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Trade Finance for
Small and Medium-sized Enterprises
in CIS Countries

New York/Geneva 2003
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Preface

The purpose of this series of trade and investment guides is to assist economies in transition, as well as economic actors in other countries, in becoming familiar with best practices in the areas of trade and investment and related legal and commercial practices. The guides are developed under the aegis of the United Nations Economic Commission for Europe's Committee for Trade, Industry and Enterprise Development and its subsidiary bodies.

The present guide was prepared by the UNECE secretariat with substantial contribution from Ms. Viktoria Alexeeva and Ms. Rosa Sarkeyeva, interns with the secretariat.

This is the seventh guide in the series. The preceding titles were:
1. *Trade Finance in Transition Economies: Practical Ways to Support Exports and Imports*
2. *Standards and Regulations in International Trade*
3. *Investment Promotion in Central and Eastern Europe and the CIS*
4. *The Polish Experience of Transition: Accomplishments and Problems*
5. *Eliminating Obstacles to Efficient Trade Finance in Transition Economies: Practical Aspects*
6. *Services in Transition Economies*

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Introductory remarks by Ms. Brigita Schmögerova
Executive Secretary, United Nations Economic Commission for Europe

The text which follows draws on the deliberations of the Workshop on “Practical Aspects of Trade Finance in CIS Countries with Special Reference to Problems Encountered by Small and Medium-Sized Enterprises” held in Minsk, Belarus, on 4 - 5 October 2001. This Workshop, the fourth in a series of seminars and workshops on this topic, was organized by the United Nations Economic Commission for Europe in cooperation with the Government of Belarus.

At the current stage of the transition process the issues discussed in this book have acquired particular significance. Many transition countries have successfully stabilized and liberalized their economies and created conditions for economic growth. Major market economy institutions have been established enabling the restructuring of enterprises and enhancing the competitiveness of various sectors. Eventually, the objective now is to integrate the transition countries into the regional and world economies.

While private initiative represents the vehicle for raising the national competitiveness, Governments establish the institutional environment conducive to the constructive application of this initiative. That is why the exchange of opinions between private companies, banks and government agencies on operational issues is so important. Seminars and workshops such as the one organized in Minsk permit all stakeholders to understand better each other’s needs and fine-tune their policies respectively. In particular, by acquiring feedback on existing policies and regulations from business operators, the government officials dealing with trade support can improve their vision of ways and means to upgrade the regulatory framework for export finance and promotion.

The focus of this volume on problems encountered by small and medium-sized enterprises is particularly relevant. In a modern economy, SMEs represent the most dynamic sector, providing employment to millions. At the same time, these enterprises are particularly fragile when facing the imperfections of regulatory systems. In transition economies, in particular, new sprouts of private initiative wither away easily when faced with bureaucratic hurdles and self-invented rules, corruption, lack of legal protection, inadequate regulations and poor law enforcement.

As a result of economic recovery and the build up of market economy institutions, an increasing number of small and medium-sized enterprises in central and eastern Europe enjoy access to modern forms of financing. Banks in this group of transition economies have initiated support programmes for SMEs, and in particular for small and medium-sized exporters. In many CIS countries, however, the role of private commercial banks as independent sources of medium- to long-term financing, especially for small and medium-sized enterprises, remains limited. The various credit facilities provided by the state constitute the prevailing source of project and long-term trade finance, while international financial institutions provide financial resources for small and medium-sized enterprises.
With few exceptions, in the CIS region the removal of institutional and regulatory hindrances to the development of small business and, in particular those companies that engage in foreign trade, is slow and often inconsistent. As an example of persisting barriers, participants in the Workshop mentioned regulations preventing companies and banks from using modern payment terms and instruments, the lack of financial transparency with enterprises, high guarantees and other fees charged by commercial banks, and inadequate bankruptcy laws which impede banks from recovering their loans in case of default.

We hope that the free exchange of opinions between companies, bankers and government officials on foreign trade finance in transition economies presented in this book will help their decision makers in establishing a framework conducive to the unimpeded growth of new private companies and their involvement in international business.

Brigita Schmögnerova
Introduction by Mr. Andrei Tur
Deputy Minister, Ministry of Economy, Republic of Belarus

The modern world is characterized by the integration of national economies and intensive economic cooperation links among them. No country in the world can develop its economy in isolation. This is particularly true with respect to the CIS countries, which have inherited from the past a developed division of labour and cooperation links both between countries and between individual enterprises.

Trade can be regarded as the basic link in the network of external economic relations. Therefore, it seems reasonable to discuss within the scope of our Workshop the practical aspects of trade relations with special reference to problems encountered by small and medium-sized enterprises.

As compared to many transition economies, CIS countries have started economic reforms with a certain delay. Private entrepreneurship in CIS countries is a relatively new phenomenon and we understand that we have to learn how to work under market conditions and draw on the experience of other countries. While doing this, we also need to take into consideration the particularities of countries.

The development of a socially oriented market economy can contribute considerably to the efficiency of production in the Republic of Belarus. Private entrepreneurship, especially the potential of small and medium-sized enterprises contributes to national competitiveness, and the development of the consumer goods market and the service sector. Furthermore, entrepreneurship creates additional sources of budgetary revenues. Eventually, it gives people the possibility to fully apply their physical and intellectual potential thus reducing social tensions and strengthening support for reforms.

The policy of the State in the area of enterprise development aims at establishing adequate conditions for the successful development of small business enterprises and entrepreneurial initiatives within the population.

As I mentioned, for a number of subjective and objective reasons, we have not yet attained the landmarks for reform that have been already achieved in a number of other transition countries. At the same time, we have established a consistent framework of support for enterprises. Entrepreneurship plays an increasing role in the emerging market economic system in our country.

There are more that 28,000 small businesses in the Republic of Belarus employing some 386,000 people, which is equivalent to almost 9 per cent of the working population of the country. If more than 175,000 individual operators are added to the above-mentioned figure, small business can be estimated to provide employment to over 12 per cent of the labour force.

The majority of small enterprises still operate in the sphere of trade and catering (42.7 per cent). At the same time, recent analyses have shown an increase in the number of SMEs involved in the production sphere. Indeed, as much as 20.8 per cent of small businesses operate in industry, some 11.5 per cent in construction, about 5.6 per cent in transport and 1.1 per cent in agriculture. It should be mentioned that the Government pays special attention to the development of small and medium-sized enterprises in industry.
In 2000, there were 2.8 small business and 15.8 individual operators per 1,000 inhabitants. Three quarters of retail trade turnover was created by the private sector. In the same year, SMEs accounted for about 9.5 per cent of industrial production and for 11.4 per cent of consumer goods output. Private commercial organizations and individual businesspersons contribute about 17 per cent of the tax revenues in the Belarusian budget.

Since 1997, the Government has been developing and annually updating a programme of small business-support in Belarus and allocating to this end financial resources from the budget. Similar programme exist also at the regional level.

Priorities for State support to small enterprises are set by the Programme of socio-economic development of the Republic of Belarus for 2001 – 2005. In particular, these priorities include the development of external trade and the encouragement of exports by SMEs. At present, small and medium-sized enterprises are facing financial difficulties owing to the lack of own funds, lack of experience in dealing with foreign partners, too short performance record and, hence, a lack of trust from foreign partners. For this reason, small business needs some State support as well as financial assistance from banks and international financial organizations.

These are the issues we would like to see discussed during this workshop where we hope to see a fruitful discussion and exchange of experiences that will bear practical results for transition economies.
CHAPTER I

Trade Finance Issues of Particular Relevance for Small and Medium-sized Enterprises:
Recent Developments in the Area of Trade Finance.

Note by the UNECE Secretariat

Introduction

The European transition economies refer to the formerly centrally planned economies of Eastern Europe and the former Soviet Union. Eastern Europe refers to the economies of Albania, Bulgaria, Hungary, Poland, Romania and the Czech Republic, Slovakia, and the successor States of the former Socialist Federal Republic of Yugoslavia: Bosnia and Herzegovina, Croatia, Slovenia, the former Yugoslav Republic of Macedonia, and Yugoslavia. Among the newly independent republics of the former Soviet Union, a distinction is made between the Baltic States, Estonia, Latvia and Lithuania, and the remaining republics which cooperate within the institutional framework of the Commonwealth of Independent States (CIS): Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Russian Federation, Republic of Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

1. Recent trends in transition economies’ trade

In the second half of the 1990s, growth in the European transition economies’ trade was unstable and tended to slacken. Overall, their annual export growth rates at current prices plummeted from over 25 per cent in 1995 to minus 3 and minus 6 per cent in 1998 and 1999. Import growth rates followed the same pattern, decreasing from 32 per cent in 1995 to less than half a per cent in 1998 and finally turning into a decline of 14 per cent in 1999. Recovery started in 2000 when exports of European transition economies rose by some 28 per cent (the first 9 months of 2000). Over the same period, imports of these countries increased by 13 per cent. Recovery in foreign trade was fuelled by strong import demand from developed market economies as well as by the rising prices of energy and other commodities.

In the CIS region, in the second half of the 1990s exports showed an even steeper downward trend: at current prices the export growth rate fell down from 23 per cent in 1995 to minus 15 per cent in 1998 and 10 per cent in 1999. On the import side, the performance of the CIS member States was even worse: import growth rates dropped from 26 per cent in 1995 to a negative 14 per cent in 1998 and an additional minus 13 per cent in the subsequent year. The year 2000 brought a recovery to the foreign trade of the CIS countries as well. During the first nine months of that year, the USD value of the CIS countries merchandise exports increased by almost 50 per cent, while imports followed at a more modest growth rate (16 per cent). Increasing commodity prices (oil, gas, metals, cotton), strong import demand in partner countries, as well as the depreciation of national currencies, contributed to boosting export revenues. On the import side, the recovery of economic activity from the 1998 financial and economic crisis was the major factor supporting growth.

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1 The note summarizes recent developments in the trade of transition economies; traces the evolution of trade finance risks and instruments used in export and import transactions; and highlights the changing role in trade finance and promotion of Government agencies and of some international financial institutions in transition economies.

Primary commodities continue to dominate the composition of exports from the CIS countries, and this suggests particular forms of financing. As opposed to high value-added exports to developed market economies from countries of central and eastern Europe, primary commodities and intermediate goods exports from the CIS countries may not need elaborate long-term financial arrangements, however, it may demand considerable investment in export production.

2. Trade Finance Risk Perceptions

The fundamental systemic transformations that have taken place, accompanied by the emergence of thousands of new exporters and importers from the private sector, have considerably increased risks in trade with transition economies. This circumstance has badly affected both the availability and the cost of trade finance for enterprises, and SMEs in particular.

During the transition, the risk perceptions of credit rating-institutions for various groups of countries have increasingly diverged. In general terms, they have tended to improve for countries of central and eastern Europe, and the so-called “first echelon” of candidates for EU membership. Alternatively, the situation has not changed or has even worsened for the majority of CIS and southeast European countries.

In 1999, the Export Credit Agencies (ECAs) of the Organisation for Economic Co-operation and Development (OECD) member countries harmonized their classification systems and adopted a new OECD Consensus Risk Classification for export credit. Under this classification, country risks are subdivided into seven levels, with category one signifying minimal risk and category seven the highest risk. Logically, the insurance and guarantee fees of exporting companies depend on the country of the importer they are dealing with.

According to the OECD Consensus Risk Classification, in July 2001 all western industrial economies were classified at level one risk. The Czech Republic, Hungary, Poland and Slovenia were placed at level two, while Slovakia at level three. These were followed by Latvia and Croatia (level four), Bulgaria and Lithuania (level five), and Kazakhstan, Romania and Russia (level six). Finally, all other countries of the CIS and southeast Europe (Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Georgia, Kyrgyzstan, the Former Yugoslav Republic of Macedonia, the Republic of Moldova, Turkmenistan, Ukraine, Uzbekistan and Yugoslavia) were ranked as the highest risk partner countries under category seven.3


3. Payment terms

Along with the improved risk perceptions, payment conditions in trade of countries more advanced in transition have tended to improve. According to the data provided by “International Trade Finance” (see table 1), in 1999-2001, open account terms were increasingly applied both in export and import transactions in countries of central and eastern Europe, particularly in immediate candidates for accession to the European Union. At the beginning of 2001, these terms were most broadly used in Hungary, the Czech Republic, Poland and Slovakia. The application of open account terms was less frequent but also preponderant in Croatia, Estonia, Lithuania and Slovenia, while in Romania and Bulgaria exporters and importers used open account and other modes with about the same frequency.
Table 1. Payment terms in export and import transactions, 1999 – 2001 (I – II Q)

<table>
<thead>
<tr>
<th>Transition Economies</th>
<th>1999</th>
<th>2000</th>
<th>2001 (I – II Q)</th>
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<tbody>
<tr>
<td></td>
<td>OA</td>
<td>BE/CD</td>
<td>LC</td>
</tr>
<tr>
<td>Central and eastern Europe</td>
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<tr>
<td>Bulgaria</td>
<td>1/2</td>
<td>-</td>
<td>1/2</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>3/4</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>Hungary</td>
<td>3/4</td>
<td>-</td>
<td>+</td>
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<tr>
<td>Poland</td>
<td>(1)</td>
<td>-</td>
<td>+</td>
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<td>Romania</td>
<td>3/4</td>
<td>-</td>
<td>+</td>
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<td>Slovak Republic</td>
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<td>Slovenia</td>
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<tr>
<td>Bosnia and Herzegovina</td>
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<td>Croatia</td>
<td>2/3</td>
<td>-</td>
<td>+</td>
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<td>Yugoslavia (Serbia)</td>
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<td>Baltic States</td>
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<td>Estonia</td>
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<td>CIS</td>
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<td>Armenia</td>
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<td>Azerbaijan</td>
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<tr>
<td>Georgia</td>
<td>-</td>
<td>+</td>
<td>6/10</td>
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<td>Kazakhstan</td>
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<td>Kyrgyzstan</td>
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<tr>
<td>Russian Federation</td>
<td>2/5</td>
<td>*</td>
<td>3/5</td>
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<td>Tajikistan</td>
<td>...</td>
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<td>Turkmenistan</td>
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<td>Ukraine</td>
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<td>Uzbekistan</td>
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Source: International Trade Finance (various issues 1999-2001)

Note: Fractions in the table represent the incidence of payment terms, e.g. 6/7 means that payment terms are used in 6 out of 7 cases.

* payment terms applicable to imports only.

Legend: OA Open account; BE/DC payment by bill of exchange and documentary (bank) collection; LC Letter of credit; CA cash in advance.

+ payment terms are used; - payment terms are not used;
(1) payment terms are used virtually in all transactions
(2) predominantly used payment terms
While the data available are clearly incomplete, over the same period the evolution of payment terms was more contradictory in the CIS countries and in those of southeast Europe. The Russian Federation has witnessed a certain improvement in payment conditions: in 1999, two of five shipments (exports and imports) were settled on open account terms, while the other three required advance payments. At the beginning of 2001, already more than half of shipments were paid through open account. In the other CIS countries, however, the payment terms for exporters and importers have not visibly improved: in most cases letters of credit were the preponderant payment mode, while cash in advance was also used in both types of transactions.

Even worse, were the payment terms used in the foreign trade of Yugoslavia and Bosnia and Herzegovina. In 2000, export and import bills in those countries were settled through advance payments.

In short, at the beginning of the new decade, in the CIS countries the least costly payment modes (open account, sight draft) were used less often than in countries of central and eastern Europe. For small and medium-sized importers, the use of letters of credit, let alone cash in advance payment terms represents a significant cost, often rendering importing either unfeasible or unprofitable.

In the context of CIS exports to the West, the major obstacle to the use of less costly payment modes have been the elevated performance risk perceptions in partner countries, and, in some cases (letter of credit confirmation), a certain lack of expertise within the banking systems of those countries.

4. Access to external funding

New private companies, small and medium-sized enterprises in particular, are known to depend on borrowed funds both for their domestic operations and for exports. The availability of commercial bank credit crucially depends on the state of the banking system. In many transition economies commercial banks remain small by western standards and few have sufficient know-how to provide an adequate range of services for companies engaged in foreign trade.

In 1999, the sum of loans to the private sector was equivalent on average to: 54 per cent of GDP in the Czech Republic, 26 per cent in Estonia, about 23 per cent in Poland and Hungary, 21 per cent in Latvia and 13 per cent in Lithuania. In the same year, loans to the private sector were about 11 per cent of GDP in the Russian Federation, 9 per cent in Ukraine and about 6 per cent in Kazakhstan (1998). By comparison, in the 11 countries of the European Union belonging to the “Euro zone”, the percentage in question exceeded 100 in the same year.4

The difficulty of obtaining sufficient pre-shipment working capital remains one of the most important obstacles for small and medium-sized exporters in the CIS countries. While SMEs own funds are limited, the access to credits of commercial banks is linked with heavy collateral requirements, creating a heavy burden on exporters' resources.

At the same time, empirical studies provide evidence of considerable bank financing of new start up companies, including very small firms in the Czech Republic, Hungary and Poland, where these enterprises are able to obtain credit even at an early stage of their existence. In particular, in some countries of central and southern Europe, the restructuring of the banking sector has contributed to creating facilities for SME financing. After the 1998 crisis, the Hungarian banking sector, for example, started improving conditions for such lending, and today, small and medium enterprises account for a considerable part of all private sector loans. At the beginning of 2001, the market leader Magyar Külkereskedelmi Bank Rt. (MKB) had as many as 8000 SME clients accounting for 25 per cent share of all corporate credits.

In the CIS area, banks have recently facilitated the financing of small enterprises in Kazakhstan. In 2000, the volume of bank lending to small business increased by 86 per cent on a year-to-year basis. However, the share of SMEs in the total lending to the economy remained unchanged (about 27 per cent both in 1999 and 2000). In Uzbekistan, local banks have simplified the procedures for obtaining credit finance for SMEs. However, the rigid collateral requirements remain the principal condition for obtaining a loan.

In Russia as well, a recent bank survey has shown the willingness of the banks to expand SME financing. However, it seems that so far no Russian banks have designed special programmes to that end.

As a result of a prudent approach to risk-taking in the CIS countries, the access of small and medium-sized exporters to bank funding remains limited. In the Russian Federation, for example, in the second half of the 1990s the number of SMEs receiving commercial bank loans tended to decline: while in 1995 it was as high as almost 58 per cent, in 1998 this percentage dropped to some 37 per cent. In the aftermath of the 1998 financial crisis, the number of SMEs enjoying access to bank loans declined further to 28 per cent of the total number of SMEs.

In general terms, the availability of commercial credits to small exporters is limited by the banks’ reluctance to service smaller companies because of the relatively high risk associated with such financing and the costs of evaluating the creditworthiness of small clients. In addition, high interest rates and protracted procedures for obtaining credits also impede the access of SMEs to bank financing.

Particularly limited is the capacity of small exporters to get access to the longer-term financing required to modernize and develop export production. Its availability depends both on the strength of the banking system, and overall health and good prospects of the economy. It should be noted that in countries consistently progressing along the path of transition (Latvia, for instance) the share of long-term credits in the overall commercial credits’ volume has grown. However, in most CIS transition economies, medium- or long-term credits are barely available to small and medium-sized enterprises. The average length of commercial credits granted in most countries varies from 3 to 6 months. According to a recent enterprise survey conducted in the Russian Federation, only 7 per cent of the total credits extended to small enterprises had a length

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5 As much as 49 per cent of interviewed small new enterprises in the Czech Republic, Hungary, Poland reported obtaining a bank credit at a certain stage of their operation. Andrzej Bratkowski, Irena Grosled, Jacek Rostowski “Investment and finance in de novo private firms. Empirical results from the Czech Republic, Hungary and Poland”, Economics of Transition, Volume 8(1) 2000, P. 104.
of more than one year (the rest being shorter). Overall, in 2000 the commercial loans granted for more than one year accounted in Russia for only 18 per cent of the total commercial loan volume.

5. Leasing

Being an increasingly important means of trade and investment finance in transition economies, leasing services have enjoyed buoyant growth in a number of countries of central and Eastern Europe. In 2000, the share of leasing in capital investment financing was as high as 42 per cent in Estonia, 19 per cent in the Czech Republic and 12 per cent in Hungary.

Simultaneously, leasing accounted for 7 per cent of capital investment in Poland and for 3 per cent in Slovakia. In the CIS States, the growth of leasing has restarted recently, although its scope is still considerably smaller than in the developed market economies. In Russia, for example, there has been a considerable upswing in the number of leasing companies registered. However, the leasing market still remains small: in 1999 as little as 1.5 per cent of capital investment in Russia was directed through leasing.

Increasing stability in the economic situation of several advanced transition economies has had a positive impact on medium- and long-term leasing and on the leasing opportunities for SMEs. Again in the Russian Federation, in 2000 as many as 17 leasing companies provided their services to small and medium-sized enterprises. It is important to note that these leasing companies are typically affiliated with regional and/or federal and local SME development agencies. As an example, Moscow Leasing Company, set up and wholly owned by the Moscow City Government, has become the first leasing company in the Russian Federation to lease exclusively to small and medium-sized enterprises. At this point, the company has developed substantial clientele amongst the SMEs by offering medium-term leasing contracts (2 to 3 years) in the Moscow region. In addition, the Moscow Leasing Company has generated business activities in other regions through a network of its agencies.

Despite these encouraging developments, it can hardly be denied that in the CIS countries the potential of leasing as a means for enterprise and trade finance has been underutilized, and this holds in particular for small and medium-sized enterprises.

6. Non-conventional trade

During the second half of the 1990s, the importance of barter and countertrade in trade declined in a number of CIS countries (e.g. Kazakhstan, Republic of Moldova, Uzbekistan, and more recently in Russian Federation and Ukraine). However, their role remained important.

11 Ibid., p. 57.
13 Leaseurope Association “Statistics 2000”.
According to a recent World Bank enterprise survey, in 1999 the highest share of barter in trade was registered in Croatia (33 per cent). Russia and Ukraine had a barter share in trade of about 24 per cent, while in the leading central European “accession” countries - Hungary, Poland and Czech Republic – it was much smaller, between one and five per cent. According to company interviews conducted by the European Bank for Reconstruction and Development, at the end of the 1990s in the non-CIS countries, the proportion of firms reporting no barter transactions ranged from 49 per cent in Estonia to 90 per cent in Hungary.

According to the same source, at the end of the 1990s in the Russian Federation and Ukraine over half of the enterprises surveyed used barter in more than 10 per cent of their business transactions, while for one-third of them this proportion was more than 25 per cent. Elsewhere in the CIS, the incidence of barter varied considerable, with high levels in Belarus, the Republic of Moldova and Kazakhstan and very low levels in Armenia, Azerbaijan and Georgia.

Barter deals are affected primarily by larger enterprises through the supply chains inherited from the years of central planning. While SMEs usually have fewer opportunities to settle their transactions via barter or countertrade, a number of enterprise surveys conducted between 1998 and 2000 indicated a relatively high percentage of small and medium-sized enterprises involved in barter operations in transition countries. For example, in the Republic of Moldova almost 69 per cent of small agricultural enterprises are involved in barter transactions.

Empirical studies suggest that, to a certain extent, trade-related monetary transactions within the CIS may be more costly than barter owing to high taxes, insecure property rights, imperfect credit markets, as well as rent seeking by banks and other intermediaries. Countertrade is also perpetuated by the existence of specialized intermediaries dealing exclusively with this type of trade and reducing its costs to the parties involved.

In the future, a number of factors will contribute to decreasing the potential for countertrade. Among these, the opening of markets and a growing exposure to outside competition, which will eliminate inefficient enterprises and their networks of traditional subcontracting links. At the same time, the lack of convertible currency, political pressure to preserve non-viable companies and the need to maintain a stable supply of particular products in individual regions will contribute to maintaining countertrade transactions.

7. Government support for trade finance

Since the beginning of the 1990s, a number of countries in Eastern Europe, the Baltics and the CIS have initiated Export Credit Insurance and Guarantee Schemes (ECGSs), and established Export Credit Agencies (ECAs) and State-sponsored Export and Import Banks (Eximbanks). At present, ECAs and Eximbanks are operating in Albania, Bosnia, the Czech Republic, Hungary, Poland, Romania, the Russian Federation, Slovakia, Slovenia, and Uzbekistan. The Berne Union (The International Union of Credit and Investment Insurers) provides training and technical advice to these countries through a special contact group that holds twice-yearly conferences.

Export Credit Insurance Corporation (Kuke) in Poland, Export Guarantee and Insurance Corporation (EGAP) in the Czech Republic, Hungary’s MEHIB (Hungarian Export Credit Insurance Ltd) and Slovenia’s Export Insurance and Finance Corporation (Slovene Export Corporation or SEC) have already become full members of the Berne Union, i.e. they have met the benchmarks for Berne Union membership (approximately CHF 600 million of trade turnover insured per annum and CHF 6 million a year in premium income). The national export credit and

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guarantee schemes of these countries have developed a range of services comparable to those of their counterparts in western countries.

In major exporting countries up to 85 per cent of insurance policies from ECAs are issued for small and medium-sized enterprises. A growing number of European export credit agencies are beginning to intensify links with smaller companies. Improving assistance for SMEs is one of the major objectives of the Export Credits Guarantee Department of the United Kingdom (ECGD). To this end, bank guarantees, forfeiting support and collaboration with private sector insurers are among the ideas currently under consideration. In 1999, the Eximbank of the United States also launched a pilot programme to assist small United States business unable to tap traditional sources of export finance. Furthermore, the Italian Sezione speciale per l’Assicurazione del Credito all’Esportazione (SACE) is reported testing a new service of commercial and political risk coverage for SMEs.

Some of the eastern European Eximbanks and ECAs have been following a similar path. In the Czech Republic, for example, export financing, including short-term direct supplier and similar loans for export production are used especially by small and medium-sized enterprises active in the export sector. In 2000, the share of SMEs in the export financing of the Czech Export Bank reached about 20 per cent in terms of loans on commercial terms and over 10 per cent in terms of government-subsidized loans. Also in the Czech Republic, the number of small and medium-sized enterprises insured by EGAP on commercial basis increased from 61 per cent of the total number of insured companies in 1999 to 64 per cent in 2000. In the same year, their share in the total volume of insured receivables was 18.3 per cent.

Along the same lines, the Hungarian Export Credit Insurance Ltd (MEHIB) provides an export-prefinancing credit for medium-sized Hungarian companies at reduced interest rates for a maximum period of 18 months. This facility aims at financing a part of working capital needs for export production and delivery. The Slovene Export Insurance and Finance Corporation has developed a special financing programme for SMEs with a maximum of 500 employees and at least 50 per cent of their revenue derived from exports. Such companies receive a preferential access to long-term loans in foreign currency for financing their working capital.

Despite their growing volume of operations, the scale of activities of Eximbanks and ECAs in transition economies, especially the CIS countries, remains limited. The CIS Eximbanks and ECAs are significantly undercapitalized compared with similar institutions in eastern Europe. The expansion of their operations is further hindered by inadequate information on the scope of ECAs’ activities; difficulties in collecting “problem” loans; lack of re-insurance facilities, and the lack of reliable credit information systems which are required to assess risks.

The growing integration of world markets renders transition economies, CIS in particular, more vulnerable to changing world market conditions. This raises the importance of export-credit insurance and the need for ECAs’ flexibility, their prompt reactions to partners’ failures and innovative approaches to claim settlement.

8. International Financial Institutions

International financial institutions (including the European Bank for Reconstruction and Development, and the World Bank/International Finance Corporation) seem to remain the major...
source of SME financing in transition countries. Typically, the credit lines earmarked for this type of financing are extended via local financial intermediaries. Apart from providing funding for the private sector, the international financial institutions also aim at assisting local banks to gain experience and develop networks of clients so that upon the termination of programmes for financing of SMEs, these banks could continue with the help of their own funds.

In this respect, the scope of the efforts of the EBRD is worth noting. Within the framework of Micro- and Small Enterprises (MSE) lending programmes, by the end of 2000 the EBRD had disbursed over 100,000 loans to small and medium-sized enterprises in 13 countries with transition economies. During 2000 only, over 50,000 loans worth USD 244.5 million were extended (see Table 2).

Even better focused are the commercial banks specialized in SME finance (see Box 1).

Table 2. EBRD lending to micro and small enterprises (MSEs) in 2000

<table>
<thead>
<tr>
<th>Country</th>
<th>Project</th>
<th>Number of loan granted</th>
<th>Per cent of total number of loans</th>
<th>Value of granted loans (mn USD)</th>
<th>Per cent of total value</th>
<th>Average loan value (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>FEFAD Bank</td>
<td>2,450</td>
<td>4.9</td>
<td>16.8</td>
<td>6.9</td>
<td>6,848</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>MEB d.d.</td>
<td>3,042</td>
<td>6.1</td>
<td>12.0</td>
<td>4.9</td>
<td>3,955</td>
</tr>
<tr>
<td>Georgia</td>
<td>MBG</td>
<td>2,529</td>
<td>5.0</td>
<td>17.4</td>
<td>7.1</td>
<td>6,889</td>
</tr>
<tr>
<td>Georgia</td>
<td>MBG consumer loan</td>
<td>19,691</td>
<td>39.3</td>
<td>3.7</td>
<td>1.5</td>
<td>187</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>KSBP</td>
<td>5,458</td>
<td>10.9</td>
<td>40.4</td>
<td>16.5</td>
<td>7,403</td>
</tr>
<tr>
<td>Moldova</td>
<td>MEC</td>
<td>230</td>
<td>0.5</td>
<td>1.7</td>
<td>0.7</td>
<td>7,231</td>
</tr>
<tr>
<td>Moldova</td>
<td>Swiss-American Programme</td>
<td>74</td>
<td>0.1</td>
<td>1.0</td>
<td>0.4</td>
<td>13,636</td>
</tr>
<tr>
<td>Russia</td>
<td>RSBF</td>
<td>13,840</td>
<td>27.6</td>
<td>122.1</td>
<td>49.9</td>
<td>8,823</td>
</tr>
<tr>
<td>Ukraine</td>
<td>Micro lending</td>
<td>2,001</td>
<td>4.0</td>
<td>24.6</td>
<td>10.1</td>
<td>12,283</td>
</tr>
<tr>
<td>Yugoslavia (Kosovo)</td>
<td>MEB Kosovo</td>
<td>806</td>
<td>1.6</td>
<td>4.8</td>
<td>2.0</td>
<td>5,986</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>50,121</strong></td>
<td><strong>100</strong></td>
<td><strong>244.5</strong></td>
<td><strong>100</strong></td>
<td><strong>73,241</strong></td>
</tr>
</tbody>
</table>

Box 1. KMB-Bank in Russia

KMB-Bank, Small Business Credit Bank, a leading institution in the sphere of small business financing was founded in 1992 by the European Bank for Reconstruction and Development (EBRD) and Soros Economic Development Fund (SEDF) from the United States.

In December 1998, KMB-Bank started operations and by the end of 1999 the Bank had granted 1200 loans while the loan portfolio had reached USD 14 million. In 2000, KMB-Bank tripled the level of disbursements having extended as many as 4,642 micro and small loans worth almost USD 60 million. The scale of its operations continues to grow. The KMB-Bank issues monthly about 600 – 700 loans ranging from RUR 3 thousand to USD 150 thousand at the respective yearly interest rates of 22 - 40 per cent and 12 – 19 per cent. By the end of 2001, the bank planned to grant 1,500 credits monthly.

The KMB-Bank is developing its regional network in Russia. At present, the Bank operates through ten representative offices and five affiliates in Saint Petersburg, Omsk, Nizhny Novgorod, Samara, Novosibirsk, Ekaterinburg, Togliatti, Barnaul, Tomsk and in several other cities.

Source: EBRD

In 1999, the EBRD launched a new Trade Facilitation Programme (TFP) covering 26 countries in central and eastern Europe, and the CIS to support intra-regional and international trade.

Under this programme, the EBRD facilitates the financing of the trading activities of SMEs. To this end, it guarantees the payment obligations of issuing banks, provides the off-balance-sheet credits and extends its cover to letters of credit and standby L/Cs, advance payment bonds and other forms of payment guarantees. Moreover, under the Trade Facilitation Programme short-term revolving loans for pre-export financing of SMEs can be also provided.19

One should also mention similar efforts made by other international organizations. The World Bank, for example, focuses some of its new projects on the facilitation of SME development in central and eastern Europe. One of its objectives is the strengthening of local financial institutions’ capacity to provide credit to SMEs. The World Bank intends to support six SME-related projects in the region with credit lines totalling approximately USD 385.6 million.20

Along the same lines, the Black Sea Trade and Development Bank (BSTDB) operating under the Organization of the Black Sea Economic Cooperation extends revolving credit facilities for pre-export finance in Turkey, Romania, Bulgaria and Georgia, with an overall value of USD 30 million. Within the same Trade Finance Programme, a new credit line worth USD 10 million has been opened to the Vneshtorgbank (Russian Federation).21

9. Summary - conclusions

Recently, the economic situation and the trade performance of transition economies, including the CIS countries has improved. Both exports and imports of the CIS countries show an important positive growth. At the same time, the structure of foreign trade remains basically unchanged: the CIS exports are dominated by primary commodities and intermediate goods.

Since the beginning of the transition, the risk perceptions of trading with countries of central and eastern Europe have improved and many of them benefit from favourable terms of payment both in export and import transactions. The CIS countries, however, represent the highest perceived risk for their partners, and, with the exception of the Russian Federation, the payment terms in the region have not relaxed recently: letters of credit and prepayment remain the predominant payment modes.

The access of SMEs to external financing has been facilitated recently in a number of central and eastern European countries (Czech Republic, Hungary, Poland). In the CIS countries as well, there have been signs of an emerging interest in SME financing on the part of commercial banks. However, for the time being, the availability of bank loans to small and medium-sized enterprises, especially long-term loans, remains limited because of the underdevelopment of the banking system, high risk perceptions, excessive collateral requirements and high interest rates.

While the scope for countertrade has tended to decline recently in several CIS countries, it remains an important vehicle of trade. Although barter deals are effected mostly by large enterprises, they are also used by quite a number of SMEs in specific sectors. The future of countertrade and barter will largely depend on the growth of economic efficiency and competition in transition countries.

Eximbanks and ECAs in a number of central and eastern European countries recently have developed programmes for SMEs financing, including longer-term credits. However, in most CIS countries the scope of operations of government-sponsored export financing agencies is limited and special programmes for SME support are more an objective for the future.

The bulk of targeted SME financing in CIS countries comes from international financial institutions, especially the European Bank for Regional Development. Particularly important in this context are its efforts to develop a network of local banks having experience, resources and interest in future SME financing.
CHAPTER II

Short- and long-term payment and credit arrangements as instruments of trade finance: some practical experience of SMEs.

A. Company perspective

1. Mr. Bronislav Šimek
   Commercial Director, JSC ALTA (Czech Republic)

I would like to share the experience of ALTA in financing export credits on the CIS markets. My company deals with these markets very closely: as much as 90% of its turnover results from operations in the CIS countries (primarily in Russia, Belarus and Ukraine). In 1991, when ALTA started its trade operations on these markets the majority of contracts used prepayment and barter. This restricted the scope for operations. Gradually ALTA has investigated the possibilities for using other payment mechanisms.

In particular, though to a limited extent, it has started to extend short-term loans to reliable customers. Therefore, the introduction in 1995 of an export support system was much welcomed. The establishment of the Czech Export Bank and the Export Insurance Agency has improved conditions of financing trade operations for commercial banks.

Regarding the commercial contracts of ALTA, the first contract, where a short to medium term financing scheme was applied, was with the Poltava Mining Enterprise (Ukraine). This enterprise supplies raw materials to its Czech partners and the latter deliver equipment for mining and processing of metals. Such equipment is classified as investment/capital goods and the Ukrainian partner, because of its cash flow problems, sought to pay for these goods in instalments. ALTA has structured this first medium-term credit for the supply of equipment in cooperation with Komercní Banka A.S. (Czech Republic) and Prominvestbank (Ukraine) without government guarantees. Under that deal, Prominvestbank guaranteed the credit; the total amount of the loan worth USD 5 million was repaid in equal half-year instalments over 24 months. The deal was insured by the Czech insurance agency EGAP.

Following this successful experience ALTA used the same scheme for financing purchases of other Ukrainian enterprises. Moreover, subsequent contracts were implemented without guarantees from Prominvestbank. Instead, an escrow account and export contract insurance were used as a guarantee.

In 1997, a similar scheme was used in Belarus. That project related to financing the imports of equipment for BELAZ, and was implemented by ALTA, again in cooperation with Komercní Banka. The financing took the form of an inter-bank loan worth USD 4 million extended by Komercní Banka to Belvnesheconombank, with the repayment conditions being identical to those applied in the Ukraine.

The largest of ALTA’s outstanding projects in the CIS countries so far is the financing of the BELAZ modernization programme. The total amount of loan is USD 119 million; and its structuring has required a considerable amount of time (the work started in 1997). The project is co-financed by the Czech Export bank with an 85% share of the loan financing (five years inter-bank loan) and Belvnesheconombank, and Interbank (Czech Republic), which finances 10 per cent of the
loan (short-term part: two years loan as a buyer loan). Therefore, as much as 95 per cent of the total project is financed by banks and the remaining five per cent is to be paid by the buyer, BELAZ.

The loan agreement and the contract on equipment supply have been signed. However, the Russian financial crisis has badly affected the project implementation. The loan documentation package has been reconsidered and financing has been split up into three stages. In 1999 new agreements were signed and in September 1999 the first phase of the project realisation started. The financing of this first phase amounts to USD 49 million, and this phase has almost been completed.

In November 2000, the agreements covering the second and third phases of the project were signed. The second phase is now being implemented and the third phase is due to start soon.

I should emphasize the important role of guarantees in structuring finance for this project. Among those there are, firstly, government guarantees (on both 10 per cent and 85 per cent segments of the project loans) and secondly the setting up of an escrow account in the Interbank, where the revenue from BELAZ shipments is accumulated to cover the six month repayment instalments plus interest.

Let me repeat that projects of this scope require a thorough preparation of a considerable number of legal documents implying the involvement of lawyers that help design them.

In addition to this major project, ALTA is currently implementing several other projects, where it applies different types of export financing.

My company cooperates with companies from the CIS countries not only as an exporter but also as an importer. Buying from Belarus exporters, however, is hindered by a number of obstacles. In particular, due to restrictions in the Belarusian legislation BELAZ shipments of trucks cannot be paid for in instalments. More general obstacles relate to the insufficient development of financial intermediation and the lack of export finance mechanisms in CIS banks.

2. Mr. Stanislav Sokolenko
Chairman of the Board, Joint Stock Company “UKRIMPEX” (Ukraine)

Today, Ukrainian enterprises cannot use the forms of payment predominant in developed market economies. The importer often has to pay in advance 50 to 100 per cent of the shipment’s value and only afterwards is the good delivered. Only a few enterprises can afford to operate on these terms, which are very resource consuming. There are also several regulatory problems, which impede exporting. Last year, for example, export duties were imposed on sunflowers, on metal products and on fertilizers. Another hurdle relates to so-called “indicative” prices. This mechanism does not allow the supplier to be competitive on the market because he cannot sell below the “indicative” price. Because of these obstacles, many foreign trade transactions have to be conducted semi-illegally.

Obtaining a bank guarantee also often creates insurmountable obstacles for Ukrainian suppliers or buyers. The bank guarantee costs less than one per cent when you deliver from Switzerland to

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22 The major documents, which had to be signed to implement our deal with BELAZ included: general and individual contracts on equipment supply, general loan agreement between the Czech Export Bank and Belvnesheconombank, between Interbank and BELAZ, agreement on the escrow account, security agreements on equipment supply to BELAZ, Interbank agreement between Interbank and Czech Export Bank, insurance agreements between EGAP, Interbank and Czech Export Bank, and a number of agreements on the Belarusian side: between Belvnesheconombank and BELAZ, Belarusian Ministry of Finance, BELAZ and Belvnesheconombank.
France. At the same time, the bank guarantee for a Ukrainian supplier costs about 10-15 per cent of the contract value.

I think that the establishment of consortia by enterprises to participate in tenders is a very promising way of encouraging exports. In particular, on a regional level, with the help of our tax inspection system we are developing schemes encouraging small and medium-sized enterprises to take part in export tenders. This refers to food and light industry enterprises in the western part of Ukraine. These industries have been revitalized with the help of credits from regional banks. Now we are trying to pull the resources of these enterprises together to make them more competitive. And here we need the support of financial institutions, namely commercial banks, to finance research and the training of enterprise workers.

Finally, one more form of assistance to small and medium-sized exporters that has started developing in Ukraine is micro-credit which is offered by some of commercial banks.

B. Bank perspective

3. Mr. Sergei Kobrynski
   Deputy Director, International Department, OAO “Priorbank” (Belarus)

During the eleven years of its history, Priorbank has gone from being a strictly specialized innovation bank to being a universal financial institution integrated into the international banking community. To assess the results of its activities, Priorbank uses international criteria: the market value of stock, amount of profit, market share. As of May 2001, Priorbank’s assets accounted for 8.5 per cent of all banking sector assets in Belarus (5th rank) and its equity capital amounted to about USD 20 million.

The Bank has always striven to build relations with international financial institutions, considering them as one of the means of attracting funds into the Belarusian economy.

In 1997, Priorbank was the only bank in Belarus to be assigned a credit rating by an international rating agency “Thomson BankWatch”. In December 2000, the rating of Priorbank was reviewed and upgraded by the Fitch agency and up until today it is the highest possible rating in the Republic of Belarus: i.e. rating of long-term – CCC and short-term – C.

In 1992, Priorbank, was the first among Belarusian businesses to Commission an international audit company to audit its books. At present, our auditor is a well-known international audit company, “Ernst & Young”, performing audits twice a year.

One of the main criteria of success in our view is the scope of our operations on international financial markets and of our cooperation with western financial institutions (banks, financial and State insurance companies).

Cooperation with the European Bank for Reconstruction and Development (EBRD), began in 1993, culminating in EBRD’s acquiring a 27 per cent stake in our bank. Priorbank has contributed to implementing a number of EBRD programmes aimed at developing the market system in Belarus. In 1994, we started servicing the EBRD credit line earmarked for financing small and medium-sized enterprises. During 1995 - 2000, as much as USD 12 million were invested.

Priorbank is also the most active participant in the Trade Finance Guarantee Facility Program. This Program supports inter-regional and international trade in the EBRD’s countries of operation. The
Practical aspects of Trade Finance in CIS countries

participants include 41 banks from 18 countries with emerging markets, which issue letters of credit/guarantees, and 125 banks from 49 industrial countries, which confirm them. In January 2001, under this programme Priorbank acquired the right not only to issue letters of credit/guarantees but also to confirm them. At present, the credit line granted to Priorbank by EBRD for confirming L/C and L/G with a validity of up to one year amounts to USD 5 million.

Priorbank currently services over 37 per cent of international transactions of Belarusian enterprises. We offer to clients financial instruments that are widespread in international trade but new to the Belarusian market. Financing of projects is tailored to customer needs and is always conditioned by export contracts involving buyers that have irreproachable creditworthiness.

An example of using new financial instruments is the financing of the purchase of new technological equipment by the Belarusian Metallurgical Plant in Germany, which was arranged with the active participation of Priorbank. The repayment of the loan worth USD 22 million will be based on the additional revenue generated by increased sales by the plant and will be effected over a 3-year period.

Structured finance offered by Priorbank includes: short-term financing (factoring, trade and commodity financing), medium and long-term financing (pre-export financing, forfeiting, financing under special programmes of international financial organizations, financing involving participation of insurance companies), and special kinds of financing (project and syndicated financing).

Commodity and trade financing (CTF) is a short-term transaction involving financing of trade in commodities or other marketable goods. It is an interesting option for trading companies with relatively little equity, but which deal with large volumes of sales. The credit, in this case, is only granted to traders with excellent knowledge of the market and good working relations with buyers and sellers. The advantage of CTF for the trader is that it enables transactions to be carried out which would not have been possible otherwise because of the trader’s lack of funds (i.e. working capital).

Advantages of CTF to the producer (exporter) include:

- No risk in case of non-payment by the middleman or final buyer
- All costs are borne by the trader
- Foreign currency payment is guaranteed by the foreign bank (by L/C or L/G)
- High volumes of products can be sold by the producer (exporter) via trader(s) without establishing their own distribution network
- Increase in turnover and profit

Export pre-financing is based on long-term contracts between Belarusian producers and foreign buyers with a good reputation and track record. Since a foreign bank grants credits or lines of credit to the Belarusian producer and not to a foreign trader or buyer, the analysis of the risk situation in the case of export pre-financing is of utmost importance.
Advantages for the producer (exporter) include:

- Adequate financing of export production
- Lines of credit available in case of revolving deliveries under long-term contracts
- Low costs of financing, corresponding to the prevailing rates in partner countries
- Possibility of combining pre-export financing with other types of financing, for instance financing of import transactions
- Transactions between producer, buyer and foreign bank (via Priorbank) under long-term contracts can be repeated on a revolving basis.

**Forfeiting** is the sale or purchase of obligations, falling due at some future date, arising from deliveries of goods or services, without recourse to any previous holder, with interest deducted up front (i.e. discounted), from the date of purchase until a future maturity or due date. In other words, forfeiting is a form of supplier credit involving the discounting of international trade receivables on a «non-recourse» basis.

In this case, advantages for the exporter include:

- Elimination of non-payment and non-timely payment risks
- Possibility of offering credit terms to the customer
- Possibility of financing exports of both goods and services
- Little additional documentation required
- Non-recourse, that is off balance sheet financing
- Improved cash flow
- Other banking facilities remain available

I would also like to highlight the financial cover offered by foreign insurance companies. Insurance companies dealing with foreign trade transactions operate in all countries of the OECD, in the majority of emerging markets and in the largest developing countries. As a rule, the cover by the insurance company has two legal forms: security (if a foreign buyer, borrower or guarantor is a State body or a legal person of public law) and guarantee (if a foreign buyer, borrower or guarantor are individuals or legal persons of private law).

One of the signs of Priorbank’s recognition by the world financing community is the readiness of such foreign state insurance companies as “KUKE”, “COFACE”, “EGAP”, and “HERMES” to insure deals with Priorbank’s participation without state guarantee. In particular, we have considerably improved our cooperation with the German State insurance company HERMES, which has agreed to insure deals involving Priorbank. This will help Priorbank obtain credit lines from the leading German banks.

There are a number of impediments, beyond the control of Priorbank, which hamper the financing of Belarusian companies. Since government-sponsored insurance companies insure the bulk of export credits, they use rather formal criteria when choosing the bank-contractor: country rating, the political relations between countries, State support to the bank and some others. The use of such criteria limits our business opportunities.
Currently, all credit lines, both long-term and short-term, opened by foreign exporters and investors in favour of Belarusian contractors, are direct credit lines, i.e. they are intended to finance individual projects. The low level of confidence in Belarusian enterprises and the high country risk encourage foreign contractors to demand enhanced insurance coverage of deals.

On the whole, the cooperation of Belarusian banks with foreign insurance companies is in the initial stages.

In conclusion, I would like to point out that in spite of a difficult economic situation demanding flexibility and responsiveness, we are well prepared to continue the financing of foreign trade of Belarusian enterprises. To this end we are:

- developing our client base;
- increasing the level of capitalization and our share of financial market;
- using up-to-date banking technologies and enhancing our experience in international settlements;
- introducing new instruments in investment and commodity finance, and pre-export financing, forfeiting and factoring;

We hope that this will help Priorbank to further contribute to the integration of Belarusian enterprises into the global economy

4. Mr. Bohumil Paukner, Relationship Banking Manager, Komercní Banka (Czech Republic)

Komercní Banka is the second largest bank on the Czech market and since June 2001 is a member of the Société Générale Group.

The bank finances export operations mainly through buyers export credits, which are provided in two forms, direct and indirect. By means of those credits it is possible to overcome the importer’s lack of liquidity and to make terms of payments mutually acceptable to both the exporter and importer.

The direct export buyer credit is an individual credit agreement between the bank and the foreign importer. It requires a delivery contract between the importer and exporter. After the delivery of goods has been effected and the documents stipulated in the contract presented, the bank transfers payments to the exporter’s account.

The indirect export buyers credit has two varieties: either a credit agreement is concluded between the lender and a foreign bank, and the latter becomes the borrower for one large project, or an agreement on an inter-bank credit line for financing recurring transactions is concluded.

The export buyer credit is a bank product particularly suitable for SMEs. Terms and conditions for granting this type of credit are determined by OECD consensus, and our bank often cooperates with Export Guarantee and Insurance Cooperation (EGAP). Basic terms for granting the buyer credit stand as follows:
1. Availability of a delivery contract between exporter and importer;
2. At least 60 per cent of the product value to be exported must be manufactured in the Czech Republic;
3. An appropriate portion of risks associated with the credit has to be covered by the EGAP;
4. Financing provided in the form of the buyer credit covers a maximum of 85 per cent of the commercial contract value. The remaining 15 per cent is not covered by the loan and is to be paid in advance directly to the exporter in the form of immediate payment, irrevocable letter of credit or via a combination of both. Interest rates for these loans are fully competitive with those of OECD countries for this type of financing. It is a floating rate based on LIBOR plus the bank’s small margin.

The documents required by the bank to evaluate commercial risks of granting a buyer credit include all documents attesting to the trustworthiness of the borrower and profitability of the project, and audited financial statements in accordance with international accounting standards for the three years preceding the deal. If the guarantee is provided to the importer by a local bank, the latter has to submit the same type of documents. All documents must be presented either in English or in German.

When cooperating with EGAP, Komercní Banka always meets its requirement with regard to assuring sufficient guarantee of credit repayment. Usually it is a guarantee issued by the importer’s bank, which EGAP finds acceptable. At the same time there are alternative ways of insuring credit payments.

Export finance can be interpreted as quasi-project finance when the borrower is given the opportunity to repay the borrowed funds invested in the project from its sales revenues. In this case, an escrow account opened with our bank to which the sales proceeds are transferred, can be used as a financing instrument.

An ideal collateral is a State guarantee. However since the International Monetary Fund (IMF) and other international financial institutions stipulate limits to official indebtedness and bind Governments to financial discipline, such an instrument can be used only for extremely important projects.

The borrower might need to assess the feasibility of guarantees extended through the local budgets of municipalities. I consider this type of guarantee to be particularly suitable for SMEs. Such a guarantee can be supported by revenues generated by commercial activities conducted under the respective administrative unit. For example, a guarantee could represent revenues from gas exports. In the case of one transition economy, the loan by our bank has been repaid from fishing revenues, while the fishing licence has been guaranteed by the central administration. That project was worth USD 80 million.

To conclude, I would like to emphasize that although it is difficult to find something new in this line of business, the Komercní Banka tries to be inventive in order to satisfy our various types of customer.
5. Mr. Meirambek Karazhigitov  
Manager, International Finance, KAZKOMMERTSBANK (Kazakhstan)

I think it would first of all be useful to highlight a number of programmes, that our bank is undertaking, their scope, eligibility criteria for enterprises, financial conditions (e.g. applicable interest rates as opposed to prevailing market rates, types and maturity of loans, etc.), and the results of these programmes in terms of enterprise and export growth.

During the last two to three years, the financial situation in Kazakhstan has improved and the relations between banks and borrowers have changed considerably. The tightening of monitoring by the central bank and improved regulations have reduced the number of banks from 204 at the end of 1993 to just 46 at the end of 2000. Moreover, the State has indicated that, in view of the size and composition of the economy and the country’s relatively small population, the banking system should ideally consist of some 20 to 25 banks. This tightens up the competition between the banks in all spheres, including the attraction of new, financially solvent customers.

The National Bank of Kazakhstan (NBK) has managed to streamline legislation and gradually institute regulatory practices akin to those of international markets. As early as 1998, the largest 15 banks were asked to adopt the International Accounting Standards (IAS), which are now applied by the majority of financial institutions and the country’s major corporations.

Kazakhstan has also introduced an insurance scheme for deposits placed with the banks by individuals. Currently, the private customer deposits held with the banks have reached USD 2.5 billion. This means that commercial banks have access to the cheapest local financial resources.

In parallel, the National Bank has imposed stringent reporting requirements on banks. The capital adequacy ratio (a required ratio of 12 per cent to be compared with the Bank of International Settlements’ (BIS) 8 per cent), large exposures, investments in fixed and non-financial assets, and classification of credits, must be reported monthly. Such policies create a conservative reporting atmosphere, especially with regard to write-offs and reserves, resulting in comparatively healthy bank finances. They have also improved the ability of banks to access international credit markets.

In line with the healthier economic conditions, the liquidity of the banking sector has also improved. This should be further boosted by the Government’s recent amnesty on repatriated capital, which began on June 14, 2001, aimed at resolving the capital flight issue common to most CIS countries. The amnesty has already brought back to Kazakhstan a total of USD 500 million. The majority of these funds has been deposited in commercial banks.

Even more impressive is the Government’s pension fund programme initiative. Introduced in 1998, the programme obliges employees to contribute 10 per cent of their pre-tax earnings to the pension fund. The inflow of funds has grown by USD 30 – 35 million a month and their total amount has reached some USD 1 billion (or about 6 per cent of GDP). This step toward pension reform has reduced the traditional financial burden on the State, while raising domestic savings rates.

The Oil Stabilization National Fund was established in August 2000. When oil prices are above average, the difference between the higher and the average revenue is accumulated in this Fund. Its functioning permits to control the effects of fluctuations in government revenues resulting from commodity price movements. The fund currently holds USD 953 million in assets and is expected to grow to some USD 1.5 bn by the end of 2001. It is hoped that it could finance future budget
deficits and offset a large part of public debt. Finally, the fund is expected to help bolster Kazakhstan's credit rating.

The acknowledged need for further diversification of the economy, import substitution and job creation, places the onus on the country’s banking sector to support entrepreneurial initiatives. We are assisted in this endeavour by multilateral financial institutions, the European Bank for Reconstruction and Development (EBRD) in particular, which extends credit lines to domestic banks for on-lending to small and medium-sized enterprises.

In Kazakhstan, the three largest banks together with seven medium-sized banks control more than 50 per cent of the banking sector’s assets. Assets of this sector have climbed to approximately USD 3 billion, equivalent to some 20-25 per cent of GDP, and are expected to grow as the economy continues to expand.

Owing to all these transformations the style of relations between the banks and borrowers has changed dramatically. Now the banks have sufficient and relatively cheap sources of funds and are looking for borrowers, whilst the borrowers now have a choice and can select the best offers and pricing.

The Government has declared SME development a priority, and this is supported by international financial institutions. The following table sets forth the list of current SME financing programmes, which are operated by Kazkommertsbank (table 3).
Table 3 - List of SME programmes, sponsored by national and international financial institutions, and operated by Kazkommertsbank

<table>
<thead>
<tr>
<th>Lending Institution</th>
<th>Total loan amount</th>
<th>Industry</th>
<th>Tenor, min/max</th>
<th>Sub-Loan amounts, min/max</th>
<th>Interest rate for final borrower</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBRD</td>
<td>ECU 100 mn</td>
<td>Manufacturing &amp; services</td>
<td>7-10 years</td>
<td>USD 500 th – 5 mn</td>
<td>Credit Committee</td>
</tr>
<tr>
<td>EBRD (A + B tranches)</td>
<td>USD 40 mn</td>
<td>Any eligible projects</td>
<td>Up to 2 years</td>
<td>USD 500 th</td>
<td>Credit Committee</td>
</tr>
<tr>
<td>EBRD (micro+small)</td>
<td>USD 12.5 mn</td>
<td>Any with EBRD standard exceptions</td>
<td>1-12 mnths (micro) 1-36 mnths (small)</td>
<td>USD 30 th (max) USD125 th (max)</td>
<td>Credit Committee</td>
</tr>
<tr>
<td>IFC</td>
<td>USD 10 mn</td>
<td>Any with IFC standard exceptions</td>
<td>Up to 7 years</td>
<td>Min USD 1 mn</td>
<td>Credit Committee</td>
</tr>
<tr>
<td>Asian Development Bank</td>
<td>USD 50 mn (for all participating banks)</td>
<td>Agriculture – USD 21 mn utilised by KKB</td>
<td>7 years</td>
<td>Not fixed</td>
<td>11 per cent</td>
</tr>
<tr>
<td>KfW – German Credit Institute</td>
<td>DEM 27 mn (3 banks)</td>
<td>No limitations - priority is given to processing</td>
<td>2 – 4 years</td>
<td>DEM10 th. – 1.5 mn</td>
<td>12 per cent</td>
</tr>
<tr>
<td>DEG – German Investment &amp; Development Company</td>
<td>DEM 20 mn</td>
<td>Projects with German element are preferred</td>
<td>Up to 5 years</td>
<td>Up to DEM 4 mn</td>
<td>Credit Committee</td>
</tr>
<tr>
<td>FMO – Netherlands Development Finance Company</td>
<td>USD 10 mn</td>
<td>Agriculture &amp; agroindustries, manufacturing &amp; export-oriented industries, tourism, local resource-based industries with export potential</td>
<td>5 years</td>
<td>Up to USD 5 mn</td>
<td>Credit Committee</td>
</tr>
<tr>
<td>Islamic Development Bank</td>
<td>USD 2.45 mn</td>
<td>Any industry not prohibited by Shariah</td>
<td>Up to 10 years</td>
<td>Not fixed</td>
<td>11 per cent</td>
</tr>
<tr>
<td>International Bank for Reconstruction and Development (IBRR)</td>
<td>USD 12.5 mn (for all participating banks)</td>
<td>Any project under World Bank Agricultural Post-Privatisation Assistance Programme</td>
<td>Up to 12 years</td>
<td>Not fixed</td>
<td>Credit Committee</td>
</tr>
<tr>
<td>EBRD Trade Facilitation Programme</td>
<td>USD 35 mn</td>
<td>Any industry, complying with EBRD policy</td>
<td>Not fixed</td>
<td>Not fixed</td>
<td>Credit Committee</td>
</tr>
</tbody>
</table>

Source: Kazkommertsbank
It can be seen from table 3 that there is a sufficient number of SME financing programmes available. Only three institutions – the Asian Development Bank, KfW and Islamic Development Bank stipulate fixed interest rates for final borrowers. Regarding the others, the Bank fixes loan interest rates in accordance with the decision of its Credit Committee. Some programmes stipulate regional priorities, i.e. lending should be spread over all regions of Kazakhstan and should not concentrate only in the central areas of the country.

For very small enterprises, which need loans within the limits of USD 200 and USD 200 thousand, we have a special programme under the EBRD Small Business Programme. The enterprise eligibility criteria set forth by international financial institutions and investment companies are generally standard (see Annex I).

Secondary-borrowers may only be enterprises domiciled in Kazakhstan. The own contribution of an enterprise to the estimated total cost of the project should be 20 – 25 per cent. As a rule, the eligible companies are allowed to have a grace period of one to three years for repayment of principal and interest.

There is no internationally acceptable classification of SMEs provided by international financial institutions. However, KKB has worked out and applies the following SME criteria (see box 2).

<table>
<thead>
<tr>
<th>Box 2 – Kazkommertsbank’s SME criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average annual turnover</strong></td>
</tr>
<tr>
<td>Up to USD 700 000 – small enterprises (up to 50 employees)</td>
</tr>
<tr>
<td>Between USD 700 000 and USD 2 500 000 - small and medium-sized enterprises (up to 200 employees)</td>
</tr>
<tr>
<td>Between USD 2 5000 000 and USD 10 000 000 – medium and large enterprises (over 200 employees).</td>
</tr>
</tbody>
</table>

Source: Kazkommertsbank

Although recently lending to SMEs has increased the share of these companies in the total volume of lending in Kazakhstan this share is still low at about 22 per cent. Although the number of profitable companies that are promising borrowers has grown, it remains small. The main problems faced by the banks when financing such enterprises relate to identifying suitable investment projects, obtaining reliable financial information and adequate business plans, and identifying adequate collaterals. Currently, the Bank accepts as collateral not only real estate, but also other types of securities, such as guarantees of third parties, government securities and shares, and the stock of good Kazakh corporate companies, listed in the “A” category of the Kazakhstan Stock Exchange. However, borrowers still experience difficulties in providing adequate collaterals. This, clearly, slows down the implementation of the SME financing programmes.

In broader terms, however, since their start in 1995 the implementation of SME financing programmes has been successful. A number of companies that have obtained pre-export financing managed to purchase new equipment and currently manufacture competitive products having sufficient export proceeds.

Finally, I should mention that local banks receive extensive assistance from experts of international financial institutions when conducting subsidiary loan assessments. Seminars and training on the economic and financial evaluation of projects, market and sector analyses, balance sheet, cash flow
Practical aspects of Trade Finance in CIS countries

and risk analyses, and revision of banks’ credit procedures are regularly provided by the EBRD, the World Bank and International Finance Cooperation (IFC). On-site visits of companies permit an evaluation of their management and commercial conditions, financial dependencies, prospects and risks in purchases, production and sales, collateral evaluation, examination of loan and pledge agreements, export-import contracts, etc.

Annex I. Activities not eligible for financing by international financial institutions

- Production or activities involving harmful or exploitative forms of forced labour/harmful child labour
- Production or trade in any product or activity deemed illegal under host country laws or regulations, or international conventions and agreements
- Production or trade in weapons and munitions
- Production or trade in alcoholic beverages (excluding beer and wine)
- Production or trade in tobacco
- Gambling, casinos and equivalent enterprises
- Production or trade in radioactive materials
- Production, trade in or use of unbonded asbestos fibres
- Commercial logging operations or purchase of logging equipment for use in primary tropical moist forest
- Production or trade in products containing PCBs – Polychlorinated biphenyls – a group of highly toxic chemicals
- Production or trade in pharmaceuticals subject to international phase outs or bans
- Production or trade in pesticides/herbicides subject to international phase outs or bans
- Production or trade in ozone deleting substances subject to international phase out
- Drift net fishing in the marine environment using nets in excess of 2.5 km in length
- Trade in wildlife and wildlife products
- Release of genetically modified organisms into the natural environment
- Hazardous waste storage, treatment or disposal
- Projects, which may have a negative impact on human health, safety and environment

Source: Kazkommertsbank

6. Mr. Igor Shabanov  
Head, Documentary Operations Division, Trade Finance Department, GAZPROMBANK (Russian Federation)

Gazprombank, although established to service the gas industry, over the past decade has diversified its portfolio and currently, in addition to gas industry stock, holds shares from other sectors, namely the petrochemical industry, machine building, armaments production, construction and agriculture. Gazprombank is one of the largest banks in Russia, its total assets amount to USD 3.5 billion with own capital amounting to USD 700 million.

Gazprombank has benefited from the Russian financial crisis because it has brought more new clients to the bank. There is a special division in the bank that deals with financing export-import trade operations. Gazprombank is one of the largest banks in Russia and has a good reputation in international financial markets. On matters of trade finance, our bank cooperates with 20 large European banks.

When it comes to financing SMEs, Gazprombank has several opportunities for obtaining relatively cheap financing from abroad:
1. Borrowing from foreign banks with government guarantees or covered by insurance from foreign insurance agencies. This option is relatively complicated and requires submitting documentation and procedures that take a substantial period of time (3-6 months).

2. Borrowing from foreign banks using the individual borrowing limits set by them for Gazprombank. The advantage of this type of borrowing consists in immediate availability of resources. A major disadvantage relates to the volume of borrowing, which is limited, and the restricted tenor of loans: for Russian banks they are provided for up to 12 months not allowing enough time to finance investment projects that normally require a minimum of 2 - 5 years.

In the Russian Federation, for the time being, there is no State export insurance agency; this type of insurance is arranged by the State banks.

Obstacles to export development in Russia are associated primarily with the current foreign exchange legislation. Notably, the regulation on export controls includes a clause that obliges companies to transfer the totality of foreign exchange export revenue to its bank account. This and some other rules and restrictions prevents Russia from using financial instruments that are common in international export financing practice.

Because of these regulatory hindrances, banks often cannot provide working capital to exporting companies. The decision by the Central Bank to allow importers to use Letters of Credit (L/C) represents an important step forward. In practice, however, its use is hampered by bankers’ lack of experience, and also importantly, by shortcomings in Russian tax legislation. The Central Bank is still reluctant to permit the use of L/C in export operations. This restriction impedes the financing of many export projects, since Russian banks often lack resources to assure the required volume of working capital (even large companies are in need of working capital).

Through their association, the Russian commercial banks have raised the issue of regulatory barriers to foreign trade financing in the Parliament. However, making amendments to laws is extremely difficult and requires much time. Nevertheless, in September 2001 the need to change the foreign exchange regulations was acknowledged by the President and the Central Bank.

Discussion

Miroslava Hrncirova (Czech Export Bank, Czech Republic) noted that Bronislav Šimek (Commercial Director, JSC ALTA, Czech Republic) had touched upon a very important issue. The story of his company showed well how an advanced Czech producer operated on CIS markets and how the banking system and governmental support schemes had been used to support commercial transactions at the enterprise level. Government agencies dealing with trade finance in transition countries should be aware of the requirements of the world market, including those related to payment terms. Otherwise, even producers having good quality products, including machinery and equipment, would not be able to develop their export markets.

Pavel Gul (Joint Enterprise Santa Bremor OOO, Belarus) informed the workshop about the activities of his company established in 1998 due to a loan extended by the EBRD via the Priorbank. In his view, the EBRD’s lending rates are overly high and requirements for participating firms to qualify for these loans are excessively tough. Thus, many entrepreneurs are not able to finance potentially good projects. On the other hand, the available credit lines are not fully used (only 50 per cent of the USD 50 million loan extended by EBRD to Priorbank) owing to the lack of qualifying projects. However, there are many SMEs in Belarus that could use these resources to develop their business.
Pavel Gul also criticised the credit risk assessment of companies on the basis of country risk ratings. This is appropriate in cases when government guarantees have been provided, while in other cases enterprise-related risks should be considered separately without direct reference to the overall country risk grade. He noted that successful exporters normally insured their contracts with sound western insurance companies and stuck to strict collateral requirements. Banks should be more flexible in their policies and ease their collateral requirements in order to minimize credit costs for exporting companies.

Dmitriy Romanovskiy (Belpromstroibank, Belarus) asked Bronislav Šimek to explain how his company used export contracts as credit collateral.

Bronislav Šimek explained that this practice was based upon customers buying products from a particular supplier on a long-term basis, in this case from BELAZ. There was than a security agreement between the long term supplier (BELAZ) and its customers, according to which all the proceeds from the export contract identified in the agreement must be accumulated in an escrow account. This account would then accumulate an amount equivalent to a certain percentage of the credit used and serve as collateral. Whenever the amount accumulated on the account exceeds the agreed percentage, the surplus can be used by the exporter (BELAZ) for other needs.

Alexei Skraga, (State Insurance Company “BELGOSVONSEHSTRAKH”, Belarus) asked Pavel Gul what payment terms his company offered to its customers.

Pavel Gul replied that his company had developed an efficient distribution network in many countries of the former USSR. It uses a simple purchase contract with delayed payment of up to 60 days as allowed by the Belarus legislation. Since the customer network is well established, no additional measures to insure export contracts are taken today. At the same time, if shipments expand to non CIS-countries or to countries that do not belong to eastern and central Europe (e.g. Lebanon), this issue will be reconsidered. Within Belarus, conventional trade arrangements without any special know-how or financial guarantees are used – company partners and their financial conditions are well known. Today Santa Bremor does not face any major collection problems.

According to Miroslava Hrncirova, in the Czech Republic export contract insurance is extended for 30, 60 or 90 days. EGAP always checks the solvency of the buyer using information from similar agencies abroad. On that basis, it provides the seller with information advising on how big the shipments and how long the payment delay could be. The premium for this kind of insurance is not very high. The advantage of such insurance to the seller consists in being paid immediately for the delivery, which allows this demand for external funding to diminish significantly. This insurance is particularly beneficial when interest rates are high.

Justinas Alekna (Lithuanian Export and Import Insurance, Lithuania) indicated that his company covered almost 10 per cent of Lithuanian exports. When providing insurance to an exporter it has to assess the risks associated with the purchaser. And here problems related to a lack of financial information arise. For example, when the purchasing company is contacted and refuses to provide the balance sheets or profit statements. It is to be noted that this happens not just with small obscure firms but with well-established companies from CIS countries, Belarus in particular. In this case, the Export and Import Insurance cannot provide the commodity credit and the purchasing company has to buy this good from the Lithuanian supplier on a pre-payment basis. This circumstance creates a serious hindrance to cooperation between Lithuania and Belarus.
**Pavel Gul** mentioned that the refusal to provide balance sheet information stemmed from a lack of understanding as to why this was needed. One would assume that the management of the company in question failed to realise the advantage of providing adequate information to the export credit agency. This is an internal issue of management competence.

**Miroslava Hrncirova** mentioned that information openness along with professional ability were a prerequisite for trust between trading partners. Information transparency and trust also make financing cheaper. Country risk is inherent in foreign trade transactions. At the same time, country risk is a component that partly determines the cost of insurance and of financing while there are some residual parts of the risk that should be borne by the financing institutions or banks. For instance, Eximbank takes into account a part of the coverage of the bank credit and examines the repayment sources if not all parts of the credit are covered by the insurance. Insurance itself depends however on the category of risks attributed to a certain country. As many as seven categories of risk are used in OECD countries and in European Union countries. Individual transactions should be considered within this framework. Therefore, the insurance company should have access to diversified information. Possibilities of making credit cheaper are closely linked with the degree of transparency and the performance of an economic entity.

**Lennart Skarp** (Berne Union secretariat) emphasized that subcontracting was a very important exporting mechanism for SMEs, through which they obtain access to medium- and long-term finance. Experience around the world shows that small and medium-sized enterprises can often play a strategic role in export transactions; however, not as direct exporters but rather as indirect exporters or, more correctly put, as subcontractors.

**Iouri Adjoubei** (UNECE secretariat) asked **Sergei Kobrynski** (Priorbank, Belarus) what the proportion of small-sized exporters among clients of Priorbank was and what problems, in his opinion, small and medium-sized enterprises encountered when seeking long-term financing.

**Sergei Kobrynski** noted that Priorbank was servicing about 18,000 corporate clients but the bulk of its profits was generated by the operations of one thousand clients, such as, Belarusneft, Druzhba Pipeline, Mosyr’ Oil Refinery and the Belarusian Metallurgical Plant. Larger exporters account for 90 per cent of the bank’s transactions. The key problem hindering medium and long-term financing of exports relates to the Belarus legislation, which has not yet been adapted to the new requirements of producers and financiers. Through forfeiting, for example, enterprises might have access to external resources. Under this scheme, the forfeiting banks, which finance the exporters, take over their risks and respectively have the right for a premium that is a part of exporters’ revenue. However, according to current legislation, the exporter cannot sell the promissory notes of the importer to the forfeiter at a discount; in order to close the transaction as much as 100 per cent of its value has to be shown on the exporter’s account. This is just one example, which illustrates the present situation.

**Inga Badikoniene** (Vilniaus Bankas AB, Lithuania) noted that when speaking about forfeiting, **Sergei Kobrynski** referred to problems relating to governmental restrictions on payments in export transactions. She inquired at what price a shipment would be paid if the goods did not comply with the agreed quality standards and would the buyer qualify for a discount?

**Sergei Kobrynski** replied that a quality certificate, which had been specified and agreed upon by the buyer and the seller, accompanied each lot of goods. Therefore, as a rule such situations do not arise. But if non-conformity with quality standards is discovered, the whole lot should be returned.
CHAPTER III

Government support to small and medium-sized exporters: direct financing and risk insurance

A. Direct financing

1. Ms. Anita Katona
   Officer, Hungarian Export-Import Bank (Hungary)

The purpose of this presentation is to examine the present situation in the area of SME financing and highlight the major instruments of government support (i.e. direct financing and related services) offered by the Hungarian Eximbank and its partner institutions in order to increase SME exports.

Overview

Today, the transition countries in general – and Hungary in particular - are characterized by a dual economic structure:

- a significant part of GDP and exports is generated by a handful of large export-oriented foreign-owned companies,
- the contribution of Hungarian-owned SMEs to GDP and exports falls well below the weight of this sector in employment terms.

At present, as much as 70 per cent of Hungarian exports and nearly half of gross value added and sales revenue are produced by ventures which are exclusively or predominantly in foreign ownership. On the other hand, the share of SMEs predominantly owned by Hungarians in total GDP is about 45 per cent.

The above-mentioned dual structure is impeding the formation and strengthening of the middle class in Hungary. The rapidly growing sectors of the economy have emerged as “modernization islands” built up by a few multinational large companies. However these “islands” often do not integrate SMEs into their production and distribution network.

Consequently, the challenges of globalization make it imperative to strengthen the SME sector.

The Széchenyi Plan – Enterprise Development programme – facilitating the foreign market activities of SMEs

Since the decision-makers have recognized the importance of this problem, the mitigation of economic structure duality has become one of their most important goals. In particular, this objective is listed among the priorities of the Széchenyi Plan – a medium-term programme launched in 2001.

The Széchenyi Plan bears the name of Count István Széchenyi, an outstanding figure of the 19th century Hungarian reform era. Under his guidance, a number of economic reforms were implemented, and their scope is similar to that of the present programme.
The key objective of that Plan is to mobilize the development potential of the entrepreneurial and municipal sector. In order to achieve this, the government provides partial co-financing for different projects. The available State fund amounts to nearly USD 2 billion. However, the Government’s participation is limited. It intends to support a maximum of one fourth to one third of such projects.

A part of the Plan, entitled the Enterprise Development Programme, is of particular relevance to our discussion. The Programme does not aim at increasing the number of enterprises. Its major objective is to strengthen the competitiveness of the already existing ventures. Within this context, one of Government’s priorities is to facilitate the foreign market activities of SMEs.

According to SME surveys, government support aimed at facilitating their access to foreign markets should focus on two areas:

- dissemination of information on standards, procedures and formalities governing foreign trade in the European Union countries, as well as of information on markets and business opportunities in countries adjacent to Hungary;
- different means of financial support, which would facilitate SME access to markets and lower accompanying risks.

In accordance with these expectations, the objectives of the Enterprise Development Program are twofold:

- to assist SMEs in preparing for accession to the European Union;
- to support, using direct and indirect instruments, the foreign market entry of Hungarian SMEs and their foreign investment, primarily in the neighbouring countries;

To achieve its objectives the programme:

1. provides information pertinent to SME exports and foreign investment;
2. subsidizes the participation of SMEs in training and information sessions aimed at facilitating their access to EU markets;
3. establishes „organizational units” abroad capable of assisting SMEs in launching their products in foreign markets;
4. works out means of financial support to promote SME activity in neighbouring countries (the micro credit programme, preferential development credits, direct support facilities encouraging foreign investment);
5. extends export guarantee and credit accommodation facilities.

The Eximbank’s role in promoting SMEs’ export

Modelled on State credit institutions established in many countries of the world with similar purposes, the Hungarian Export-Import Bank Ltd. was founded in 1994. The principal objective of the Bank’s activities is to facilitate exports of Hungarian goods and services efficiently using budgetary funding and State guarantees. Eximbank operates as a 100 per cent State-owned specialized credit institution.

The bank uses the benefits arising from its affiliation with the state and special regulations to encourage commercial banks to finance foreign traders, reasonably share foreign risk and to improve exporters’ competitiveness. Activities of the Eximbank often enable exporters to tap into markets which could not be reached without its support. Terms and conditions offered by the bank are determined by OECD directives.
Given its future accession to the EU, when developing rules of Eximbank operation, Hungary takes into consideration the EU regulations on State support. According to these, State support can be granted for regional development purposes; in the case of small-scale financial support the so-called *de minimis* rule should be applied. According to this rule the support given to one client cannot exceed EUR 100 thousand over a three year period.

**Box 3. The Eximbank offers to enterprises and banks the following products.**

<table>
<thead>
<tr>
<th>A. LENDING</th>
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<tr>
<td>Direct lending</td>
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<tr>
<td>- export prefinancing</td>
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<tr>
<td>- working capital loan</td>
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<tr>
<td>- post financing</td>
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<tr>
<td>Indirect lending (refinancing)</td>
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<tr>
<td>- to Hungarian commercial banks</td>
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<td>- to foreign commercial banks</td>
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<th>B. GUARANTEES *</th>
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<tr>
<td>Credit guarantee</td>
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<tr>
<td>- advance repayment guarantee</td>
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<tr>
<td>- performance guarantee</td>
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<td>- tender guarantee</td>
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<td>- counter guarantee</td>
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<tr>
<th>C. RISK SHARING/GUARANTEE BACKING SERVICES</th>
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<tr>
<td>Source: Hungarian Export-Import Bank</td>
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*Guarantees can be extended at the Eximbank’s own risk or be backed by the State budget

In the field of direct lending we offer short- and medium-term **export prefinancing** loans. Among these, the short-term working capital loan, the so-called Eximloan, offers particularly favourable conditions for SMEs. The prefinancing loan granted to the Hungarian company enables it to use these funds to pay its suppliers.

The **working capital loan**, which is a new service offered by our bank, can be granted as a prefinancing loan. Eximbank also finances the working capital requirements of Hungarian foreign investors.

According to our experience, the above-mentioned products are particularly popular with SMEs.

When it comes to **post financing**, I should mention the buyer credit. Our Bank extends loans to buyers for terms of less than one year or more than one year. The Hungarian exporter can apply for a loan to be extended to the foreign buyer as soon as documentary proof of the deal is presented.

In connection with **indirect lending**, refinancing credit lines placed with Hungarian and foreign commercial banks should be mentioned. With the help of these credit line, exporters and importers can receive credit on favourable conditions.
Guarantees, such as credit, advance repayment, performance, tender and counter guarantees can be issued not only at Eximbank’s own risk but also at the risk of the state, that is with budgetary support.

Risk sharing/guarantee backing services eliminate the risk of non-payment for the Hungarian exporter in all cases where the export deal is covered by a banking instrument.

These services include the backing of letters of credit, of the drafts guaranteed by foreign banks, backing of guarantees, and forfeiting.

Preferential lending and guarantee services for SMEs.

Eximloan

In order to assure a partial prefinancing of working capital needed by SMEs for production, our bank offers the so-called Eximloan. Eximloan is a short-term loan facility on favourable conditions, which is available to companies upon application. In the case of Eximloan not only the length/tenor but also the amount of the loan is limited: an applicant can receive a maximum of USD 0.7 mn (HUF 200 mn) per year.

Eximloan can be especially beneficial given the fact that in the first 6 months of the tenor the interest can be decreased by 50 per cent, while if the applicant venture operates in one of the least developed counties, this reduction can amount to 75 per cent. With respect to bank guarantee the degree of allowance is similar.

Refinancing credit lines

Eximbank offers refinancing credit lines for SMEs as a medium-term credit facility.

In the case of export pre-financing or export-related corporate loans the borrower has to be a Hungarian entrepreneur, while if it is a buyer credit, the borrower can be either a foreign buyer who purchases the Hungarian goods or services, or its bank.

The interest rate is fixed and favourable for the final borrower. For loans maturing in 1 to 2 years its level is around the annual LIBOR, while for loans maturing in 2 years or more, the rates will correspond to the CIRR level.

State-backed guarantee

If the export transaction meets special requirements, Eximbank can supply the SME with a state-backed guarantee. The state-backed guarantee can only be issued if a certain export transaction is in the interest of the national economy and the value of the export transaction justifies its issue.

The advantages of a State-backed guarantee are as follows:

- it renders feasible those export transactions, which could not be effected under the normal conditions of risk taking by banks;
- it facilitates financing by commercial banks: these prefer financing high-risk operations with the counter-guarantee of Eximbank;
- the client limit can be exceeded.
**Information services**

In addition to providing financial services, Eximbank also plays an important role in disseminating information to enterprises that wish to enter foreign markets. Our bank informs customers of the OECD guidelines, publishes updated information on interest rates in different currencies, and provides updates on the Government’s economic policy. In addition, every month Eximbank organizes conferences for Hungarian exporters, where – as on our website - we inform the exporters not only on financing possibilities, but also of business opportunities and available tender calls.

In order to improve our services to enterprises we maintain contact with and obtain information from institutions, which have similar endeavours. These institutions are local commercial and industrial chambers, and domestic and foreign commercial organizations. We also take part in the events organized by the Hungarian Office for the Development of Foreign Economic Cooperation (ITD Hungary) and business clubs organized for exporters.

**Services offered to SMEs by our partner institutions**

*Hungarian Export Credit Insurance Co. Ltd. (MEHIB)*

MEHIB has strengthened its SME support through its so-called Partner insurance programme. This company has worked out a special export credit insurance facility for SMEs, which is aimed at improving their export capacity and possibilities for export finance.

The Partner insurance programme conditions are as follows:

- the credit limit per buyer cannot exceed EUR 60,000;
- charges fixed in advance enjoy a 30 per cent support;
- the administration is simplified;
- the procedures for reimbursement are simple and take little time.

The Partner export credit insurance programme entered the market in February 2001, and it is expected by MEHIB to become popular not only with SMEs, but also – as a credit security - with SME financing banks.

*Corvinus International Investment Ltd.*

Corvinus Ltd. is a risk capital investment company and majority-owned subsidiary of Eximbank. It acts as a financial investor mainly when medium-sized companies invest abroad, mostly in neighbouring countries. The objective of the company is to provide part of the starting capital in relatively risky projects abroad. Corvinus Ltd withdraws from the business when the investment proves to be a success.
Both Eximbank and our partner-institutions hope that the State, municipal and private investment mobilized through SME support programmes will bear fruit. We hope that the competitiveness and foreign market penetration of SMEs will increase considerably, thus improving the SME position and alleviating the duality of company structure.

2. **Mr. Georgy Tufatulin**  
*Deputy Chairman of the Board and Head of Credit Department, “Belvnesheconombank” (Belarus).*

I would like to highlight one of the aspects of the Belarusian export support system. This relates to the direct financial assistance provided by the state to small and medium-sized enterprises (SMEs) through the Fund for Export Support.

After the collapse of the Soviet Union, Belarus inherited an economy which was deeply integrated into the economy of other republics, with industrial production capacity several times exceeding domestic demand. Therefore, the Belarus economy has always been export-oriented, and the issue of export support remains one of the most important on the Government agenda. In particular, export promotion is one of the priorities in the Government’S Programme for State Development for the near future.

In 1997, the Government and National Bank established a Fund for Export Support, and Belvnesheconombank was chosen as an agent responsible for servicing the Fund’s operations. So far, the Fund has financed 60 enterprises with different forms of ownership.

The principal financing of the Fund, in particular at the first stage of its operation, came from the State budget. Its financial resources are allocated by the Committee for Export Support, which is composed of heads of ministries and other government bodies. The procedure of application and approval starts with the preparation of a business project proposal. The latter is examined by experts of different ministries in the case of a State enterprise or by the relevant local authorities if it is a joint stock or private enterprise. Subsequently, the application together with the expert opinion goes to the Ministry of Economy, which has to give its approval. Belvnesheconombank also considers these project proposals and evaluates the creditworthiness of the applicant.

Finally, the application is submitted for consideration to the Committee for Export Support. The Committee takes a decision on the project and, if it is positive, sets the interest rate to be applied to the loan allocated from the Fund. The interest rate can vary from one half of the refinancing rate of the Central Bank to almost zero, depending on the importance of the project and its export effectiveness. The major objective of Belvnesheconombank in this context is to ensure the timely financing of projects, repayments of the principal and interest rates, and to monitor the use of funds. In other words, it makes the Fund operational.

The resources of the Fund can be used for financing any stage of a project, including research and development, design of new products, production, investments, product marketing (i.e. advertisement, participation in exhibitions, risk insurance for products). The Fund can also finance Belarusian enterprises when they establish joint stock enterprises abroad, in which case it receives dividends from those companies.

The resources allocated by the Fund so far have been relatively small because the capital of the fund is formed by the State budget, interest rates are low and, therefore, the accumulation of resources is relatively slow.
It is difficult to make projections; however, in the future with a gradual decrease in inflation, the resources of the Fund will be growing, as should its effect on export growth.

Assessment of the economic efficiency of the resource allocation to the Fund and its impact on enterprise performance is difficult because to finance projects enterprises use both their own capital and borrowed resources from different sources. The Fund is not big and it does not compete with or substitute for commercial banks in export finance. Since, all the decisions concerning terms of credit and loan extension are taken by the above-mentioned Government Commission for Export Support Fund, the Government guarantees to bail out troubled State enterprises. Consequently, Belvnesheconombank does not bear risks and does not make any provisions for losses in relation to the Fund’s operation.

3. Ms. Miroslava Hrncirova
   
   Deputy General Director and Member of Board, Czech Export Bank (Czech Republic)

In my presentation I would like to highlight the government-sponsored medium and long-term export support schemes existing in the Czech Republic.

There are a number of State entities providing enterprises with information on existing insurance and financial opportunities. Czech Trade, for example, is a small agency that provides information to SMEs. This information relates to external markets and support schemes offered by international organizations (e.g. the World Bank). Czech Trade also conducts market research, helps companies to participate in international fairs, and offers them advice on export finance and insurance. This agency has branches abroad, which assist in promoting Czech goods abroad.

The most important link in the export support system is the Export Insurance Agency (EGAP a.s.). Established in 1992 it has achieved considerable results in export credit financing and insurance. In 1995, the Czech Export Bank (CEB, a.s.) was established with the aim of financing medium and long-term export projects.

The Czech Government participated in the statutory capital of EGAP and CEB, having allocated funds from the State budget. It also provides government guarantees for EGAP and CEB. At the same time, both institutions have created their own reserves and are financially self-sufficient.

The Czech Export Bank provides refinancing credits to commercial banks: it borrows on international markets with government guarantees and then on-lends these resources to Czech commercial banks. Further on, direct export credits channelled from western banks to Czech commercial banks via CEB have become more common. Pre-shipment (pre-export) financing appears to be the most demanded financial instrument in export financing. At the same time bank guarantees the exporters’ obligations (notably, guarantees on pre-shipment finance, performance bonds, etc.).

What are the effects of the existing export support system?

It supplies medium and long-term export financing, whereas domestic commercial banks are unable to provide such a service. It also creates the possibility for Czech exporters to provide credit to their buyers at internationally competitive conditions. The system of minimal fixed interest rates adopted by the OECD allows Czech exporters to be competitive as compared with their German, French and other OECD competitors. It should be noted that CEB does not subsidize interest rates on loans to exporters and it does not anticipate using this instrument of export finance.
Owing to expanded credit facilities available to exporting companies, the speed of their capital turnover and consequent cash flow increases, exporters find themselves in a better position to amplify their investment and competitiveness. The entry of Czech entrepreneurs into new markets is facilitated by the fact that most foreign trade risks are covered by the government-sponsored insurance agency CEB finances only two per cent of Czech exports. At the same time, this portion of exports is important because it includes products with high value added, the production of which involves many local suppliers and sub-contractors. Therefore, its operations also have an indirect, positive effect on export growth in machine building, in particular. In 2000, CEB’s share in the outstanding credits in foreign currency was over 8 per cent.

CEB products aimed at long-term export financing include:

- Direct supplier credits
- Direct buyer credits
- Refinancing of supplier credits
- Refinancing of buyer credits and
- Bank guarantees against non-payment (big bond, advance payment bond, pre-payment bond).

CEB products aimed at short-term (up to 2 years) export financing include:

- Pre-export credits (direct or revolving)
- Export credits (direct or revolving)
- Export credits connected with pre-export credits (direct or revolving)
- Refinancing credits to commercial banks
- Short-term payment and non-payment guarantees

CEB also offers a number of consultative and financial services related to export financing. These include, for example, preparing the project documentation for financing and co-financing of the Czech subcontractor’s part of projects undertaken in cooperation with multinational institutions.

CEB export financing activities have shown that major impediments in its cooperation with companies often relate to the lack of experience of the latter. For example, the basic documentation package to be submitted together with application for a loan is often incomplete. Sometimes, contracts and related agreements do not correspond to international standards, when the contract specifications of goods and services are insufficient. It also happens that the payment conditions do not adequately protect the exporters’ property rights, while the delivery conditions are not in accordance with INCOTERMS 2000. Sometimes, methods of trade dispute resolution are also insufficiently detailed.

Nevertheless, the situation is improving and all these shortcomings are gradually being eliminated.

The CEB’s objectives for the future include:

- Maintaining a good quality credit portfolio
- Continuing structured financing of complex projects
- Extending the use of co-financing schemes in cooperation with EBRD and the World Bank.
Major directions foreseen for improving CEB’s services include:

- Consistent transparency and accountability in its relations with exporters, domestic and foreign banks, and international institutions;
- Improved information and other services to clients and adequate borrowing strategy;
- Development of new products and additional services: advising and consultancy, structured framework credit agreements;
- Participation in the work of the OECD Trade Directorate’s Export Credit Group.

4. Mr. Mikhaylo Butsko

_Deputy Head, Export Development Department, Eximbank, Ukraine._

I would like to highlight the activities of the Export-Import Bank of Ukraine and introduce to you its most interesting projects for export development.

My presentation is dedicated mostly to the financing of exporters (as opposed to the financing of exports). Unfortunately, instruments for financing exports in Ukraine are underdeveloped; only a small number of banks have just introduced these instruments. They are mostly being used by western banks in financing large Ukrainian exporters, primarily in the ferrous and non-ferrous metallurgy sector. With the assistance of the EBRD and IBRD our bank is also starting operations in this field.

State support to enterprises in transition economies has not always been successful. Some time ago there was an Innovation Fund in the Ukraine, which was financed through deductions from company revenues (one per cent of the total revenue). This fund was actually governed by State officials; they were in charge of loan allocation. The history of this Fund testifies that as much as 70 per cent of loans were provided to enterprises that were operational for less than one year. Consequently, the Fund’s loan portfolio mainly consisted of bad loans.

Currently the Innovation Fund is under liquidation and there are several proposals on how to use its financial resources; probably they will be transferred to one of the banks. In particular, there are discussions in the Government regarding the establishment of a State Bank for Reconstruction and Development.

One more example of an unsuccessful State-supported project in which our bank participated relates to servicing intergovernmental credit lines. In the early 1990s, through these intergovernmental credit lines, Ukrainian enterprises obtained loans worth more than USD three billion. The loans were approved by the Foreign Exchange and Credits Commission of the Ukrainian Government. As in the case of the Innovation Fund, borrowing through intergovernmental credit lines resulted in a large amount of bad debts, which the Government had to service imposing considerable burden on the State budget.
The State Export-Import Bank of the Ukraine was established in January 1992 on the basis of the former-USSR Vneshekonombank representative office in Ukraine. The bank inherited from Vneshekonombank its staff, and, as you know, personnel are the most precious asset. The Export-Import Bank has become one of the leading banks in servicing the foreign trade of Ukrainian enterprises. During its first years of operation it serviced up to 40 per cent of Ukrainian foreign trade. At present, the respective figure is about 20 per cent and the Export–Import Bank is considered by enterprises to be one of the most professional in foreign trade financing.

Initially, the founders of the Export-Import Bank thought that its functions would be similar to those of western banks specializing in foreign trade financing. However, on practice, the functions of the bank have become very broad, characteristic rather of a universal bank. Until last year, the Export-Import Bank, which was established as a State-owned entity, was outside of the Ukrainian legal framework - according to the Law on Banks and Banking Activities of Ukraine, the banking structure comprises only two levels, namely the Central Bank and commercial banks, while the then already existing State Sberbank and Export-Import Bank are not mentioned. To remedy this, in 2000 it was decided to transform our bank into a joint stock company and that is how the open Joint Stock Company “State Export-Import Bank of Ukraine” was established.

The name of the bank was left unchanged because it is known and trusted in Europe, the Export-Import Bank being one of the rare Ukrainian banks whose guarantees are accepted by western banks. At present, as much as 100 per cent of the bank’s stock still belongs to the state, however the additional emission of shares worth about Ukrainian Hryvnia 100 million (USD 18 million) will take place soon. Currently, the bank’s management is seeking a strategic investor.

Since the foundation of the bank, its management has been conscious of the bank’s important role in supporting exporters. It understands that in order to achieve results it has to finance companies at competitive terms, provide informational and technical support, and broaden the range of banking services to exporters. With this objective, in 1995 the Export-Import Bank launched an Export Development Project and in 1997 obtained from the IBRD a credit line guaranteed by the government of Ukraine and earmarked for developing this project. The Export Development Project aims at estimating the export potential of domestic producers of goods and providing them with technical assistance. The total value of the IBRD credit line is USD 60 million and DM 15 million to be repaid before 15 October 2015. The credit line repayment period might be extended for another two years and the Eximbank might receive additionally USD 10 million in credit resources.

The IBRD credit line fuels the three main institutional components of the Export Development Project. The first component is a technical assistance fund to finance exports, entitled “The Export Development Fund”, the capitalization of which amounts to USD 5 million. The resources of this Fund are used to grant financing to Ukrainian enterprises to promote their export activities. It was assumed that up to 50 per cent of enterprises’ expenditures on business planning, international audit, certification according to ISO 9000, participation in exhibitions and personnel training in export marketing skills would be covered by this Fund.

The second component, or component B, capitalized at USD 5 million, is earmarked for developing the Eximbank itself. In particular, the indicated resources have been used to strengthen the bank’s technical and technological basis.

Finally, the third component, C, is a credit line itself, targeted to promote the export development of Ukrainian enterprises. Its capitalization amounts to USD 50 million and DM 15 million.
There are two more international agreements aimed at institution-building in export finance, which are indirectly related to this project. The first is an agreement between Eximbank and the Export Import Bank of Japan on partnership and the second is an agreement between Eximbank and ABN AMRO Bank on consulting services. These two agreements aim at improving the bank’s management, technologies used, personnel training, upgrading crediting procedures and other technical developments. They were financed through the Japanese and Netherland’s governments’ grants.

There are several eligibility criteria for enterprises wishing to receive a loan from the IBRD credit line:

- The borrower should be an exporting company or a potential exporter that is capable of proving the existence of markets for the company’s products. Because of the enterprises’ lack of experience and absence of marketing networks, they often assess the marketability of their products very approximately and cannot demonstrate the commercial viability of their export projects.
- A company should not be majority-owned by the State, the share of the State should be less than 50 per cent of its total capital. While this criterion is very attractive for SMEs, it restricts the participation in the programme of many well-functioning State enterprises.
- The project should be at least 30 per cent financed by the company itself, while the borrowed resources should not exceed 70 per cent. This condition does not allow for the participation of newly established firms lacking own funds. There are exceptions, however. For example, one new joint venture qualified for borrowing because its foreign partner had invested considerable funds into its statutory capital.
- The World Bank set a very strict criterion: financing should be offered only for the manufacturing of export products. Companies that provide export services are not eligible for participation. The profit margin for investment projects was set at no less than 15 per cent. Such a profit rate excluded from participation some basic industries, for example, metallurgical enterprises. The bank considers applications on the basis of submitted financial documents, and if the indicated profit margin is below the 15 per cent floor the bank cannot credit them. Since many SMEs minimize or conceal their profits in order to lower their taxation, they also turn out to be non-eligible.
- The index of debt service over the project realisation should stand at 1.5. Environmental protection requirements are also high, and in order to satisfy them Eximbank has had to refuse potentially very successful projects.

Two other requirements, which often become hindrances include:

- Procedural requirements. Projects amounting to more than USD 2.5 mn need to be approved by the World Bank.
- Procurement requirements. The bank demands that enterprises make their procurement in accordance with World Bank recommendations. Experience shows that despite the training of managers that has been undertaken, Ukrainian companies often fail to comply with these requirements.
Loans provided to enterprises to replenish their working capital and for investment finance enjoy favourable terms of repayment. Working capital loans are extended for two years with up to one year of grace period and the investment loans have a maturity of up to five years and with a grace period of up to two years. The interest rates are not set by the World Bank and depend on the LIBOR and the Eximbank’s assessment of risks on the Ukrainian financial market. Overall, interest rates are lower than the average market rate.

When Eximbank started its activities there was practically no competition on the market. Western banks focused mainly on financing large enterprises, in the metallurgical sector in particular, whereas Eximbank worked with small and medium-sized firms in other sectors. Recently, the situation has changed. Along with the strengthening of the Ukrainian SME sector, western banks have shown more interest in financing projects of small companies. On the other hand, according to the initial credit agreement with the World Bank, Eximbank was not allowed to extend loans exceeding 25 per cent of its capital, and this restricted its credit potential. Since the Eximbank's capital has increased recently, it has started to explore investment opportunities in a number of larger projects in metallurgical and petrol chemical industries.

On 15 September 2001, as many as 15 exporting companies, which were the leaders in their sectors, participated in the above-mentioned programme. There are 39 loan agreements and it is worth mentioning that the loan portfolio is of high quality. At the same time, as much as USD 12 million of the credit line remains unused. One of the reasons for this is the strict eligibility requirements. Another reason relates to the high risk of crediting in foreign currency in 1997-1999.

Implementation of the Export Facilitation Project has had a positive effect on export promotion. Average maturities of loans are 36 months for investment loans and 18 months for working capital loans. As much as 3.7 per cent of the portfolio consists of short-term loans (maturities up to 12 months), 51 per cent of medium-term loans (maturities between one and two years) and 45 per cent are long-term loans (maturities exceeding two years).

It should be mentioned that the share of investment loans increased from 20 per cent in 1996-98 to 50 per cent in 2000-01. This attests to the macroeconomic stabilisation in Ukraine.

In terms of industrial sectors, as much as 28 per cent of the loan portfolio is accounted for by machine-building enterprises and 20 per cent by light industry. The share of agricultural firms is also important.

Practically all enterprises, which have received credits from the Eximbank have become leading producers in their respective industries and enhanced their exporting capacity. For example, in 2000 the growth of exports of participating firms exceeded USD 50 million. In more general terms we assess the export increment since the start of the programme at USD 167 million.

B. RISK INSURANCE

1. Mr. Lennart Skarp, Deputy Director, Berne Union

I would like to highlight the role of Government support to export finance as channelled through export credit agencies.

The objectives of the Berne Union are:
1. To promote sound practices in export credits and investment financing;
2. To enable the exchange of information and expertise among its members.

At present the Berne Union counts 50 members from over 40 countries. The magnitude of the Union’s activities is characterized by the following figures relating to 2000:

- Short Term Insurance: USD 387 billion
- Medium/Long Term Insurance: USD 72 billion
- Investment Insurance: USD 13 billion
- Outstanding insurance obligations at year-end: USD 574 billion covering about 10 per cent of world trade.

The Prague Club was established 10 years ago with the intention of creating a platform for cooperation among export credit agencies (ECAs), which had not yet matured to be accepted as full members of the Berne Union. This association targeted primarily ECAs from transition economies of central and eastern Europe and the CIS. In 1993, its membership included six agencies, and now as many as 25 have become members (including agencies outside of the above-mentioned region from a number of Middle Eastern and Asian countries).

Jointly with the EBRD and individual member countries, the Berne Union supports and finances some of the Prague Club activities. In particular, twice a year it organizes meetings and workshops for the Prague Club members; it also encourages their participation in Berne Union workshops and provides some ad hoc technical support.

The role of Export Credit Agencies (ECAs) consists in supporting exports. They should not provide aid or subsidies (prone to trigger trade credit wars). ECAs are required by the World Trade Organization to operate on a break-even basis.

Such agencies should not encourage export credits to bad payers, support exporters that are not creditworthy nor subsidize credits and/or interest rates. In the short run, it would be tempting to increase market share, to find new buyers by giving subsidies and insurance with premiums below market rate. However, as the experience of eastern European countries shows, this ultimately leads to huge losses in the State budget, imposing costs on future generations.

In other words, bad reasons for having ECAs are:

- Encouraging exports to bad payers
- Subsidizing credits to foreign buyers
- Starting a credit war
- Substituting for an aid programme
- Subsidizing working capital
- Subsidizing inefficient domestic industry
- Rendering exporters non-competitive.
On the other hand, good reasons for establishing export credit agencies include:

- Risk protection and export promotion. Easier access to bank finance – banks are inclined to provide resources on better terms and for longer periods when the risk insurance from a reliable credit agency is available.
- Improved access to information on export markets and related expertise – it is cost effective to use a credit agency for this purpose. The Berne Union members have access to a database on all the export insurance products available in member countries. This database is updated yearly.
- Enhanced competitiveness of exporters – a country where there is no export credit agency puts its exporters at a disadvantage.

In organizational terms, typical ECAs do not exist. “They come in all shapes and sizes” and can be anything from government-owned to totally private entities. It should be mentioned that ECAs increasingly emphasize the importance of sound business principles of operation and the condition of breaking even. There is a strong trend for the private market to become more active in export finance and insurance. However, the role of government-sponsored institutions remains of major importance.

The involvement of Governments in export insurance creates a broader foundation for risk taking as compared with similar activities by private insurers. However, too much government involvement can make the decision-making process too bureaucratic and slow it down. The excessive role of Governments also tempts ECAs to support export deals on political as opposed to commercial grounds.

To sum up the above, in the long run, the country is better off with an ECA that applies sound principles than with an ECA that provides subsidies. Importantly, the Berne Union actively supports ECAs that apply sound principles.

2. Mr. Sergei Semjonov
   Officer, Export and Credit Guarantee Fund “KredEx” (Estonia)

Estonia is a small country and its exports are small (total export value is less than USD 3 billion). It is worth noting that Estonia has a most liberal trade regime. The development of the Estonian banking system has been dynamic, and in 1998 the Government felt that there was more demand for export risk insurance than for direct export finance. Thus, in 1999, the Law on government insurance of export risk was adopted.

“KredEx” Fund was established in 2001 on the basis of three funds, namely the Export Guaranteeing and Crediting Fund, Business Credits Insurance Fund, and Mortgage Insurance Fund, as the result of a government effort to minimize budgetary expenditure and make the insurance scheme more cost effective. At present, the volume of reserves is almost USD 5 million and the total volume of loans that the fund is able to extend amounts to USD 15 million.

KredEx’s major activities include issuing guarantees for bank credits, and, secondly, export credit risk insurance. Since the fund is quite young, at present it offers only two insurance products: a simple insurance and a framework insurance (where transactions with all the client’s principal buyers are insured).

There are a number of restrictions:
The minimum premium is 0.4 per cent for short-term credits, and
The maximum amount of guarantees provided cannot exceed USD 17.5 million.

Therefore, given the short-term nature of credits, the fund’s activity can cover about 5 per cent of total Estonian exports.

In my opinion, problems to be resolved in export insurance mainly relate to the perspective accession of Estonia to the European Union. In particular,

- The risks covered need to be split into market and non-market risks, as is done in the European Union member countries.
- The Fund faces no competition on the Estonian insurance market. Had there been private competitors they might have offered a cheaper service.
- There are two types of insurance: the first one is provided by the Fund, and, the second is provided by the State. Thus the legal basis of the Fund is obscure. Currently the respective legislation is being amended in order to remove this ambiguity.

The impact of export credit agencies in facilitating the SMEs’ export growth depends on the economy’s size. Experience shows that in small countries private insurers are interested primarily in dealing with large companies. Thus, the only way for a SME to find financing is to deal with the ECA. On the other hand, the ECA’s assistance is sought after when the required financing is too big. Therefore, ECAs should not be considered as an alternative to the private sector; their role is to complement private market operators.

Discussion

Sergey Tsedrik (Belvnesheconombank, Belarus) enquired about the scope and conditions of the Czech Export Bank’s activities in different groups of countries.

Miroslava Hrncirova noted that over 50 per cent of CEB activities were focused on the CIS countries. At the same time, the CEB also provides credits to importers in other countries and regions, for example in China, the Middle East and the United States of America. In the United States, however, the bank applies commercial terms. A lot of short-term credits on commercial terms also go to Germany because quite a number of small and medium-sized enterprises in regions neighbouring Germany are sub-contractors of German manufactured goods. It is important to mention that power plant equipment, accounts for a large part of Czech exports. This means that Czech exporters participate in a number of internationally managed deals. Most of them have main contractors from Germany or other developed market economies. Under these terms, the Czech companies have joined an international consortium formed to implement a Turkish power plant project. The differences in financing conditions result from the risk rating of countries. The CEB strictly follows the international ratings, which determine its risk assessment. At the same time, improvements of conditions are feasible within the given country category.

Iouri Adjoubei asked Mikhaylo Butsko (Eximbank, Ukraine) how the eligibility criteria for the borrowers should be amended in order to help small firms qualify for credit line loans. In Mikhaylo Butsko’s view, the World Bank procurement criteria requiring international tenders should be lifted. International tenders take too long a period (6 to 9 months) and unacceptably extend the project implementation.
Dmitriy Romanovskiy (Belpromstroibank, Belarus) mentioned that bank credit resources in Belarus were very expensive. For that reason the Government has programmes focused on developing certain prioritized sectors (e.g. agriculture) to which banks should extend cheap loans. As a result of such a policy, bank loans made available to those sectors are not efficient (a significant part of them become bad loans). In order to cover their losses, banks have to charge higher interest rates on loans financing profitable projects (including export-oriented projects). Moreover, there are cases when credits to enterprises for export-import operations enjoying government guarantees become non-performing: the Government refuses to fulfil its obligations versus the lending bank on the pretext that the bank has to exhaust all instruments to return the non-performing loan first. These instruments include also the bankruptcy procedure, which in practice is very difficult to initiate and bring to conclusion both because of unclear bankruptcy rules and the lack of bankruptcy enforcement skills within the legal system. As a result, all risks related to loans guaranteed by the Government have to be borne by banks.

Aleksei Skraga asked Mikhaylo Butsko what measures were taken to encourage Ukrainian SMEs to become more transparent and thus eligible for financing by international financial institutions.

Mikhaylo Butsko emphasized that the Ukrainian companies participating in the described Eximbank project have become more transparent. The Government can draw also on the encouraging experience in this area associated with lowered taxation of metallurgical enterprises. As a result of this move, the metal sector enterprises have taken their revenues out of the shadow and even showed a significant increase of profit in their balance sheets. This has allowed them to mobilize their own and attract external resources for modernization. In the Bank’s opinion, the ultimate benefits of accessing external financial resources for enterprises will outweigh the immediate benefits of understating profits.

Olga Lapteva (Tambov Innovation Business Incubator, Russian Federation) commented on the programmes for SME support in Russia and on their financing in particular. It is an encouraging sign that Sberbank, the largest bank in Russia, has started a special programme of SME financing. In the Tambov region, as much as 20 per cent of commercial loans are extended to small and medium-sized enterprises. Speaking about the role of business incubators in enterprise development in areas with high unemployment and tense social situations, she emphasized the need for cooperation between the local authorities and the private sector.

In the opinion of Taisia Eletsikkh (United Nations Development Programme (UNDP) office, Belarus) in order to facilitate the access of SMEs to bank financing in Belarus it is necessary to establish a government insurance fund for them under the auspices of the Government Programme for SME Business Support. According to estimates, up to 90 per cent of project applications for financing are refused owing to the insufficient collateral capacity of SMEs. Such a fund could provide part of the collateral required by banks. According to the experience of other countries, the guarantee and insurance funds are established by Governments or donor-institutions. Subsequently, their operations generate returns, and funds accumulate resources to provide guarantees. There is a positive experience to draw on in Poland, Estonia and the Czech Republic. In Poland, for example, there are 60 such funds and they are self-sufficient as their operating expenses are small, they invest their revenues into government securities or bank deposits and thus generate profits. In addition, Taisia Eletsikkh also proposed to reduce the number of documents to be submitted by entrepreneurs to banks to obtain loans.

Elena Chernous (Minsk Regional Committee on Entrepreneurship and Investment, Belarus) asked whether the Ukrainian Export Import Bank had regional programmes assisting SMEs to obtain loans. Mikhaylo Butsko explained that Eximbank had a network of affiliates through which it
collected information regarding the export potential of regions. The Bank initiates contacts with enterprises that have export potential and provides assistance to those of them, which are interested to apply for loans.

Abdurahman Sherov (Joint Stock Commercial Pahta Bank, Uzbekistan) highlighted the experience of Uzbekistan in the area of SME support. The establishment of a legislative and regulatory basis, and of institutions assisting the SME sector is of paramount importance for transition economies. In Uzbekistan, there is an agency called the Business Fund, which provides small and medium-sized enterprises with cheap loans. The funding for this activity comes from revenues generated from privatisation. SMEs need cheaper loans to be able to develop, and for this purpose the resources of commercial banks can be used. The Uzbek Government encourages banks to provide loans to SMEs at a rate lower than the refinancing rate. The amount of the bank’s income generated from such loans is excluded from taxation. There is also a special insurance company that insures bank loans to SMEs with the coverage going up to 50 per cent of the loan.

Stanislav Sokolenko (UKRIMPEX, Ukraine) asked whether the Export-Import Bank of Ukraine conducted leasing operations. Mikhaylo Butsko clarified that such operations were conducted by a leasing company established by the bank. However, the volume of operations is not large, which is partially explained by the limitations imposed by the international donors. For example, the World Bank prohibits leasing transactions within the framework of the projects sponsored by that organization. Although leasing is actively used in a number of sectors (for example in transport), more active leasing operations would facilitate the development of small and medium-sized entrepreneurship. It is more difficult to apply leasing in industry (in particular machinery and equipment leasing) because of the lack of working capital, and this instrument is rarely used there. One should not discount also the lack of experience of financial institutions in transition economies as an inhibiting factor.

Alexandre Lisovskiy (Belarusian Fund for Financial Support of Entrepreneurship, Belarus) enquired what documents were required to obtain insurance from KredEx and how long it took to consider an application.

Sergei Semjonov (Export and Credit Guarantee Fund “KredEx”, Estonia) said that the set of documents should be in accordance with usual bank requirements, and should include the business plan. There are regional centres where an entrepreneur can obtain a free consultation on how to prepare an application, including some assistance in drafting business plans. The time required to consider an application, depends on the scope of the project. There is a three-pillar decision-making frame:

- The Financial Committee (consisting of the Fund’s Board members) considers projects that are worth up to USD 50,000;
- The Credit Committee (consisting of selected banking and finance experts) considers projects that are worth between USD 50,000 and 110,000;
- The Council Committee (consisting of representatives of Ministries of Economy and Finance, and of the Association of SMEs) considers projects with capitalization between USD 110,000 and 450,000.

Depending on the decision-making level, the time required to consider an application can be anywhere from 7 to 30 days.
CHAPTER IV

Summary of general discussion

During the general discussion, the participants raised a number of practical issues relating to the improved access of small and medium-sized enterprises to efficient trade finance. They commented on the types of risks encountered by major players, ways of reducing country risk and the relationship between country and company risks, collateral requirements and obstacles encountered by SMEs when applying for bank financing, regulatory measures required to facilitate the access of small companies to financing, alternative sources of financing available to SMEs, including those offered by international financial institutions, and the role of export credit insurance in different groups of countries.

The presentations as well as the discussion showed that the correct assessment of risks in foreign trade by major players (exporters and importers, banks and government agencies) enabled the right mix of payment terms and credit instruments, and, hence, availability of trade financing. Conditions of payment and payment instruments available to exporters and importers depend on a variety of macro and micro factors, including the perception of country risks, the nature of the sector and geographical area companies operate in, and the track record of firms involved in foreign trade.

The participants agreed that the country risk borne normally by financing banks was the most relevant when dealing with transition economies, in particular when it came to long-term investment financing. Country risk perceptions are determined by the macroeconomic conditions of the country, its political situation and the prospects of both. In order to improve these perceptions, transition economies need to sustain their macroeconomic stability. It is equally important to reduce political risk and improve the country’s image within the international community.

Elevated country risks as perceived by major stakeholders do not necessarily imply high company-specific risks: even in countries which are considered high risk there are companies with an excellent track record and credit history, which represent low performance and/or payment risk. For example, there are companies in the Russian Federation, the majority of them being large natural resource exporting enterprises (in oil and gas, metals and timber sectors) that honour all their obligations and have good reputation among western banks. Those companies have high credibility and ratings. The Workshop agreed that it would be beneficial for transition economies to introduce national programmes of raising competitiveness and reducing the country’s risk index (such programmes exist in several market countries).

Participants noted that in countries of central and eastern Europe, an increasing number of corporate customers enjoyed modern forms of bank financing. As a result of improved financial conditions owing to restructuring and re-capitalisation, banks in this group of transition economies have initiated programmes of SME support, and those supporting small and medium-sized exporters, in particular. At the same time, it was argued that in many of the CIS countries, rigid collateral requirements hinder the access of potential exporters to pre-export finance and bank loans covering working capital requirements. The establishment of a government financing fund that would cover a part of the collateral for small companies could be a compliant solution to this problem.
A number of participants called on commercial banks to lower their collateral requirements in order to facilitate the access of SMEs to bank loans. The bank representatives present emphasized that rigid collateral rules were based on prudent banking requirements stipulated by the Basel Committee and were common practice among western banks. Collateral is not the goal *per se* but rather the last possibility for a bank to recover its loan. High collateral rates closely correlate with provisions for losses. When the collateral requirements are high, the bank does not need to create big reserves, immobilizing its own assets, and, consequently, can lend at a lower interest rate. Alternatively, low collateral requirements increase the cost of a loan for the borrower. It was agreed that having worthy collateral is beneficial to both the borrower and the lender.

Other obstacles to efficient trade financing mentioned in this context related to government-stipulated advance payment requirements, inadequate legislation on payment terms and instruments (e.g. currency legislation in Russia, Ukraine and Belarus), lack of trustworthy information on the financial condition of buyers (in Belarus for example), high interest rates, inadequate formats of contract documents, high guarantees and other fees charged by commercial banks, and inadequate bankruptcy laws which impede banks from recovering their loans in case of default. The participants noted that the legislative acts and regulations inhibiting export financing should be modified to give exporters and their banks more flexibility. In particular, this concerns cases where lending to non-residents in the form of supplier and buyer credits is not allowed by law.

The discussion showed that in the CIS economies possibilities for medium- to long-term financing, especially for small and medium-sized enterprises were more restricted than those of short-term financing. Where the financial intermediaries in transition economies are not yet sufficiently developed, large trade projects can be financed in collaboration with western banks. In some countries, the various credit facilities provided by the State constitute an important source of project and long-term trade finance extended on concessional terms. At the same time, in all CIS member States international financial institutions remain the major source of financial resources for small and medium-sized enterprises, including exporters. The EBRD, the World Bank and the Black Sea Trade and Development Bank earmark special credit lines extended to chosen banks in transition economies for on-lending to exporters and importers, SMEs in particular. Apart from these on-lending programmes sponsored by international financial institutions, commercial banks in the region, with few exceptions, seem to have no targeted programmes of SME support.

It was also pointed out that the credit lines of international financial institutions extended to banks in transition economies were often not utilized to full capacity. The participants noted that in a number of cases the lending rates for loans offered by the on-lending banks were too high and eligibility criteria for credits beyond the reach of enterprises. The representatives of the banking community thought that the efficiency of international assistance to export finance could be enhanced if the eligibility criteria for enterprises seeking credits could be relaxed. In particular, the applicability of financing schemes to enterprises that are majority-owned by the State and less rigid financial criteria (borrowed versus own funds) could facilitate access to funding and exporting by both State-owned and new, small private companies, which have high-quality exportable products.

In several countries of the region, Government guarantees to exporters remain the most important insurance instrument. At the same time, it was mentioned that in certain cases government bodies did not honour their obligations. Using the inadequacy of the bankruptcy legislation and requiring from the exporter initiating a protracted procedure of insolvency/bankruptcy of the buyer, the government agencies concerned choose *de facto* not to reimburse the foreign trade operators and/or their bank.
As regards export credit insurance provided by private operators in transition economies, the participants mentioned that government agencies in transition economies often had to insure short-term loans from commercial risks since no such service was offered by private agencies. In the future, the private sector should develop a range of flexible insurance products, capable of satisfying the private exporter demand in commercial risk insurance (short-term, in the first hand). The Government-sponsored export credit insurance schemes should be applied when the resources of private insurers are insufficient. The synergetic use of both segments of the insurance market (private and governmental) could thus effectively mitigate exporters’ risks.

The representatives of banks and insurance agencies underlined the importance of enhancing transparency in the corporate sector. Opaque financial statements from enterprises have become a substantial obstacle to efficient trade financing especially when the financing schemes involve foreign banks and international donors. The workshop agreed that financing banks should encourage enterprises to render their books transparent so that they can fully benefit from available external financial resources.