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A Comparative Study on a Supplier Credit and a Buyer Credit in International Transactions of Capital Goods*

- Focusing on Industrial Plant Exports, Shipbuilding Exports, and Overseas Constructions -

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Ⅰ. Overview

As it was announced, Korean Consortium led by KEPCO(Korea Electric Power Corporation) won UAE Nuclear Power Plant Project in December

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2009. This called on public attention into exports of capital goods such as industrial plant exports, overseas constructions, shipbuilding exports, etc. According to IAEA, 430 Nuclear Plants are scheduled to be constructed worldwide.[1)]

Industrial plant exports, overseas constructions, and shipbuilding exports, require high-technology, help to get access to new emerging markets, bring less trade conflict, help to transfer technology to an importing country, and attribute to promote economic cooperation with an importing country. Such benefits encourage all the countries to make efforts to promote competitiveness in industrial plant exports, the overseas constructions, and ship building exports. These exports have so strong influence on a nation's economy that most countries concentrate on the exports.

However, these transactions are so huge that tremendous amount of funds are required. Therefore syndicated loan which is provided by two or more banks is common.[2)] Most of these transactions are of over 100 million US Dollars, and some of them are of over one billion US Dollars. These transactions require longer-term financing than traditional commodities. This is because the amount of time it takes for capital goods to pay for itself is considerably longer than for consumer goods.[3)] This amount of time, known as the capital goods cycle, extends into years. It may take considerable time before enough products can be produced for it to pay for itself. Some of the importing countries are developing ones that are politically and economically unstable. Therefore the financing mechanism for these transactions is conclusive in winning the transaction. This is the primary reason why we need to study on the financing schemes for those transactions of capital goods.

Global financial market instability caused by US sub-prime mortgage

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1) Lee, Jae Kyu, "World Nuclear Market and Entering Strategy", Overseas Construction, 2010.2, p.8

2) Andrew Fight, Syndicated Lending, Elsevier, 2004, p.1

3) Harry M. Venedikian, Gerald A. Warfield, Export-Import Financing, 4th Edition, John Wiley & Sons, Incl, 1996, p.20

financial crisis expanded all over the world, and the international transactions have been decreased due to global credit crisis. This indicates how much influential the financing market is in international transactions.

The financing schemes are classified into a supplier credit and a buyer credit by who provides the financing. In a supplier credit an exporter(a supplier) is responsible for providing the financing, and in buyer credit an importer(a buyer) is responsible for providing the financing. Large amount of funding are made available by these two means.[4]

A supplier credit is quite opposite to a buyer credit in that a borrower is the opposite; in a supplier credit a borrower is an exporter, and in an buyer credit a borrower is an importer. A supplier credit and a buyer credit have their own advantages and disadvantages in the respect of the parties respectively. These two financing methods are selectively used considering financing conditions such as funding cost, importer's and/or exporter's financial conditions, importing country's political risk.

There are some articles previously published on a supply credit and a buyer credit ; 'The State and Use of Buyer Credit'[5] focuses officially supported export loan and its application rather than the comparison of these two financing schemes. 'Understanding of Short-Term Export Insurance(Buyer Credit) and Cases'[6] gives brief explanation of a supplier credit and a buyer credit. It focuses on export of consumer goods and/or commodities, and export insurance for consumer goods and/or commodities. 'The Changes of Shipbuilding Industries and Ship Financing'[7] illustrates very shortly advantages and disadvantages of a buyer credit only.

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4) Richard Willsher, Export Finance, Macmillan Press 1995, p.66

5) Kang, Mal Lee, "The State and Use of buyer credit", Export Insurance, Volume 14, 1982.10, p.105-118

6) Ahn, Yoo Shin, 'Understanding of Short-Term Export Insurance(Buyer Credit) and Cases', Export Insurance, 2006.11, p.22-29

7) Lim, Jung Duck, The Changes of Shipbuilding Industries and Ship Financing, KIET, 2009.9, p.50

However this article focuses on international transaction of capital goods such as industrial plant, shipbuilding, and overseas construction rather than consumer goods and/or commodities. This article gives more detailed explanation as well as deep analyses of a supplier and a buyer credit, analysing advantages and disadvantages of all the parties(an exporter, a financial institution, and a importer) respectively. Furthermore, this article analyzes two export transactions of capital goods proceeded respectively in a supplier credit and in a buyer credit with export insurance cover for the convenience of understanding .

The article will help the parties involved in international transaction of capital goods to choose the proper financing schemes, and to conclude a contract in an amicable way. In addition, the detailed understanding of these two financing methods will hopefully promote the international transactions of capital goods worldwide.

Ⅱ. A Supplier Credit and A Buyer Credit

1. A Supplier Credit

1) Concept

A supplier credit is credit extended by an exporter(seller, supplier) to an importer(buyer) as part of the export contract.[8] Cover for this transaction may be extended by an export credit agency('ECA')[9] to an exporter.[10] In a

8) Malcolm Stephens, The Changing Role of Export Credit Agencies, IMF Washington, 1999, p.110
Richard Willsher, *op. cit.,* p.75

9) 'ECA is an institution providing export credit insurance facilities. All credit agencies were at stage government-owned or government controlled. or, if they were private companies, operated on government account. This is no longer the case, because the position is now rather complicated, and so there is today

sales contract an exporter shall provide fund required to manufacture or procure goods, and in a construction contract a contractor shall provide fund required to complete a construction.[11] When a supplier credit transaction arises in a mid and long term[12] transaction, an importer normally makes cash downpayment up to 15%. Forfaiting is a form of a supplier credit finance where the exporter receives promissory notes or bills of exchange as evidence of the future obligations of the importer to pay for the goods.[13]

In international transactions of capital goods, an exporter(seller) shall provide finance with his own credit. An exporter borrows the amount of fund prerequisite to manufacture and install industrial plant, to accomplish overseas construction, and to build a ship. After performing its contractual obligation, it receives payment from an importer on a deferred installment payment basis. With the payment from an importer, an exporter repays the loan that it borrowed from a financial institution. Even though an importer does not pay, an exporter is obliged to repay the loan.

On a rare occasions an exporter will be prepared to deliver a ship to an importer without being paid in full, in which case an exporter will normally

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probably no single meaning for the term '"export credit agencies". It is probably best to define it in terms of functions of the organization rather than its status.' (Malcolm Stephens, *op. cit.,* p.85)

10) Malcolm Stephens, *op. cit.,* p.110

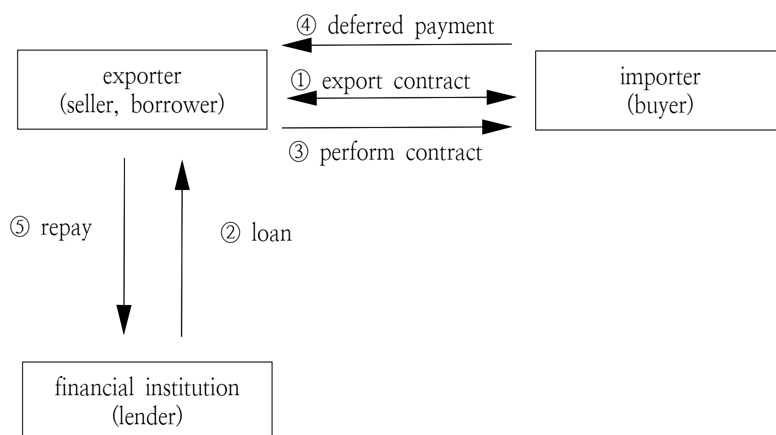
11) Kim, Sang Man, A Study on the Legal Aspects of the Financing Schemes in Plant Export Transactions, Doctoral Degree Thesis at Korea University Graduate School, 2008, p.47

12) In international finance, mid and long term means the term of over one year. However the OECD Arrangement on Guidelines for Officially Support Export Credits is applied to a transaction with repayment term of two years or more. 'The Arrangement shall apply to all official support provided by or on behalf of a government for export of goods and/or services, including financial leases, which have a repayment term of two years or more.'
(the OECD Arrangement on Guidelines for Officially Support Export Credits Chapter I Provision 5)

13) Richard Willsher, *op. cit.,* p.75

require comfort from a third party, usually a bank, unless the importer can produce a satisfactory guarantee from its parent company.[14]

(Diagram for a supplier credit[15])



The general procedure for a supplier credit is as follows;

① An exporter(a seller) enters into an export contract with an importer(a buyer), in which an importer pays to an exporter on a deferred payment basis.

② An exporter borrows funds to perform the export contract from a bank with its own credit. an exporter enters into a loan agreement with a bank.

③ An exporter, then, performs the export contract by using the funds.

④ After an exporter performs the export contract, an importer will pay to an exporter on a deferred payment basis with the revenues from the operation of the plant.

⑤ Finally, an exporter will repay the loan to the bank with the payment that it receives from an importer.

14) Stephenson Harwood, Shipping Finance, 3d Ed, Euromoney, 2006, p.17

15) Kim, Sang Man, op. cit., p.48

2) Parties to a Loan Agreement

As an exporter borrows money from a financial institution in a supplier credit, an exporter becomes a borrower and a financial institution becomes a lender. An exporter and a financial institution become the parties to a loan agreement. A supplier credit is a back-to-back funding operation whereby an exporter passes through, or assigns, to a lending bank the credit risk and the funding requirements of the transaction.[16] Although an importer is not a party to a loan agreement, a financial institution shall directly claim the payment to an importer when the payment is assigned to it.

3) Securities

A financial institution requires securities when it decides an exporter's credit rating does not meet the criteria. The main securities required by a financial institution are as follows.

First, a financial institution requires corporate guarantee by a parent company, which is the simplest security. A traditional guarantee is secondary in the sense that it requires breach or alleged breach or failure under the transaction as a condition precedent to become payable.[17] However, a financial institution requires an independent guarantee, in which a guarantor promises to pay as a primary obligor not a secondary obligor.[18] However, these days a parent company is reluctant to provide a corporate guarantee.

Second, an exporter may assign the payment to a financial institution for security, In this case, an importer is supposed to make payment directly to a financial institution.

Third, an exporter assigns an export insurance policy to a financial institution for security. Such insurance may help for an exporter to obtain

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16) Richard Willsher, op. cit., p.76

17) Matti S. Kurkela, Letters of Credit and Bank Guarantee under International Trade Law 2nd Edition, Oxford University Press, 2008, p.12

18) Roeland Bertrams, Bank Guarantees in International Trade 3rd Edition, ICC Publishing S.A. 2004, p.11

bank financing easily.[19] Many Countries have established export credit agencies to promote their exports through various forms of support including export insurance.[20] Export credit agencies share one main aim that is to promote exports from their own countries protecting exporters against commercial risks of importers and political risks in importing countries.[21] For instance, ECGD's[22] core purpose, as defined by statute, is to facilitate, directly or indirectly, exports of goods and services and overseas investments.[23] When an importer is not creditworthy, the assignment of the payment shall not be regarded as safe security. Therefore a financial institution requires an exporter to purchase export insurance.

Fourth, a letter of credit is required especially in short term transactions. Invariably an exporter would not wish to part with his goods prior to being paid for them, and an importer would not wish pay for goods prior to having inspected them and ensured that they were of the quality and specifications required.[24] A letter of credit can satisfy both an exporter and an importer.

4) Relevant Export Insurance

'Medium & long term export insurance(supplier credit)' is selectively used as a security in an export transaction of capital goods, while 'short term export insurance(general export)' is used in an export transaction of consumer goods. Export insurance covers risks which are peculiar to export transactions

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19) Harry M. Venedikian, Gerald A. Warfield, op. cit., p.2
20) John E. Ray, Managing Official Export Credits, Institute for International Economics Washington D.C, 1995, p.1
21) Eric Bishop, Finance of International Trade, Intellexis plc, Elsevier Ltd, 2006, p.100
22) ECGD is an English ECA.
23) Secretary of State for Trade and Industry, Review of ECGD's Mission and Status, 2000.7, p.16
24) Howard Palmer, International Trade and Pre-export Finance, Euromoney Institutional Investor PLC, 1999, p.21

but are not normally covered by commercial insurance.[25] Short term export insurance covers risks of nonpayment of export proceeds in an export transaction due to political or commercial risks, the payment term of which does not exceed two years. Medium & long term export insurance(supplier credit) covers risks of non-payment by an importer in an export transaction due to political or commercial risks, the payment term of which exceeds two years. In these two export insurances, an exporter becomes a policy holder.

Short term export insurance is the most frequently used insurance product among various export insurances. However, medium & long term export insurance(supplier credit) is typically considered more important than short term export insurance for the payment term is longer and therefore the risks are higher. Medium & long term export insurance(supplier credit) enables a financial institution to provide loan to an exporter for it is treated as a safe security.

The International Union of Credit and Investment Insurers('Berne Union') set 「Berne Union General Understanding」[26] which regulates starting point of credit, length of credit, minimum downpayment, and installment. One of the main purposes of the Berne Union is to work for the international acceptance of sound principles of export credit insurance and the establishment and maintenance of discipline in the terms of credit for international trade.

As the Berne Union General Understanding restricts the length of credit of consumer goods within two years, medium & long term export insurance(supplier credit) is applicable to exports of capital goods such industrial plants, the overseas constructions, and shipbuilding exports.

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25) Clive M. Schmitthoff, Export Trade : The Law And Practice Of International Trade, 9th ed., London Steven & Sons, 1990, p.471

26) http://www.berneunion.org.uk

5) Advantages and Disadvantages of a Supplier Credit[27]

(1) In an Exporter's Respect

It is comparatively easy for an exporter to borrow fund on a supplier credit basis for its good credit rating. Generally an exporter which won industrial plant export, overseas construction, or shipbuilding export has good stable financial condition. Therefore an exporter can borrow fund required to perform export contract easily from a financial institution. An exporter surpasses an importer in negotiating contract price for it provides finance.

However, an exporter is paid on long term deferred payment method. After an exporter completes its contract obligation, an importer may willfully raise claim to deduct payment or to reject payment. Furthermore, an importer can be insolvent or bankrupt, in which case an exporter can not receive payment.

A shipbuilding contract has lower risk than a industrial plant export, or overseas construction, in that a builder holds mortgage on the ship and the ship can be resold in an another country. However, as an industrial plant is not movable, it can not be resold in an another country.

During the performance of the contract, the loan is added to an exporter's balance sheet as liability(debt). After performance of the contract, the contract value is added to an exporter's balance sheet as asset(account receivable). Thus debt on balance sheet increases, and liability ratio rises, which results in the aggravation of financial structure.

The key to success for an exporter is to obtain securities to mitigate the risks. The securities are as follow ; mortgage on the object, export insurance, guarantee by a bank or a parent company.

(2) In an Importer' Respect

The advantages of a supplier credit in an exporter's respect is the disadvantages in an importer's respect, and the disadvantages of a supplier

27) Preposition : an exporter is a company with good credit rating, and an importer is a company with poor credit rating located in a developing country.

credit in an exporter's respect is the advantages in an importer's respect. In a supplier credit an importer is free from non-performance risk by an exporter for an importer makes payment only after an exporter performs the contract.

Normally an importer pays downpayment approximately 15% of the contract price. An importer can get rid of the risk of downpayment by way of advance payment guarantee issued by a financial institution. Furthermore an importer requires performance guarantee. In the event an exporter fails to perform the contract, an importer can make demand under a performance guarantee as well as under a advance payment guarantee. As an exporter provides finance, an exporter can surpass an importer in negotiating contract price, which may result the increase of contract price.

(3) In a Financial Institution's Respect

A financial institution provides loan to an exporter in a supplier credit, and to an importer in a buyer credit. Which is more beneficial to a financial institution depends on specific credit conditions of an exporter and an importer, and on the terms and conditions of a loan agreement.

Under the preposition aforesaid, as an exporter has sound credit rating, the loan is considered to be more secured. As an exporter has principal place of business in domestic area, establishing securities is easier. Therefore, a financial institution does not require high spread.

When the repayment term of a loan is long term, a financial institution tends to require securities for an event of default such as ; assignment of the payment under the export contract, assignment of export insurance policy, etc. In rare cases a financial institution purchases the payment right without recourse and with high rate of discount, in which case an exporter is free from payment risk at all.

2. A Buyer Credit

1) Concept

A buyer credit is an arrangement in which an exporter enters into a contract with an importer, which is financed by means of a loan agreement where the borrower is the importer of the goods.[28] Such arrangements are most frequently used to finance capital goods or projects on a medium or long term basis.[29] Shortly, a buyer credit is a loan or credit extended by a financial institution directly to an importer(buyer) in a third country. An exporter enters into a contract with an overseas importer, which is financed by means of a loan agreement between a lending bank and an overseas importer. In a sales contract an importer shall provide fund required to manufacture goods, and in a construction contract an employer shall provide fund required to complete a construction. an buyer credit is a tied loan for the loan is used for the export contract.[30] A buyer credit has two schemes of direct loan and relending facility. Direct loan is given directly to an importer, and relending facility is given to a bank in an importing, and the bank gives loan to an importer.

A buyer credit is common in project finance which is a method of raising long-term debt financing for major projects through "financial engineering", based on lending against the cash flow generated by the project alone.[31]

An export credit agency in an exporting country typically provides insurance cover to a lending bank, and an exporter can draw on the loan as the work is done and accepted.[32] The exporter shall be paid as he accomplishes the export contract or be paid on a progressive payment basis. A buyer credit benefits both of a seller and a buyer as the seller receives on delivery or

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28) Malcolm Stephens, *op. cit.,* p.73.
Richard Willsher, *op. cit.,* p.66

29) Malcolm Stephens, *op. cit.*, p.73.
Richard Willsher, *op. cit.,* p.67

30) Kang, Mal Lee, *op. cit.*, p.105

31) E.R. Yescombe, Principles of Project Finance, Academic Press, 2002, p.1

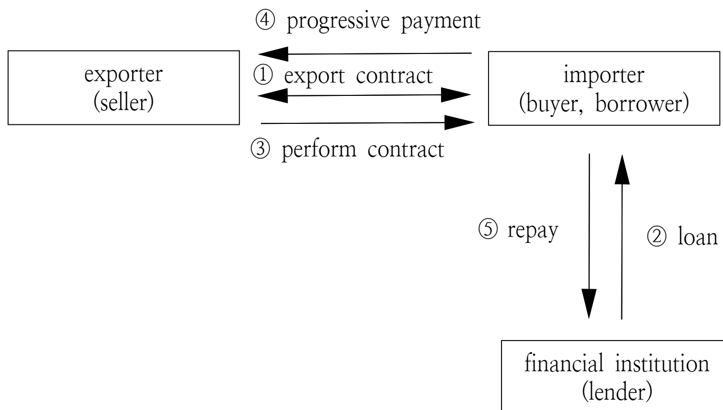
32) Malcolm Stephens, *op. cit.,* p.73.
Richard Willsher, *op. cit.,* p.67

acceptance of the goods and the buyer has affordable mid/long term finance that may not been available in its own country.[33]

Interest on the loan accrues during the drawdown period and is typically payable during the drawdown period. However these days especially in project finance, the interest during the drawdown period is capitalized for a borrower for an importer does not make any profit during construction.

Even though an exporter fails to accomplish the contract, a borrower should repay the loan disbursed. Once the project is completed, an importer makes revenue by operating the project. And an importer repays the principal as well as the interest with the revenue. The interest can be paid either at a floating rate such as Libor plus spread, or at a fixed rate such as CIRR(Commercial Interest Reference Rate).[34]

(Diagram for buyer credit[35])



33) Michele Donnelly, Certificate in International Trade and Finance, ifs School of Finance, 2010, p.136.

34) CIRR(Commercial Interest Reference Rate) is figures published monthly by OECD, which represent the lowest interest rates for each of the major currencies at which export credit agencies may support credits of over two years' maturity. They are generally set by reference to government borrowing rates in the appropriate currency plus a margin. (Malcolm Stephens, op. cit., p.76.)

35) Kim, Sang Man, *op. cit.,* p.50

The general procedure for buyer credit transaction is as follows;

① An exporter enters into an export contract with an importer, in which an importer shall pay to an exporter on a progressive payment[36] basis.

② An importer enters into a loan agreement with a bank

③ An exporter performs the export contract.

④ A bank shall disburse the loan to an importer.

In fact, a bank transfers the funds directly to an exporter.

⑤ An importer pays an exporter on progressive payment basis.

⑥ Once an exporter completes the plant, an importer shall repay to the bank with the revenues from the operation of the plant on a long term installment basis.

2) Parties to a Loan Agreement

As an importer borrows money from a financial institution in buyer credit, an importer becomes a borrower and a financial institution becomes a lender. An importer and a financial institution become the parties to a loan agreement. When an importer lacks credit-worthiness, a financial institution purchases export insurance. Typically, an export credit agency in an exporter's country covers the loan agreement. In some cases a parent company of an importer borrows money from a financial institution.

3) Securities

A financial institution requires securities when it decides an importer's credit rating does not meet the criteria. The main securities required by a financial institution in an buyer credit are as follows.

First, a financial institution requires corporate guarantee by a parent

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36) In progressive payment, an exporter shall be paid to in proportion to the performance. In plant exports, normally an exporter is paid monthly. Every month an importer checks the performance and issues a certificate. And an exporter shall be paid with the submission of certificate and invoice. Finally, at completion of the plant, an exporter shall be paid in all.

company. This is the simplest security. However these days a parent company is reluctant to provide a corporate guarantee. Especially in project finance, a sponsor, which is a parent company of a project company, does not provide direct payment guarantee to a financial institution.[37]

Second, a financial institution purchase export insurance which is provided by an export credit agency in an exporter's country. Generally an importer pays all the costs related to export insurance.

Third, in project finance, a financial institution requires completition guarantee, concession from a host country, long term off take contract etc.

Fourth, in a ship building contract, an importer requires refund guarantee (which is shortly called 'R/G')[38] issued by a first class bank. If a builder (exporter) fails to build a ship and to deliver, a beneficiary on the refund guarantee makes demand to the issuing bank for the amount of the principal of progressive payment plus interest accrued. A financial institution requires an importer to assign the refund guarantee or requests an importer to nominate it as a beneficiary under the refund guarantee.

4) Relevant Export Insurance

Medium & long term export insurance(buyer credit) covers non-recovery risk of financial proceeds by a financial institution in a medium & long term loan agreement, the repayment of which exceeds two years. Separate from the export contract (or the supply contract), a financial institution provides export financing to an importer(project company in project finance) and a financial institution becomes a policyholder. Medium & long term export insurance (buyer credit) enables a financial institution to provide loan to an importer for it is regarded as a safe security.

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37) E.R. Yescombe, *op. cit.,*, p.7

38) Refund guarantee is a kind of independent guarantee, which is issued to guarantee the performance of a shipbuilding contract by a builder. In the event a builder fails to perform a shipbuilding contract, refund guarantee shall be called.

The basic function of medium & long term export insurance(buyer credit) is to cover non-payment risks, and it plays more important role as a security for a buyer credit finance. This is why financial institutions come to visit an export credit agency to request insurance cover before they issue letter of intent for a project. The detailed terms of an ECA export insurance or guarantee will be different depending on the ECA and the governing law.[39] A borrower draws down loan from a lender to pay an exporter before delivery of goods, or to pay an exporter in progressive payment method. The importer repays the loan with the revenue that it earns by operation of the project.

5) Advantages and Disadvantages of a Buyer Credit[40]

(1) In an Exporter's Respect

An exporter is normally paid on a progressive payment method In a buyer credit, in which it receives full payment before he performs the export contract. Therefore an exporter does not bear the non-payment risk. As an exporter receives payment on progressive payment method or 100% downpayment, it enjoys the same satisfaction as cash payment. An exporter has no borrowing for it does not borrow fund to perform the export contract. After an exporter performs an export contract, not the total transaction but the margin only is added to balance sheet as asset, which results in the reduction of liability ratio and the improvement of financial status. As an exporter's finance structure improves, the borrowing cost afterwards will go down.

As an importer provides finance , it surpasses an exporter in negotiating contract price, which may result in the reduction of contract price. Furthermore an exporter is obligated to provide bank guarantee such as advance payment bond, refund guarantee, and performance guarantee. An

39) Graham Vinter, Project Finance, London Sweet & Maxwell, 1998, p.199

40) Preposition : an exporter is a company with good credit rating, and an importer is a company with poor credit rating located in a developing country.

importer requires that an export credit agency in an exporter's country provide export insurance cover for a financial institution.

(2) The Advantages and Disadvantages in an Importer' Respect

As mentioned above, an importer can surpass an exporter in negotiating contract price to reduce contract price in a buyer credit. In the event of an export credit agency provides export insurance cover, an importer can borrow fund with long term credit as well as with low spread.

However, an importer is exposed to the non-performance risk by an exporter. An importer should repay the loan to a financial institution even though an exporter fails to perform the contract. To mitigate non-performance risk by an exporter, an importer, normally, requires performance guarantee as well as advance payment guarantee by a financial institution.

In the event that an exporter fails to perform the export contract, an importer shall make demand call under performance and advance payment guarantee. With the payment from these guarantees an importer recovers what it paid and damages caused by the exporter's failure. A loan agreement stipulates Isabella Clause[41] in order to obligate an importer to repay regardless of the performance of contract by an exporter. An importer's financial structure gets worse for its liability ratio rises.

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41) Malcolm Stephens, *op. cit.,* p.91.
'Isabella Clause means a clause or provision in a contract or loan provision that separates the obligations, rights, and responsibilities under the contract from those under an associated loan agreement. Such a clause may be inserted when export credit agencies issue buyer credits. buyer credit loans subject to an Isabella clause thus involve "clean" repayment obligations on the borrower, irrespective of what may be happening under the contract being financed. In other words, problems with the contract or project do not give the borrower any right to default or delay payment on the loan or to suspend repayments.'

(3) In a Financial Institution's Respect

As an importer has poor financial condition in general in a buyer credit,[42] high spread is applied to a loan. Especially in project finance in which a project company is newly established and has poor financial structure, a financial institution requires extremely high spread. However, a financial institution should bear high risk due to an importer's poor credit rating.

To mitigate risk, financial institutions cooperate to provide a loan on a syndicated loan basis. In many instances the term and risk go beyond the willingness of one bank to carry so that several banks act as a syndicate in financing large projects requiring longer terms.[43]

Furthermore a financial institution requires securities for an importer's default as well as for political risk in an importing country. One of the most preferred securities is export insurance provided by an ECA of an exporter's country, for export insurance covers not only commercial risk but also political risk.

In a project finance more detailed feasibility study is required. One of the main elements is DSCR which means 'debt service coverage ratio'. In a power plant project with long term offtake contract, DSCR at minimum 1.3 is required, and without long term offtake contract, 2.0 is required.[44] In addition a financial institution requires performance guarantee by a sponsor. A financial institution considers all the benefits and risks involved in a loan to choose the best credit method.

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42) This is based on assumption that an importer is in a developing country with poor financial condition. In a ship building contract, generally an importer has good financial condition, and is in a developed country. Thus the general explanation above does not apply.

43) Harry M. Venedikian, Gerald A. Warfield, *op. cit.,* p.21

44) E.R. Yescombe, *op. cit.,* p.273

Ⅲ. Case Analyses of A Supplier Credit and A Buyer Credit of Capital Goods.

1. A Supplier Credit Transaction

1) Transaction Summary

D Company(Korean exporter) and N Company(Azerbaijan importer) entered into contract for supply and installation of telecommunication equipment and system. The contract value amounted to USD 12.5 millions.

The buyer shall pay 15% of the contract value in advance, and shall pay the remaining 85% on deferred installment payment for four years upon issuance of acceptance certificate. N Company shall provide payment guarantee of the Ministry of Communication as well as its own promissory note.

(Summary of Transaction)

Export Contract	
Seller	D Company(Korea)
Buyer	N Company(Azerbaijan)
Work Scope	Supply and Installation of Telecommunication Equipment and System
Contract Value	USD 12.5 million
Terms of Payment	15% : advance payment 85% : deferred installment payment for four years after acceptance certificate
Interest Rate	4.5%(fixed interest rate)
Securities	- Promissory Note of N Company - Payment Guarantee of Ministry of Communication of Azerbaijan
Loan Agreement	
Lender	K Bank
Borrower	D Company(Seller)
Loan Amount	USD 10.7 million
Interest Rate	5.18%(fixed interest rate)

Repayment Terms	the same as terms of payment of Export Contract
Security for Lender	- Assignment of Promissory Note of N Company - Assignment of Payment Guarantee of Ministry of Communication of Azerbaijan - Assignment of KEIC export insurance policy
Security for KEIC	- Promissory Note by N Company - Payment Guarantee of Ministry of Communication of Azerbaijan

2) Effect of Transaction

As this transaction was proceeded on a supplier credit, D Company(seller) shall provide itself the fund necessary for the supply and installation of the telecommunication equipment and system. It may be burdensome for D Company(buyer) to borrow the fund from a bank. Moreover the loan that D Company borrows is added to its debt, which increases the liability and causes the liability ratio to rise. As a result, this transaction will worsen D Company's financial status.

Even after D Company completes successfully the export contract, the nonpayment risk by a buyer continues until all the remaining installment payment is paid in full. In this transaction, the non-payment risk continues at least for four years even after completion of the contractual obligation by D Company.

N Company stopped payment of installment only after paying three installments out of nine installments, claiming that the equipment did not work according to the contract, which often happens in a supplier credit transaction.

Therefore D Company shall repay the loan borrowed from K Bank with its own money, which was supposed to repaid by the payment from N Company. The non-payment risk is the biggest disadvantage in a seller's respect in a supplier credit. If this transaction had been concluded in a buyer credit, such a nonpayment could not have happened. This transaction shows how big the disadvantages and the risks are in a seller's respect. These disadvantages and

risks should be included in the contract value, which means that a seller should require higher amount of contract value in bargain for a supplier credit. Otherwise, a seller is recommended to require a buyer credit in bargain for discount of the contract value.

2. A Buyer Credit Transaction

1) Transaction Summary

H Company(Korean exporter) and C Company(French importer) entered into shipbuilding contract of two container vessels, of which contract value amounted to USD 114 millions. C Company transferred the contract to S Company, Italian company.

As this transaction was based on a buyer credit, C Company bears non-delivery risk of vessel by H Company. To mitigate such risk, H Company shall deliver to C Company an assignable refund guarantee('R/G') by a acceptable financial institution for the refund of pre-delivery payment and plus interest.

(Brief Summary of Transaction)

Shipbuilding Contract	
Seller	H Company(Korea)
Buyer	C Company(France) → S Company(Italy)*
Object	Two 51,000 TEU Container Vessels
Contract Value	USD 114.3 million
Terms of Payment	40% : progressive payment 60% : on delivery of vessel
securities	refund guarantee('R/G')
Loan Agreement	
Lender	S Bank
Borrower	S Company(Buyer)
Loan Amount	USD 114.3 million

Interest Rate	6 month Libor + 0.45%
Repayment Terms	24 consecutive semi-annual installments
Security for Lender	- Refund Guarantee : for predelivery - KEIC export insurance policy : for both pre-delivery and post-delivery
Security for KEIC	- Payment Guarantee of Parent Company - Mortgage on the vessels

* C Company(France), Original buyer transferred the contract to S Company(Italy)

2) Effect of Transaction

As this transaction was proceeded on a buyer credit, C Company shall provide H Company with funds required to build vessels. It was burdensome for C Company to provide such a big amount of fund. Therefore C Company required H Company to arrange export insurance cover by Korea Export Insurance Corp[45](hereinafter 'KEIC').

KEIC's export insurance cover enabled H Company to conclude and perform this shipbuilding contract. With export insurance cover, C Company could borrow the fund from commercial banks with low spread. In this project the interest rate was 6M Libor + 0.45%(spread).,Without export insurance cover the spread would be over 1.0%.

This transaction was proceeded on a buyer credit, which enabled H Company to receive 40% of the contract value on a progressive payment method and 60% of the contract value upon delivery of each vessel. Once the delivery is made, H Company is free from nonpayment risk by S Company, which is the fundamental risk of a seller in a international transaction.

The total loan was not added to H Company's debt, but S Comany's debt. The payment received by H Company shall be added to H Company's asset, and the cost would be added to H Company's Liability. Finally, only the

45) According to the Revision of 'Export Insurance Act' to 'Trade Insurance Act', Korea Export Insurance Corporation was renamed to Korea Trade Insurance Corporation as of July 7, 2010.

margin of this transaction would be added to H Company's net asset. While H Company's liability stayed same, its asset increased. This resulted in the decrease of liability ratio. This shows that a buyer credit improves a supplier's financial status compared with a buyer credit transaction.

3. Analysis of Global Project Finance Volume in 2009

Global project finance volume reached US$ 292.5 billion in 2009, the second highest total on record despite the fact that volume dropped 9% compared with US$ 320.9 billion in 2008.[46]

The largest deal to close in 2009 was Papua New Guinea LNG project, the project amount of which was US$ 18.0 billion. This project financing comprised US$ 14.0 billion debt and US$ 4.0 billion equity. Project finance loan volume fell 6% to US$ 223.9 billion in 2009, while project finance bond volume increased 96% to US$ 12.5 billion, compared with US$ 6.4 billion in 2008.[47]

State Bank of India took the first place in mandated lead arrangers for global project finance loans reaching US$ 27.0 billion out of 51 out of 51 deals. The following table shows the financial institutions and the loans made by them in 2009.[48]

Financial Institution	Value(US$ million)	No. of Deals
State Bank of India	26,987	51
Calyon	6,992	84
IDBI Bank	6,500	15
BNP Paribas	6,034	72
Santander	5,390	87

46) Project Finance, "Dealogic Global Project Finance Review – Full Year 2009", Project Finance, 2010.2, p.85

47) *Ibid.*

48) Project Finance, *op. cit.,* p.89

Industrial & Commercial Bank of China	4,358	6
SG CIB	4,348	55
Mitsubishi UFJ Financial Group	4,258	57
China Development Bank Corp	3,954	6
Sumitomo Mitsui Banking Group	3,854	44

Ⅳ. Conclusion

The international transactions of capital goods such as industrial plant exports, overseas constructions, and shipbuilding exports, are so huge that tremendous amount of funds are required, and that most of the loans are long-term credits of over five years. Korean Consortium led by KEPCO won UAE Nuclear Power Plant Project in December 2009. In the export of huge capital goods, financing is more crucial than technology itself. Some of the importing countries are developing ones that are politically and economically unstable. Therefore the financing mechanism for these transactions is conclusive in winning these projects.

Global financial market instability caused by US sub-prime mortgage financial crisis expanded all over the world, and the international transactions have been decreased due to global credit crisis. This indicates how much influential the financing market is in international transactions. The financing schemes are classified into a supplier credit and a buyer credit by who provides the financing.

A supplier credit is a credit extended by an exporter(seller) to an importer(buyer) as part of an export contract. Cover for this transaction may be extended by an export credit agency to an exporter. In a sales contract a seller shall provide fund required to manufacture goods, and in a construction contract a contractor shall provide fund required to complete a construction.

A buyer credit is an arrangement in which an exporter enters into a

contract with an importer, which is financed by means of a loan agreement where the borrower is the importer. In a sales contract an importer shall provide fund required to manufacture and procure the goods, and in a construction contract an owner shall provide fund required to complete a construction. Therefore an exporter is paid on progressive payment method.

A supplier credit is quite opposite to a buyer credit in that a borrower is the opposite; in a supplier credit a borrower is an exporter, and in an buyer credit a borrower is an importer. A supplier credit and a buyer credit have their own advantages and disadvantages in the respect of the parties respectively. These two financing methods are selectively used considering financing conditions such as funding cost, importer's and/or exporter's financial conditions, importing country's political risk.

When a financial institution provides loan either on a supplier credit basis or on a buyer credit basis, it generally requires securities. Export insurance is considered one of the most valuable securities.

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ABSTRACT

A Comparative Study on a Supplier Credit and a Buyer Credit in International Transactions of Capital Goods

– Focusing on Industrial Plant Exports, Shipbuilding Exports, and Overseas Constructions –

Kim, Sang Man

The international transactions of capital goods such as industrial plant exports, overseas constructions, and shipbuilding exports, are so huge that tremendous amount of funds are required, and that most of the loans are long-term credits of over five years. In the export of huge capital goods, financing is more crucial than technology itself. Some of the importing countries are developing ones that are politically and economically unstable. Therefore the financing mechanism for these transactions is conclusive in winning these projects.

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A supplier credit and a buyer credit have their own advantages and disadvantages in the respect of the parties respectively. These two financing methods are selectively used considering financing conditions such as funding cost, importer's and/or exporter's financial conditions, importing country's political risk.

Key Words : a supplier credit, a buyer credit, international transaction, capital goods, ECA, export insurance, project finance