Approved February 18, 1988
Date

MINUTES OF THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT.

The meeting was called to order by Senator Wint Winter, Jr. at
Chairperson

12:40 ~~xxx~~./p.m. on February 11, 1988 in room 254-E of the Capitol.

All members were present except:
Senator Paul Feleciano - Excused

Committee staff present:
Bill Edds, Revisor of Statutes' Office
Lynn Holt, Kansas Legislative Research Department
Mary Allen, Secretary to the Committee

Conferees appearing before the committee:
Harland Priddle, Secretary of the Department of Commerce
Harry Salisbury, Director of the Trade Development Division, Kansas Department of Commerce

The meeting was called to order at 12:40 p.m. by the Chairman, Senator Wint Winter, Jr.

The Chairman said that the Committee would hear testimony on export matters and he added that the Kansas Department of Commerce (KDOC) was asked by the Joint Committee on Economic Development to study what could be done to help Kansas businesses in the export market, to conduct a needs assessment and to look at what other states are doing to help their businesses with the export market.

Harland Priddle, Secretary of the Department of Commerce, spoke on export programs and discussed the needs assessment information which KDOC has received. He gave the Committee a comparison of state programs involving financing and other support systems throughout the United States. (See Attachment I for his statement. Appendix A and Appendix B are on file in the Kansas Legislative Research Department, Room 545, Statehouse, Topeka, Kansas.) Secretary Priddle stated that the data on the problems of exporting which KDOC has collected to date substantiates the following needs:

1. A need exists for export financial assistance programs to aid small and medium size businesses in Kansas.

2. Market information on products in foreign countries is required by all size firms and all types of industries.

3. There is inadequate knowledge of export know how in the companies of Kansas to conduct international market operations.

The Secretary called the attention of the Committee to a summary entitled "State Export Finance Programs in Operation as of August 1987" (Attachment II) and noted that it outlines thirteen different state programs offering a variety of services.

Secretary Priddle said that the KDOC feels that the State of Illinois has the most comprehensive export program and that it has made the biggest commitment as far as funds and programs are concerned when compared to all other states. He called on Harry Salisbury, Director of the Trade Development Division of KDOC, to review the Illinois program for the Committee.

Mr. Salisbury first discussed the Illinois Export Financing Program. He said that the Illinois Export Development Authority (IEDA) provides competitive-rate, low-risk export financing on a continuing basis. The source of funds for financing is $15 million in bonds, not backed by the state nor by dedicated revenue, but by a partnership between IEDA and the financial industry. The bonds form a pool of money that is loaned by IEDA to provide qualified exporters with pre or post shipment financing. Mr.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT,

room 254-E, Statehouse, at 12:40 ~~a.m.~~/p.m. on February 11, 1988.

Salisbury spoke to the Committee on the Foreign Credit Insurance Association (FCIA) and addressed the consideration of the State providing access to an FCIA Unbrella Insurance policy to be used by Kansas exporters. He also discussed a Shared Foreign Sales Corporation and noted that through such a corporation an exporter may qualify for a reduction in Federal taxes as they apply to the profits of his exports. The fourth area Mr. Salisbury addressed was that of a Trade Fair Assistance Program. He said that this program would assist new-to-exports firms or companies new to a particular market to receive assistance to attend an appropriate trade show. At the end of his presentation to the Committee, Mr. Salisbury reported on some of KDOC's considerations concerning what would be involved if the four programs which he discussed were to be implemented. (See Attachment III for his testimony. The Exhibits with Mr. Salisbury's testimony are on file in the Kansas Legislative Research Department, Room 545, Statehouse, Topeka, Kansas.)

The Chairman announced that he will appoint a sub-committee to work with KDOC to determine whether or not legislation should be introduced which would set up an export program in Kansas such as the one in Illinois.

The meeting was adjourned at 1:30 p.m. by the Chairman.

GUEST LIST

NAME	REPRESENTING
~~KDOC~~	
Harry Salisbury	KDOC
Jim Kadel	KDOC
Debbie Zabel	IPPBR Univ. of Ks.
Harlene Riddle	KDOC
D. WAYNE ZIMMERMAN	KDOC
Pat Mah	KDOC
Terry Denker	KDOC
Beth Tatarko	Kansas Inc.

Attachment I

TESTIMONY

on

EXPORT PROGRAMS

to the

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT

by

HARLAND E. PRIDDLE

SECRETARY OF COMMERCE

February 11, 1987

Attachment I
Senate Eco Devo
2-11-88

EXECUTIVE SUMMARY

A great majority of the firms surveyed do not participate in the market despite the fact that they have a real potential and a desire to do so. Their potential is unrealized; therefore, the need exists that their present views be corrected. A major problem facing Kansas firms is their present market targets. The majority of their products are aimed at the local and state market despite the fact that they listed a static and declining market for their products as one of their major problems. Presently these firms only export one percent (1%) of their products in the international market.

The fear of exporting is mostly found to be with the small firms. They have a real potential for exporting, but their mistaken views of exporting prevent them from doing so. Factual information about exporting and affordable ways to finance exporting must be given to these small firms as well as other firms.

Major problems with exporting are high tariffs and/or trade barriers. Inadequate knowledge of foreign markets and export know how were two other major problems. Lack of financing is also a problem, but mostly with small to medium sized companies (1 to 100 employees).

The survey found that Kansas must tell firms how to enter the international market and ways of doing so. Exploration of methods of export for small firms needs to be developed. Better use of information networks and providing facts concerning economic development assistance is needed. Assistance must encompass areas such as financing, adaptation to new technologies, and access to international trade. Costs and efforts for contacting these firms will require greater attempts than those occurring at present.

Although small firms have the most problems in expanding into the international market, presently successful exporting firms must not be forgotten. These firms must be given continual assistance if they are to remain successful and continue to expand.

Mr. Chairman and Members of the Committee, our presentation today will be divided into two parts. I will discuss the results of the needs assessment information we have received as of this time and, also, a synopsis of comparison of state programs involving financing and other support systems throughout the United States.

The second portion of the presentation today will cover the in-depth review of the Illinois program by our trade development staff under the direction of Harry Salisbury. He will review their program in some detail and provide information in the areas of trade fair assistance, export financing, foreign sales corporations, and other related activities.

To begin our discussion of the assessment of needs and capabilities of companies for export activities, I would like to cite information from a preliminary draft of our business retention survey which was completed during the month of January. This survey covered 10 cities in Kansas ranging from populations of 10,000 to 100,000 and interviewed over 850 businesses. Publication is underway and will be completed within a few days and distributed to you and other legislators. Following are comments taken from this survey and study as they apply to international markets.

1. The firms in Kansas mid-size communities generally sell their products or services in the local and state markets with very few firms using the international

market for products or services (i.e. 55% of 852 companies sold only in the local market, 27% in the state market, 17% in the national market and only 1% in the international marketplace). This is a critical finding because we believe our state's competitiveness and economic future depends upon the ability for us to develop export markets and to participate in many markets at the same time. In Kansas mid-size communities, this is not happening. The distribution of products is locally oriented.

2. As we analyzed these very important statistics, we found that 42% of the companies stated that a static or declining market was a problem. Approximately 24% stated that lack of financing was a problem with expansion. As previously stated, 55% of firms stated their market was locally oriented. When questioned about expansion, 42% stated that a declining market was the problem, which concludes that local oriented markets cannot survive or expand in the future. With this background, lets proceed now to attempt to evaluate the reasons and problems as well as the needs for companies to expand in the international marketplace in Kansas.

Out of the total number of firms currently not exporting, 14% stated they had the potential to expand internationally, and 13% stated they had the desire to expand internationally. Manufacturing and financing companies, in particular, have the potential and desire to expand. The charts on the following pages explain these in more specific detail.

You will note the size of company does not particularly influence the desirability to expand into the international marketplace. With relation to the types of businesses desiring to expand, manufacturing, mining, and financing lead the group.

Moving away from those companies which have the potential to expand to those who have the desire, we find that similar statistics apply. Firms desiring to expand into the marketplace were 13%. The same basic criteria exists as it relates to size of company and type of business as was in the potential area.

We also reviewed the reasons for not expanding into the international marketplace during the business retention survey. The lack of affordable financing and the lack of current market information for products are the major reasons that keep firms with the desire to export from actually expanding into the international marketplace. Tables 65 and 66 break down the reasons given for the prevention of exporting a product or service. First of all, by size of firm; lack of knowledge and affordable financing rated reasonably high. The size of the firm also influenced some decisions as it relates to the variables of the sampling. With relation to exporting by industry, available financing again rated very high on the list of things preventing them from entering into the international marketplace.

We also looked at the problems associated with companies who are now exporting but were experiencing difficulties in maintaining exports which are competing in the international marketplace. At present, firms that are exporting do have problems. Problems in mid-size Kansas communities that are significant are the lack of financing, inadequate knowledge of other countries' markets, and inadequate knowledge of export know how. Smaller firms and manufacturing firms have these problems more than other size or industry firms. Companies that are already exporting should not automatically be considered successes. They will need assistance to stay competitive. The charts on the following page outline the particular and specific problems of exporting by size of firm and by industry. As we look to the future, we believe the data we have collected to date substantiates the following:

1. A need exists for export financial assistance programs to aid small and medium size businesses in Kansas.

2. Market information on products in foreign countries is required by all size firms and all types of industries.

3. There is inadequate knowledge of export know how in the companies of Kansas to conduct international market operations.

To assist us in developing an analysis of state programs, we contacted several states and worked cooperatively, in particular, with the state of Wisconsin. Included in Appendix B are the results of the Wisconsin survey of state financial programs. The summary of the state export finance programs in operation as of August 1987 outlines 13 different state programs offering a variety of services. The chart contained in Appendix B outlines specific levels of appropriation and funding as well as the services provided.

After reviewing and analyzing these states' programs, we decided to review in detail the Illinois program for you. Harry Salisbury, Director of the Trade Development Division, will conduct this review. In our opinion, Illinois has made the biggest commitment as far as funds and programs when compared to all other states.

Attachment II

Attachment II Senate Eco Dev 2-11-88

STATE EXPORT FINANCE PROGRAMS IN OPERATION AS OF AUGUST 1987

State	Type of* Authority	Year Operational	Funding Source	Amount of Fund	Counseling	FCIA Insurance Administration	Loans-to-Lenders		Loans-to-Exporters		Loan Guarantees	
							Pre Export	Post Export	Pre Export	Post Export	Pre Export	Post Export
California	A	1985	Appropriation	$3,000,000	X						X	X
Colorado	B	1987	Appropriation	$500,000	X			X				
Connecticut	B	1987	Appropriation	$1,000,000						X	X	X
Illinois	A	1984	Bonds	$100,000,000	X	X	X	X				
Indiana	B	1983	Appropriation	$8,500,000***							X	
Louisiana	A	1984	Bonds	Promissory notes issued as needed						X		
Maryland	B	1985	Appropriation	$7,000,000	X	X					X	X
Minnesota	A	1983	Appropriation	2,000,000	X	X					X	
Missouri	B	1984	Appropriation	N/A		X						
Ohio	B	1983	Allotment**	$100,000,000***		X	X	X				
South Carolina	A	1985	Appropriation	$50,000	X	X						
Tennessee	A	1983	Appropriation	$100,000	X							
Washington	A	1983	Appropriation	$400,000	X							

*A. Creation of a new export authority or agency as a separate entity or as a new office within an existing department.

B. Expansion of the responsibilities of an existing agency.

** This is a "linked deposit" program. Using state funds, the state deposits money that the bank then lends to a qualified small business at below market rates. This is a variation on the loans-to-lenders approach and is not restricted to exporters.

*** Program is not specifically an export financing program, but export financing is one of several eligible activities for program funding.

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Attachment III

EXPORT FINANCING TESTIMONY

TO

THE SENATE ECONOMIC DEVELOPMENT

COMMITTEE

FEBRUARY 11, 1988

BY

HARRY SALISBURY

DIRECTOR

TRADE DEVELOPMENT DIVISION

KANSAS DEPARTMENT OF COMMERCE

Attachment III
Senate Eco Devo
2-11-88

INDEX

INTRODUCTION

This report addresses the issues and policy questions reported under Topic IX of **Interim Committee Report of the Joint Committee on Economic Development** to the 1988 Legislature, December 21, 1987.1 Its primary emphasis is in four areas:

1. **Illinois Export Financing Program-**

   The Illinois Export Development Authority (IEDA) provides competitive-rate, low-risk export financing on a continuing basis. The source of funds for financing is $15 million in bonds not backed by the state nor by dedicated revenue, but by a partnership between IEDA and the financial industry. The bonds form a pool of money that is loaned by IEDA to provide qualified exporters with pre - or post - shipment financing.

2. **Foreign Credit Insurance Association-**

   This area addresses the consideration of the State providing access to an FCIA Umbrella Insurance policy to be used by Kansas exporters. An FCIA policy can insure an exporter on favorable terms against the foreign commercial and political risks with respect to the "receivable funds" resulting from an export shipment.

3. **Shared Foreign Sales Corporation-**

   Through a Foreign Sales Corporation an exporter may qualify for a reduction in Federal taxes (possible state) as they apply to the profits on his exports. The Trade Development Division of Kansas Department of Commerce sponsored a seminar on February 10, 1988, to explain an FSC to Kansas exporters and measure the level of interest among the attendees for the state to establish such a program.

4. Trade Fair Assistance Program-

This program would assist new-to-exports firms or companies new to a particular market to receive assistance to attend an appropriate trade show. We visualize this as an excellent program for Kansas exporters and it would provided 50%, up to a maximum of $2,000 for certain trade show expenses.

5. Considerations-

The fifth area contains considerations on each of the above topic areas.

I. THE ILLINOIS EXPORT FINANCIAL PROGRAM

The Illinois export finance program is recognized as perhaps the most successful one in the United States. However the finance program is only one part of a very strong commitment that Illinois had made to international development. This commitment includes the 200 million dollar World Trade Center being built in Chicago, a strong network of well financed state offices around the world and almost 100 state employees working on international development. The driving force behind international activities is the Illinois Export Council.

THE ILLINOIS EXPORT COUNCIL

The Council was created by legislative statute and is composed of 18 members, of which 17 are primarily from industry and banking and the 18th member is the Chairmen, the State's Lieutenant Governor. The Council has a staff of 6 and a budget of $300,000.

The Council was authorized by statute to:

- **coordinate activities of their Department of Commerce and Community Affairs/Department of Agriculture**
- **recommend state policies for enhancing exports**
- **compile export data**
- **to assess the scope of export business in the state**

The Council is staffed by the Lt. Governor's office and coordinates with the Agricultural Department's Marketing Division, Department of Commerce and the Illinois Export Development Authority. The Council itself is responsible for:

-Foreign Sales Corporations (FSC)

-Export Internships

-Various Seminars

-Coordinating and the acutual directing if desired of the various international activities within the state

The Council is currently feeling its way but is in the process of establishing itself as the guiding body for Illinois's international development.

ILLINOIS EXPORT DEVELOPMENT AUTHORITY

The IEDA is a separate organization that also reports to the Lt. Governor. The IEDA was created to **provide export financing to small and medium size businesses.** Established in 1983 by Public Act 83-919 and as amended by Public Act 83-1523 for the purpose of assisting in developing, promoting and expanding the exports of manufactured goods and services by Illinois firms. The Authority is governed by a Board of Directors of nine members, eight members of which are appointed by the Governor with the advice and consent of the Senate with the Lt. Governor as chairman. (See Exhibits 1,2 and 3)

The Authority is authorized to issue revenue bonds up to $100,000,000, the proceeds of which may be used for the purpose of making participating loans.

Illinois reasoning for the need of this type of financing is as follows:

Very few banks in their state are capable or willing to finance exports. Those banks that do are primarily the larger banks and provide their services to the larger exporters, and there is not much availability of export financing for smaller firms. Illinois contention is that a firm with smaller project financing requirements (10K - 500K) does not have much access to such funds, and the program was established to rectify this.

(Exhibit 4 is a current listing of banks which have been approved by IEDA for participation in the program).

The financing that IDEA can offer is of two types:

Pre-shipment financing provides the exporter with working capital to produce the goods identified in the sales contract.

Post-shipment financing allows exporters to extend payment terms up to 180 days, and to get paid for these orders at the time of shipment without the commercial and political associated risks.

HIGHLIGHTS OF THE ILLINOIS EXPORT FINANCE PLAN

1) The state basically does not have much risk as the financing is reinsured through the Federal Credit Insurance Agency (FCIA). This is a unique FCIA policy and it is our understanding that Illinois is the only state to have this type of hold harmless provision. However please note the hold harmless provision only applies to the post-shipment financing and does not apply to pre-shipment financing. As a result of the much greater risk for pre-shipment financing Illinois has tended to concentrate on the post-shipment financing.

2) Although Illinois is allowed to issue 15 million dollars in bonds, only about $650,000 of state money has actually been required due to the ability to leverage.

3) Illinois has 60 participating banks, many of whom were smaller banks which had not been involved in exporting at all, but now through the program can be, and as a result can offer more services to their customers. Illinois feels this program does not conflict but compliments the larger banks. Please note the bank when doing post-shipment financing through the Illinois FCIA policy is also held harmless.

4) The program will finance up to 90% of the export order value. The participating bank normally puts in 10% and IEDA 90% of the financed amount. The amount can be financed up to 180 days.

5) Any Illinois firm that exports is eligible, but there is a requirement that at least 25% of the final value added (exclusive of profit) be done in the state.

6) The only collateral required is the international receivable generated by the export.

7) IEDA offers their portion of the financing (not including insurance premium) at approximately 1% to 1½% above the prime rate. Illinois charges the exporter the FCIA insurance premium at cost and does not try to make a profit from this as most other FCIA brokers do. The bank on their portion (normally 10%) can set their interest rate as desired. Illinois is currently considering lowering their rate to prime to make it more attractive to the exporter.

8) One of the key ingredients of the program is the professional staff that IEDA has recruited to include an international banker, a former FCIA administrator and an ex U.S. Department of Commerce employee who was active in sponsoring this type of programming at the federal level.

IEDA's budget is approximately $275,000. If there is a weakness, and Illinois readily admits this, that is that, they need to pay more attention to the marketing of the program and they are currently in the process of increasing their staffing to do so.

9) The actual financing process is relatively simple, and is briefly described as follows: The exporter either contacts IEDA direct or their local bank, if they are a participant. IEDA then works with the exporter in filling out the paper work. Both the U.S. seller and the foreign buyer need to be qualified by FCIA before financing can occur. It is possible that both buyer and seller can be pre-qualified up to a certain credit limit prior to signing any contract or both can be qualified after the signing of a contract. Once qualified IEDA works with the participating local bank and provides their portion of the funding, which is usually 81% of the contract amount, 9% from the bank and 10% held by the exporter. IEDA usually charges prime plus 1½ percent on their portion and the bank is free to set their rate as they desire. Normally the bank then shows the exporter just one blended rate of interest for both their portion and IEDA's.

The local bank handles the foreign receivable. When it is collected the bank deducts their portion and then sends to IEDA theirs. Both IEDA and the bank keep tabs on the collectable and regularly report to FCIA overdue accounts.

To date Illinois has not had a foreign buyer default on a payment, and thus cannot say with accuracy exactly how the FCIA refunding would work.

10) In 10 months of operation IEDA has loaned approximately 5½ million dollars in some 60 loans. They currently have some 2 million dollars out on loan. As they have raised 15 million dollars the system financially could support many additional loans. The main reason for this is probably attributable to the weakness in marketing the program to both exporters and banks.

Response from State of Illinois Staff

To Kansas Interim-Committee Report Questions

December 21, 1987

a. **Whom should a state export finance program serve?**

Since it is the small-to-medium size businesses that could have difficulty securing bank export financing, that should be the focus of a state program. IEDA puts no floor on the size of loan they will make and the upper limit is $500,000, which would support a sale of $555,500 ($500,000 - 90%).

b. **How much and what type of financial counseling is needed?**

A considerable amount of financial counseling is needed. This effort is directed to both the participating banks and to the exporters.

With respect to the size of banks that usually serve small-to-medium exporters, they require counseling that post-shipment financing can be virtually risk-free because of the underlying insurance coverage provided by IEDA from FCIA (EX-IM Bank). Many of these banks have not been actively engaged in export sales and therefore must be counseled on the export transaction itself, i.e. letters of credit, export licensing, shipment documentation, etc. This is still necessary even though IEDA provides much of the documentation services with respect to FCIA insurance coverage since the bank handles the actual receivable.

The counseling effort directed toward the exporter is largely one of marketing the advantages of additional financing to cover either the order receivable or working capital to produce the goods. The availability of these funds can influence the company to export for the first-time or to increase their efforts to export additional goods.

When IEDA held its initial seminars to explain the program, the exporters (both active and potential) used the expression "this is great". However, their local banks said, "use the big bank". Obviously this would be a problem for the small exporter because the large Chicago banks usually require a minimum of a $1 million loan. The IEDA staff contends now that the larger banks are supportive of the program and some have even joined as it gives them a vehicle to do $100,000 to $200,000 loans.

c. **Should the state be a lender or only a guarantor?**

The Illinois staff believes that a direct-loan program is more effective and cost-efficient than a guarantee program for the following reasons:

1) Under a guarantee program the state's money is put at risk. If there is a default under the purchase contract the state must pay. Under a fully insured Illinois-type direct-loan program the state's money need never be at risk. Under a guarantee program the state becomes the insurer instead of an insured.

2) Guarantee programs do not provide any new assistance that is not available privately or through FCIA. The lack of insurance is usually not the reason that exporters cannot obtain financing. Under most guarantee programs the banks exposure is still generally too high (up to 15%) for most banks to take a risk. Under an Illinois-type insured direct-loan program the bank has virtually no exposure and is covered for any loss.

3) A bank's cost of administering a $50,000 export loan is practically the same as for a $5 million dollar export loan. These costs usually make it unprofitable for a bank to handle a small export loan even if it is guaranteed by a state. A properly developed direct-loan program eliminates almost all of the paperwork, substantially reducing administrative costs. The bank needs to make no credit decision on either the exporter or the foreign buyer. A properly developed program can make export financing almost as easy as domestic financing.

4) Guarantee programs do not insure that exporters can obtain financing at competitive rates. The bank can establish whatever interest rate it desires on the entire loan. With a 15% uninsured exposure, many smaller banks are likely to set a high-risk interest rate. Under a direct-loan program the rate to the exporter should be lower because of the reduced risk.

5) Loan guarantees are not as cost-efficient as direct-loan programs. Generally, guarantee programs can be leveraged about 3 to 5 times. Thus, every $1 million set aside for a guarantee program can support only $3 to $5 million in export loans. Illinois direct-loan program has a leverage of approximately 28 to 1. With a capital reserve of only $650,000 Illinois (through use of its bonding authority) is able to provide financing for up to $18.5 million in exports at any one time.

The final determination on whether to go with a loan guarantee or a direct-loan program will, of course, depend on a state's particular needs and resources. In general, however, a properly structured direct-loan program is less costly to establish and administer, provides greater assistance to the exporter, and reduces the risk of loss to the state and participating bank.

d) How much, if any, credit risk should the state assume?

Under the Illinois program for postshipment financing it is not necessary for the state to assume any credit risk.

As the result of approximately 18 months of experience with their program, IEDA is now considering making a request for legislative authority to extend loans in some cases to exporters that do not qualify under FCIA insurance rules. They feel this could be advantageous for new-to-export companies without a credit history. In such cases, the state would bear some credit-risk.

e) **What other service gaps exist with respect to export activities?**

- Market research
- How to get an export order
- Shared Foreign Sales Corporation
- Export Trading Companys
- Trade Show Assistance
- Performance Bonds

f) **What policy options exist that would deter the state from competing unfairly with financial institutions?**

The IEDA financing program provides loan funds to the exporter's bank. Therefore, rather than competing, the program is supportive of private financial institutions.

g) Please note the following exhibits are also enclosed with in this report:

Exhibit 5 Illinois Export Council Annual Report of 1986

Exhibit 6 Illinois Export Development Authority Annual Report of 1986

Exhibit 7 Illinois Export Development Act of 1983 Legislature

Exhibit 8 Illinois Export Development Act of 1985 Legislature

Exhibit 9 Lt. Governor George Ryan Testimony on need for finance program

Exhibit 10 Chicago International Associates Export Finance Program

COMMENTS OF Ms. Betty J. Drogos, V.P.

International Banking Services

Parkway Bank & Trust Co., Harwood Heights, Illinois

Regarding participation in the Illinois Export Development

Authority Program for Export Financing

1. Large banks with international experience do not look favorably on small loans of $500,000 and less.

2. Her bank is a medium-size "community commercial" operation with $251 million in assets.

3. Most banks the size of Parkway and smaller fear financing associated with international business transactions. However, Ms. Drogos has 23 years of banking experience of which 16 years has be related to international import business and is comfortable with export financing.

4. **IEDA Program Positives:**

a. IEDA's management and handling of documents necessary for the loan and insurance was very competent.

b. The IEDA staff (Chicago and Springfield offices) are professional, knowledgeable, and supportive of banks and exporters.

c. Participation in IEDA's finance program permits the bank to do business development with potential new bank customers, and to offer better services to their existing customers that export.

5. **IEDA Program Negatives:**

a. Would have preferred that IEDA present a seminar for participating banks at the beginning of the program. None was held and a "case study" type of presentation covering the mechanics of the program is still needed.

b. There is no advice available to banks as to what will <u>actually</u> transpire in case there is a default on a loan. The financing program has not been "tested" through an actual default procedure.

c. The larger Illinois banks show no interest in the IEDA program.

d. The local bank supplies 10% of the loan amount. A loan origination fee at an annual rate of 1% is permitted. Also, the bank can set the finance charge on their portion of the loan (usually prime plus 2%). Example: \$100,000 loan x 1% loan origination x $\frac{60 \text{ days}}{365 \text{ days}}$ = \$165

plus interest of \$100,000 x 10% participation x (.02 + .0875 interest) x 60 days/365 days = \$176

Thus, the economics to the bank of \$341 income are not attractive.

e. The kind of company that is applying for IEDA financing is of the "entrepreneurial" style and generally not long-time manufacturers who are new-to-exporting.

f. The Parkway Bank does not participate in making working capital loans with the IEDA umbrella. There are two reasons for this: (1) FCIA hold harmless insurance protection does not extend to working capital loans, and (2) they regularly provide their customers with working capital loans for domestic business and working capital loans for export business represent similar risks.

6. It was Ms. Drogos concluding observation, that, due to the size and lack of international experience that is likely with local Kansas banks, many of these banks would be reluctant to participate in an IEDA type of loan program.

COMMENTS OF Mr. Bernie Siegel, Owner

Star Floor Products Company

Chicago, Illinois

as an exporter that has used

IEDA Post-Shipment Financing

The Star Floor Products Company (floor cleaning machines) has been an exporter since 1972 and exports about $1 million annually to European distributors.

Prior to using the IEDA financing program, it was Mr. Siegel's practice to allocate each year how much post-shipment export credit risk his company would assume. This would then set the limit on export sales he would accept. With these credit risks now insured under the IEDA Program, his company accepts more export orders.

In the last year Mr. Siegel has had loans ranging from $8,000 to $87,000 in size for an average of 61 days and no defaults. These loans covered 38 different shipments to four of his distributors in Europe. Once a distributor's credit has been approved by FCIA, multiple shipments can be made against the distributor's pre-approved credit-line. Mr. Siegel is currently requesting a pre-approved line-of-credit for each new distributor, that he will make proposals to during a Spring, 1988 trip to Europe. This will permit him to offer open-account terms and be competitive with local suppliers.

II. FOREIGN CREDIT INSURANCE ASSOCIATION

(FCIA)

Umbrella Insurance Policy

The Foreign Credit Insurance Association (FCIA) is a private association of approximately 5 insurance companies that acts as the agent for the United States Export-Import Bank (EX-IM) for the purpose of marketing and administering insurance policies on behalf of EX-IM. One of these policies is the FCIA Umbrella policy.

The Association began operation in 1962 and at that time assumed the commercial risk portion of FCIA policies with EX-IM assuming the political risk. Following the overseas credit-crunch of the early-1980's (FCIA premium income of $25 MM with $250 MM of underwriting losses), FCIA became only the marketing arm for EX-IM of such policies.

The marketing function for these insurance policies is carried out through FCIA Regional offices located in: New York, Atlanta, Chicago, Houston and Los Angeles. The State of Kansas is served from the Chicago office by Mid-Western Regional, Vice-President, James E. Pulbratek.

The FCIA insurance is a policy under which an exporter can be insured on favorable terms against foreign commercial and political risks with respect to the "receivable funds" resulting from an export shipment.

The exporter retains 10% of the commercial risk: FCIA insures 90% of commercial risk and 100% of political risk.

Those exporters who are eligible to use the FCIA Umbrella policy are any manufacturing, service or trading firm which:

has had export sales averaging $2,000,000 or less in the preceding two fiscal years (in determining export sales, sales on a cash basis and on confirmed irrevocable letter of credit terms will be excluded), and has not been an FCIA insured during the preceding two fiscal years (nor has any affiliate).

Those who can hold an FCIA Umbrella Policy are:

governmental entities, such as state export finance or development agencies

financial institutions, such as

*commercial banks,

*commercial finance companies

*small business investment companies

export companies, such as

*export trading companies

*export management companies

*export financing cooperatives,

service firms, such as

*insurance brokers

*accounting firms

trade organizations, such as

*chambers of commerce

*industry trade associations

*other business or professional groups, as long as they have a staff capable of administering a policy

Current holders of FCIA Umbrella Policies are shown on Exhibit 11. A review of this Exhibit will show that as of August, 1987, there were seventeen (17) Umbrella policies issued country-wide. Further, five (5) policy holders handle 87% (162 out of 195) of the insured exporters and year-to-date actions (315 out of 359). The Illinois policy covered 48 of the 195 exporters (24%) and 42 out of 359 actions (11%) and was thus percentage wise active. It should be noted there are no Umbrella policy holders in Kansas or Missouri. In the case of Kansas, the policy has not been marketed within the state to potential users. For Missouri, a St. Louis broker markets the policy that is administered by International Insurance Associates of Los Angeles. This modest participation suggests the FCIA Umbrella program suffers from a lack of marketing emphasis to the small-to-medium size exporter. It is likely that FCIA regional offices concentrate their marketing efforts on other FCIA programs such as the master policy for major exporters.

The responsibilities of the policy holder as a policy administrator are:

A. administer the policy

B. provide shipment and other information to FCIA

C. remit premiums to FCIA for export shipments

D. assist in the processing of claims under the policy

The administrator will have no responsibility for the underlying export transaction; it will, however, be responsible for performing administrative duties specified in the policy.

The insured exporter will be the beneficiary of the insurance, will retain 10% of the commercial risk, will pay shipment premiums and service fees, if any, to the administrator in agreed amounts and will have the attributes of ownership, including the right to assign policy proceeds as collateral for financing.

The initial cost of the FCIA Umbrella policy itself is $500. However, the costs to administer it can be substantial. These costs would accrue from expenses of a qualified administrator with the necessary clerical support and office space to process applications, shipping documents, credit reports and insurance premium payments and to generally manage the program.

If the state chooses to absorb part or all the cost of policy administration, there can be a significant (up to 50%) difference in the insurance policy premiums paid by the exporter using the policy.

Exhibit 12 shows insurance policy rates charged by FCIA to the policy holder. Exhibit 13 shows typical rates charged by an independent administrator for the same coverage. For example, a Class III transaction covering a $100,000 receivable for 120 days would cost the state as a policy holder $100,000 x $94/$100 = $940. A typical independent policy holder/administrator would also be charged $940 by FCIA, but would charge the exporter $100,000 x 1.39/$100 = $1,390. The difference of $450 (47%) would cover the brokers cost of administration and profit.

As an administrator there are potential liabilities resulting from possible errors in processing the documentation. For this reason, administrators are required to provide a fidelity bond and an errors and omission insurance policy. FCIA has waived these requirements when state agencies act as the administrator. However, the potential liability remains and must be underwritten by state funds or excluded as a condition of policy use by the exporter.

To make the FCIA Umbrella policy program available to exporters there are four steps that must take place:

1. An application is made to FCIA to establish an Umbrella policy by an eligible applicant (a state agency or a commercial bank are included as eligible holders). Form 900-A (Exhibit 14) is used for this purpose and it asks pertinent information about the proposed policy holder such as credit history, qualifications of the organization and its employees to administer the policy and a committment to rules and regulations. A $500 prepayment of the first years minimum premium is made to FCIA by the policy holder.

2. Since the exporter is the actual insured under the policy, the FCIA must approve each exporter. Form 900-A1 (Exhibit ___) is used for this purpose and is prepared by the policy holder. It requires the exporters business and credit history and the last twelve months of export sales activity.

3. Issuance of FCIA insurance coverage is accomplished by Special Buyer Credit Limit (SBCL) applications. This is handled under Form 900-S (Exhibit 16), which is submitted directly to an assigned underwriter in the FCIA office in New York. Approval of this credit limit establishes a maximum dollar total, terms and time for shipments that can be outstanding to a single foreign buyer by the insured exporter.

A separate SBCL must be submitted by an exporter for each of its foreign buyers. The most important information necessary for buyer approval is adequate credit reports. As the value of the shipment increases, so do the number and depth of the credit reports. For example, for less than $5000, a favorable trade reference will suffice; however, for greater than $200,000 value, a credit agency report (D & B), buyers financial statements for past three years, plus one other credit-type report is required.

4. Each month the policy holder must submit reports to FCIA on behalf of each insured exporter. These are:

a. Past due accounts - Form 900-OD (Exhibit 17)

b. Shipments and premiums payable - Form 900-PR (Exhibit 18)

c. Buyers in financial difficulty - Form 900-FD (Exhibit 19)

Failure to properly administer these reports on behalf of the exporter could subject the policy holder (state or bank) to liability in case a claim on an insured transaction is necessary.

The foregoing describes the standard form of FCIA Umbrella insurance policy (Exhibit 20). The Illinois Export Development Authority (IEDA) policy with FCIA includes six modifying endorsements for the purpose of meeting the needs of Illinois exporters. These endorsements are included as Exhibit 21 and should be reviewed in detail for consideration in any export financing program that the State of Kansas might initiate.

III. SHARED FOREIGN SALES CORPORATION (FSC)

Through a Foreign Sales Corporation (FSC) an exporter may qualify for a reduction in federal taxes as they apply to the profits on his exports. A number of states are investigating or in various stages of implementating a state shared Foreign Sales Corporation (FSC).

The Foreign Sales Corporation (FSC) means a non-U.S. corporation organized in an eligible U.S. possession or other qualified jurisdiction. To qualify for benefits, the company must meet certain statutory requirements and engage in certain export-related activities. A State-Sponsored, Shared FSC permits up to 25 exporters to participate as shareholders. A Shared FSC allows each participating exporter to gain the tax benefits of operating through an FSC while substantially reducing costs. By sharing administrative costs as stockholders of an FSC, smaller exporters can benefit from the 15% federal exemption on gross profits from overseas sales funneled through an offshore sales corporation.

The State of Illinois through the Illinois Export Development Authority (IEDA) began to develop a program for its exporters in 1986 and they expect to have it operational in 1988. A detailed review of that program is included on the following pages as Exhibit 22 .

The Trade Development Division of KDOC is sponsoring an FSC seminar on February 10, 1988, for Kansas exporters. The purpose of this seminar is two-fold:

First, to explain an FSC; and second to measure the level of interest on the part of Kansas exporters for the state to establish such a program. This will be a rather indepth overview of the FSC presented by Price Waterhouse. For the Kansas companies who have continued interest after the seminar worksheets will be provided. From these worksheets and one-on-one discussions with these firms, Price Waterhouse has agreed to provide preliminary information on expected tax gains for each company. (Exhibit 23)

Major highlights

1) A state shared FSC can contain up to 25 exporting firms. For such a FSC to be cost effective, Kansas probably would need to have close to that number.

2) The cost of setting up a state shared FSC is approximately $50,000 using Price Waterhouse. If there were 25 interested Kansas firms the state would then need to decide its interest in providing funding for the start up. A further decision would need to be made on whether a similar percentage of state taxes as that of federal taxes could be deducted from the exporters tax liability.

3) As of January 1, 1988, there have not been any state sponsored FSC's established, primarily due to the only recent IRS clarifications on certain FSC provisions.

IV. TRADE SHOW ASSISTANCE PROGRAM

One of the most economical and proven methods of entering a new market is by attending trade shows, this also is true of the export market. In fact, in some foreign countries, particularly the European Economic Community, trade shows play a larger role than they do here in the United States. It would be our hope to be able to offer meaningful assistance to Kansas companies in this vital area.

The program we envision would be as follows:

For us to provide up to 50%, to a maximum of $2,000 for trade show expenses for a new to export firm or a new to a particular market firm to attend an appropriate trade show. The assistance would be for booth space, shipping, advertising, etc., but would not apply to travel or lodging expenses.

The actual company selection would be done by the Trade Development Division. The criterion would be similar to the attached exhibit 24 . This attachment is a copy of the Maryland program, who so far claims to have helped 10 companies for a cost of 40,000 resulting in sales of over $2,000,000. Maryland feels this has been their most successful program.

For the first year to implement this program with existing staff we would need $40,000 which would enable us to work with 20 or more firms.

We believe that this program would:

1) Be a very tangible and visible addition to our export financial assistance package.

2) Help us recruit companies for the trade shows that we are planning to attend during 1988/1989.

3) Provide an excellent return for an outlay of forty thousand dollars.

V. CONSIDERATIONS

1) Export Financing

If the Illinois model is followed FCIA would play a major role. Therefore any recommendations would need to first cover FCIA and then an export financing package.

FCIA

If the decision was made to wait until a later period to implement a complete export financing package the state could still establish a state FCIA policy. This policy could either be administered by the state or by another party.

If the state decided to administer its own policy, appropriate qualified staff would need to be hired and possibly some type of errors and omissions insurance secured to cover state employees. With proper training existing staff could assist with the policy marketing.

If the decision was made to have an outside party administer the policy a suggestion would be to contact the major international banks serving Kansas to see if they would be interested in being the administrator. A bank would be an excellent choice due to their current level of involvement in FCIA related activity. Existing state staff would again, with proper training be able to assist with marketing.

Export Financing

If the state decided to implement a complete export financing package then the state should be the administrator of the FCIA policy. There would obviously be many areas to address if the state wanted to create a complete package including:

a) appropriate legislation

b) how to survey and involve the banking community

c) how much money to be raised initially and how it should be raised

d) what interest rate to use

e) staffing

f) working with FCIA to develop an acceptable policy

g) program parameters

h) is it to be self-supporting or state subsidized

i) who administers the programs

Please note exhibit 10 is from the Chicago International Association (CIA) composed of individuals who were involved in developing this Illinois program. For a fee they would be willing to work with Kansas in developing ours.

2. Foreign Sales Corporation (FSC)

For a shared FSC to be viable would probably require as close to 25 exporter members as possible. One Feb. 10 the Trade Development Division conducted a seminar on FSC to over 35 Kansas export firms, and the results will be made available as soon as possible.

Some FSC considerations would be as follows:

a) If we are unable to find close to 25 export firms wanting to join then the question is moot and the state does not need to establish a FSC.

b) If sufficient interest was uncovered the state would need to consider the following:

1. Should the state create a shared FSC?

2. What firm should the state contract with to set up and administer the FSC?

3. Would the state pay the set up cost for a shared FSC which would probably be in the range of $50,000?

4. Should the state allow a proportional amount of state tax as of federal tax to be deductable?

5. What legislation would be required?

6. Whom would administer the program at the state level?

3) <u>Trade Show Assistance Program</u>

If the state decided to implement such a program how much money should be allocated to do so.