreign country.

While investment guarantees can only provide cover against political risks for the equity participation of the German company in the marketing company in such cases, the scope of cover available under the export credit guarantees varies according to whether one of

two basic scenarios is given. If the receivables due to the marketing company from the foreign buyer are openly assigned to the German exporter prior to the commencement of the risk, both commercial and political risks in connection with these claims can be covered by an export credit guarantee. The Federal Government does, however, exclude any further risks which may be involved in such a contractual construction from cover compared with transactions contracted directly with the exporter. Both the German exporter and the foreign marketing company are obliged to follow any instructions given by the Federal Government. Moreover, the German exporter must be answerable for the actions of the foreign marketing company. However, if it is not possible to openly assign the receivables due to the marketing company from the buyer to the German exporter, cover under the export credit guarantees only applies to the receivables due for the delivery to the marketing company (subsidiary) and is limited to political risks (including insolvency caused by political measures). The two forms of cover described above can be deployed in parallel.

Especially for German small and medium-sized businesses with only limited equity capital, the combined use of both instruments can present a distinct advantage. The promotion schemes of the Federal Government impact both on the liquidity and the creditworthiness of the German companies, thus helping to safeguard German manufacturers and ensuring a level playing field in international competition.



B. PROJECT FINANCE

In practice, the focussed combination of both instruments is also found in **PROJECT FINANCE** constructions. Project finance means the financing of the investment costs of a business entity (a project company) where the borrowed funds are repaid exclusively from the (future) cashflow of the business entity. In principle, the assets of this business entity are the only collateral available to the lenders (see also in this context the brochure “**PROJECT FINANCE – THE ESSENTIALS**” in the series “Hermes Cover Special”).

In international plant construction projects above a certain size and with a significant interest from the state institutions of a country are often given a project finance structure in which a project company acts as buyer for the plant and is obliged to operate it for a fixed number of years after construction. The conditions of tender for such projects usually stipulate an equity participation in the project company by the exporter and thus a contribution towards the financing of the project. The state is also often involved in the project company, either directly or indirectly via state-owned enterprises, and is in many cases involved in addition as granting authority for concessions or through offtake agreements for the products.

The German exporter is exposed to a variety of risks over which he has no influence in such projects. On top of this, in such project constructions it is inherently difficult to separate the commercial and the political risks.

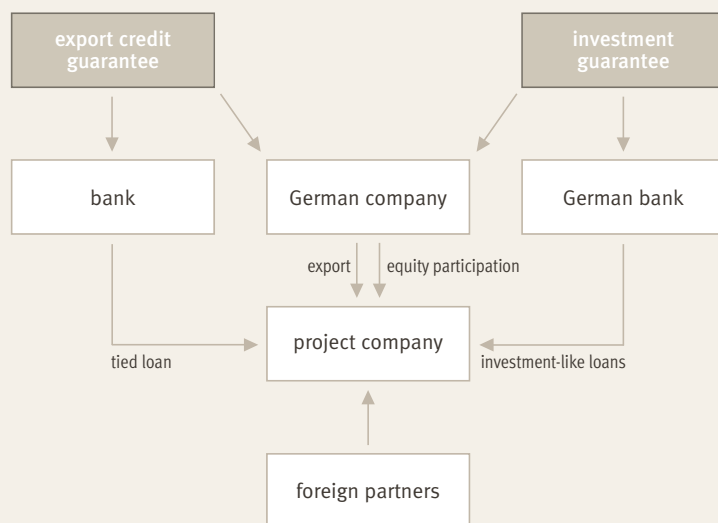
Since the liability risks in project finance business remain in principle at the level of the project itself, and do not extend to the creditworthiness of those involved in it, it is of crucial importance in deciding whether a project can be financed to clearly limit the identified risks.

Federal export credit and investment guarantees provide firm support here, since both promotion schemes can be built into the collateral construction of the financing, thus helping to secure the realisation of the project: In such cases the export credit guarantees secure exports as well as the tied loans given to the project company in this connection against commercial and political risks. Investment guarantees, on the other hand, protect the German exporter’s equity investment against political risks. (You can find further information on the use and types of investment guarantees in project finance in the information leaflet “**PECULIARITIES OF OPERATING MODELS**”.)

Over and above this, investment-like loans from the German shareholder or from German banks are also often factored into the financing construction of project-financed transactions in addition to tied loans. Investment-like loans can be covered under investment guarantees, provided that they comply with the requirements defined by the Federal Government for the eligibility for cover. The precondition for this is that the investment interest in the foreign project is paramount, not the financing of German supplies of goods and services. Investment-like loans are therefore particularly suitable for financing local costs. They are not subject to the OECD Consensus and for that reason can have variable credit periods and capital repayment schedules.



COMBINED USE OF EXPORT CREDIT AND INVESTMENT GUARANTEES



Cover combining both instruments in a project has up to now been used primarily in connection with infrastructure, energy and mineral resources projects. Since this combination presupposes an intensive process of consultation between all the entities involved, it is advisable to contact the consortium mandated by the Federal Government to handle this business – Euler

Hermes Kreditversicherungs-AG and Pricewaterhouse-Coopers AG Wirtschaftsprüfungsgesellschaft – at the earliest possible stage of project design. Only in this way can it be guaranteed that the decisions necessary to secure cover for the project are taken in good time.

Herwig Maaßen

Cover from the Federal Republic of Germany for business transactions abroad

The German Government supports German business ventures abroad with its Export Credit and Investment Guarantee Schemes as well as the Untied Loan Guarantee Scheme, thus securing economic growth and safeguarding jobs. To this end, the Federal Republic of Germany provides guarantees against commercial and political risks in connection with export transactions as well as against the political risks of foreign direct investments. In addition to this framework, it is also possible to cover the commercial and the political risks of untied loans relating to projects which are in the overriding national interests of Germany.

The German Government has mandated a consortium formed by Euler Hermes Kreditversicherungs-AG and PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft to manage these promotion schemes.



Federal Ministry
of Economics
and Technology

OUR PARTNERS



EULER HERMES
Kreditversicherung



**Euler Hermes
Kreditversicherungs-AG**
Federal Export Credit Guarantees

Postal address
22746 Hamburg

Visitors should call at
Gasstraße 27
Hamburg - Bahrenfeld

Phone: +49 (0)40/88 34-90 00
Fax: +49 (0)40/88 34-91 75

info@exporkreditgarantien.de
www.agaportal.de

Branch offices: Berlin, Frankfurt,
Hamburg, Köln, München, Stuttgart