

A Study on Export Financing Policy for Korean SMEs*

– Focusing on Korea EXIM’S Bank –

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Key Words : Export Financing, Export Program for SMEs, Bill of
Exchange, Export Factoring, Export Forfaiting

I . Introduction

According to the 2013 statistics released by the Statistics Korea, the small/medium-sized enterprises(SMEs) of the Korean economy with 87.8%

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of employment. This simple figures also indicate SMEs export extension is a key task for the national economy stimulation and job creation.

However, SMEs exportation plummeted from 18.7% in 2006 to 3.19% in 2012 of the whole economy. Such fall in SMEs exportation has brought a negative effect on the national economy.¹⁾

The SMEs export plunge has been affected by the European financial turbulence, US financial instability, developing countries like China entering foreign markets, a weak yen, etc.

Such changes in the trading environment need to be wisely responded by diversified trade finance system for elevated SMEs competitiveness. Also for the same purpose, other countries such as the US, Japan, China, and Taiwan have implemented proactive trade financial assistance for own SMEs.

In the international trading practices, trade finance is defined variously according to the party who defines it. In a broader sense, it includes every financial assistance rendered to every market access activity related to trade, trade preparatory activity, export goods securing, etc. Whereas, in a narrower sense, trade finance could mean borrowing funds as security for trade bonds, insurance on possible failure of trade bond redemption, etc.

In this thesis, we will look at EXIM Bank's trade finance system for its problems and improvement, which can ease one of the largest problems of SMEs export-capital turnover and credit risk.

Previous researches in relation to this present research are, first, Gwangseo Park's research proposing to expand the use of export factoring as a way to reduce exporters' risk from payment after goods arrival. And second, Geunseo Park explored ways to give an appropriate loan method of Korea's trade finance system. Third, Seyun Park examined finance regulation history and status while analyzing trade finance per financial instruments to find out implications for actual practices in his research on

1) IIT(Institute for the International Trade), <http://iit.kita.net>.

trade finance and financial regulatory measures.

Most of the researches on trade finance are on the trade finance system appropriateness, factoring, export assistance system awareness and trade finance products but not on the overall aspects of trade finance for SMEs support. In this thesis, we seek to investigate EXIM Bank's trade finance products and find out aspects applicable to Korea's SMEs trade finance assistance system.

II. Korea's SMEs Exportation

1. SMEs Definition and Scope

For a more effective understanding of the discussion herein, SMEs should be first well understood. According to Article 2(1) of the Small Business Act of Korea, SMEs are (1) enterprises with the number of full-time employees, capital, sales or total asset, etc specified per industry, not exceeding the threshold described by Presidential Decree (2) enterprises of which ownership and management independence status in terms of shareholding status, etc. meet the standard.

SMEs are further divided into smaller enterprises and SMEs under Presidential Decree. If deemed necessary, firms can be defined as SMEs according to SMEs Cooperatives Act or other laws.²⁾

〈Table 1〉 The scope of SMEs in Korea

Type of Business	The scope of SMEs
mining industry, construction industry, transportation business	regular employment not more than 300 employees or less than 30 billion won in capital
manufacturing business	regular employment not more than 300 employees or less than 80 billion won in capital

2) SMEs Fundamental Law Article 2.

combination of large retailers, hotel business, computer related business	regular employment not more than 300 employees or less than 300 billion won in capital
fishery industry, gas and waterwork business, fuel and related product manufacturing business, condo operating business, travel agency, warehousing and transportation related business, communication, engineering service, hospital, film industry, broadcasting service etc.	regular employment not more than 200 employees or less than 200 billion won in capital
wholesale and commodity brokerage, telecommunications vendor, door to door distributor, industrial machinery and equipment rental business, science and technology service, show industry, youth-related business etc.	regular employment not more than 100 employees or less than 100 billion won in capital
all other industries	regular employment not more than 50 employees or less than 50 billion won in capital

source : Kim, Eun Young, "A Study on Utilization of Export Assistance Programs for SMEs and Their Exportation Performance", Dept. of Global Trade Graduate School of Hannam University, 2011, p. 6.

Such a system means that SMEs of Korea are entities engaging in trade with the position of SMEs.³⁾ <Table 1> is the scope of SMEs in Korea.

3) SMEs in Japan and Taiwan are as follow(www.kbiz.or.kr).

The name of a country	Type of Business	Division
Japan	manufacturing business, the others	regular employment not more than 300 employees or less than 300 million yen in capital
	wholesale business	regular employment not more than 100 employees or less than 100 million yen in capital
	retail business	regular employment not more than 50 employees or less than 50 million yen in capital
	service business	regular employment not more than 100 employees or less than 50 million yen in capital
Taiwan	manufacturing business, construction business, mine industry, extraction of sand and stone	paid capital not more than 80 million NTD or employment not more than 200 employees
	distribution, transport services, others service	total sales revenue last year not more than 100 million NTD or employment not more than 50 employees

According to the 2012 statistics by Korea International Trade Association, there are 85,866 SMEs in terms of the registered business numbers.⁴⁾

2. Current SMEs Status and Comparison with Foreign Country Status

1) Current SMEs Status

The statistics on SMEs status by Small and Medium Business Administration. In 2011 the number of SMEs is approximately 3.23 million, accounting for 99.9% of the whole companies in the country. They hire 12.63 million employees and it is 86.9% of the whole work force. After 1997 until 2011, about 560,000 SMEs increased(2.67 mil in 1997 3.23 mil to 2011). SMEs job creation rose by 4.36 million employees(8.27 mil in 1997 to 12.63 mil in 2011). Due to post-foreign exchange crisis restructuring and so forth, large group employment fell but SMEs added new jobs to the market, solidifying its position as a main job creator.⁵⁾

2) Foreign Countries' SMEs Status

〈Table 2〉 is from Small and Medium Business Administration of Korea about current SMEs status. The table shows the comparison with the numbers of foreign SMEs and their employees in 2010. Korea, compared to other countries, has significantly higher numbers of SMEs and their employees, signaling that SMEs have a higher effect on job creation and the whole national economy.

4) IIT(Institute for the International Trade), <http://iit.kita.net>.

5) www.index.go.kr

〈Table 2〉 Foreign countries' SMEs status

(unit: %)

	Korea	Taiwan	Japan	USA	UK
No. of business	99.9	97.6	99.1	85.2	99.9
No. of employee	86.8	77.1	77.8	50.2	59.2

source : www.index.go.kr

3. SEM Export Status

1) Corporate Size-Specific Export Amount and Importance

〈Table 3〉 shows company size-specific export shares. Larger firms' export share decreased slightly from 66.8% in 2011 to 66.4% in 2012. Whereas SMEs export share went up a bit from 18.3% in 2011 to 18.7% in 2012. Other enterprises' export share stayed flat at 14.7% during the same period.

Korea recorded USD 555.2 billion for export in 2011 and it fell to USD 547.9 billion in 2012, representing a 1.3% cut in the whole export amount. But during the same period, SMEs export, despite the overall drop, rose by 1.1%.

〈Table 3〉 Corporate size-specific export shares

(unit: billion dollar, %)

Division	2011 years		2012 years		Rate of increase
	The amount of export	Specific export shares	The amount of export	Specific export shares	
SMEs	1,016	18.3	1,026	18.7	1.1
Strong medium corporate	819	14.7	804	14.7	-1.8
Large corporate	3,710	66.8	3,638	66.4	-1.9
Total Export	5,552	100.0	5,479	100.9	-1.3

2) SMEs Export Amount & Share

〈Table 4〉 Shows the amount of SMEs and specific export shares. As of 2012, 41.7% of the SMEs recorded export value not exceeding USD 50,000, staying as a micro business. The Korean government recognize SMEs as healthy when their export is at least USD 50 bln.

About 83.1% of them, however, recorded their annual export less than USD 10 bln. And more than half of them actually reported their export no more than USD 1 bln, indicating micro scale business.

〈Table 4〉 The Export amount of SMEs and specific export shares

(unit: No, %)

The Export Amount	No. of Corporate	Specific Export Shares
Less than USD50 thousand	35,843	41.7
More than USD50 thousand ~Less than USD100 thousand	8,865	10.3
More than USD100 thousand ~Less than USD500 thousand	19,726	23.0
More than USD 500 thousand ~Less than USD 1 million	6,973	8.1
More than USD1 million ~Less than USD5 million	10,467	12.2
More than USD5 million ~Less than USD10 million	2,041	2.4
More than USD10 million ~Less than USD50 million	1,758	2.1
More than USD50 million ~Less than USD100 million	149	0.2
More than USD100 million ~Less than USD500 million	42	0.1
More than USD500 million ~Less than USD 1 billion	2	-

III. SMEs Trade Finance Assistance System

1. Trade Finance Assistance System

The policy goal of Korea's trade finance system is to supply SMEs necessary funds to support their exportation. On the other hand, it is to prevent any insolvent loaning attempt with the supplied funds, ultimately to help maintain the trade finance system as a sound export assistance scheme.

After the 1960s, the government prioritized its policy goal to stimulate export for national economic growth. To boost up exports, the government implemented diverse trade finance assistance schemes.

Initially, most of the trade finance systems supported large groups first over SMEs, making them hard to access such assistance. Recently, as SMEs have become increasingly important in the national economy, various trade finance schemes have been designed specifically for SMEs.

Currently EXIM Bank is offering many trade finance instruments and services such as negotiation, export factoring and forfeiting, etc.

2. Organizations Receiving EXIM Bank's Trade Finance Assistance

EXIM Bank provides financial assistance necessary for export and import, overseas investment and overseas resource development, also facilitating Korea's foreign economic cooperation. EXIM Bank has operated SMEs assisting trade finance schemes including negotiation, export factoring and forfeiting, etc.

1) Negotiation

A loan for export draft purchase is a post-shipment export financial instrument that buys a draft issued for L/C or non-L/C trades with

payment period between 30 days and 2 years.⁶⁾

Companies subject to the export bill product are those with an export record and chosen by considering their previous ex/import performance, estimated amount, credit rating, ability to put up security, etc. The loan amount is limited to transactions exceeding USD 50,000 per case only. <Table 5> shows the conditions of EXIM Bank's export draft purchase loan product.

<Table 5> The conditions of EXIM Bank's export draft purchase

Division	Conditions
Eligible exporters	Companies which have past transaction(consider to
Eligible Transaction	L/C(payment period : below 2 years) or Non L/C(D/P, O/A)
Currency	a Foreign currency
Coverage	More than USD 5million per transaction
Terms	SMEs : 30days ~ 2 years or O/A can be below 30days
Method	the revolving limit method (can be treated by a case by case)
Interest Rate	Libor+Margin (Type of transaction, credit grade, Collateral Type apply differential)
Security	Loan can be made on credit to creditworthy borrowers. In addition, bank guarantee, negotiable securities, real estate etc.

source : www.koreaexim.go.kr

6) *Ibid*, p. 1.

2) Export Factoring

Export factoring is an export financial product that purchases an export bond of credit export transactions without resource. Export factoring has two different methods of direct purchase where the Bank directly acquires a foreign importer's credit risk and indirect purchase where the Bank supports through a foreign factoring company.

Exporters using the export factoring can be benefited as follows. First, they can transfer an importer's credit risk to the factor, avoiding the uncertainty of export payment. They can facilitate cash flow as they receive pre-payment, which is especially favorable for SMEs with insufficient cash amount.

Second, exporters can effectively manage multiple importers' account receivables, who are in foreign countries with unfamiliar laws, regulations and general trading practices. Forth, export factoring is good for repeated transactions. Once a specific transaction between an exporter and importer is recognized as credible, then after, they can use the product repeatedly.

Third, they can save extra expenses, improving competitiveness. Export factoring, compared with L/C, is simple in its process and as the factor deals with general businesses regarding payment instead of exporters, exporters can save overall costs for account receivables management. Sixth, the selling of sales credit is not recognized as a borrowing, improving corporate financial structure.⁷⁾

EXIM Bank, after introducing the export factoring scheme in 2005 first in the country, has recorded til KRW 2,609.9 bln in its performance as of now.⁸⁾ <Table 6> shows the conditions of EXIM Bank's Export Factoring.⁹⁾

7) Park, Se Hun·Lee, Gyu Chang·Seo, Kyung, "A study on the Problems and Improvement of International Factoring Systems in China", *The International Commerce & Law Review*, Vol.59, 2013, pp. 163~164.

8) www.koreaexim.go.kr.

9) www.koreaexim.go.kr.

〈Table 6〉 The conditions of EXIM Bank's Export Factoring

Division	Terms & Conditions
Eligible Transaction	Open account Export transactions on credit (including transactions on D/A)
Eligible exporters	Companies with experience of producing or exporting the export item for more than a year or, Companies which have past transaction with the same foreign buyer
Termination	One factor system : payment terms less than 6 months Two Factor system : payment terms less than 6 months
Payment for the purchase of trade Bills	80-100% of the export amount
Fees	Discount fee : LIBOR + Spread + Import Factoring Fee(Two factor system)

3) Forfeiting

EXIM Bank brought in the forfeiting scheme in 1997 when the nation-wide foreign exchange crisis hit financial institutions seriously to the extent that L/C-based trade became impossible. With the scheme, the Bank aimed to help companies which was capable to export but hit by difficult situation.¹⁰⁾

EXIM Bank's forfeiting is a trade finance where the Bank offers negotiation and discount to exporters at a fixed rate regarding L/C, payment certification, etc. issued in international trades.

Exporters using the forfeiting scheme can have benefits as follows.

First of all, they sell a bond, removing credit risks.

Second, they collect export payment immediately after goods' shipment,

10) Park, Se Hun·Jung·Young Dong·Kim Jung Nyun, "A study on debt instruments in forfeiting", *Korea trade review*, Vol.34 No.1, 2009, p. 272.

improving cash flow.

Third, they sell bonds at a fixed interest to collect forfeiting cost in advance and remove the need to borrow from a bank for credit transaction-generated expenses. Exporters can enjoy better financial structure.

Forth, exporters pre-set forfeiting expenses and transfer them to an importer. Fifth, they can transfer credit risk, exchange risk, interest risk, etc. to forfaitor.¹¹⁾ <Table 7> describes the required conditions for EXIM Bank's forfeiting loan.

<Table 7> the Conditions of EXIM Bank's Forfaiting

Division	Terms & Conditions
Eligible Exporters	Companies with experience of producing or exporting the export item for more than a year or, Companies which have past transaction with the same foreign buyer.
Eligible Transaction	Issued or confirmed L/C or In the case of Non L/C, guaranteed by foreign bank(including intermediate trade)
Currency	A Foreign currency
Loan Amount	per case more than USD 10,000 ~ less than USD 50 million
Loan Period	More than 30 days ~ Less than 2 years
Interest Rate	below 1 year : LIBOR + Addition Rate(Period, Country, Bank applied to the differential) below 2 years : SWAP + Addition Rate
Security	Credit

source : www.koreaexim.or.kr

11) *Ibid*, pp. 274~275.

Although there is yet to be accurate statistics in Korea, according to a recent research, Korea's forfeiting market size is estimated approximately USD 10.4 bln as of 2010 with the biggest player, HSBC(25%), followed by BOC(15%), EXIM Bank(KEXIM(13%)) and BONY(10%).¹²⁾

IV. Problems and Improvements of Trade Finance Scheme

1. Problems and Improvements of Export Bill Scheme

1) Problems

The draft purchase scheme(Negotiation on B/E) was once much activated before when L/C or Collection accounted higher portion of export to the extent to form a draft trading market. But recently, its use has decreased as more T/T have been used.

As for EXIM Bank's draft purchase program, O/A can also apply for but since the program evaluates previous export performance, credit rating and security capacity, SMEs face huge difficulties to access the benefits. Also if an issuing bank, collection bank or debtor does not pay proceeds, exporters are required to refund, exposing to credit risk.

2) Improvements

L/C and collection has been less frequently used in Korea's trade payment practices. As such, corresponding trade finance services also have declined. However, to open a new market, L/C and collection are still necessary.

12) Lee, Woon Chang, "A study on the measures to enhance the use of forfeiting : focusing on the function of the export-finance risk reduction and the financing method", Dept of International Trade Sungkwan University, 2013, p. 106.

The Korea International Trade Association's 2012 trade statistics show that L/C, and collection methods accounted for a mere 23.1%(L/C(13.7%), Collection(9.4%), respectively) of Korea's export practices. But for new market opening and continued export activities, these are just necessary for SMEs.

A problem for SMEs, in particular, as shown in <Table 3>, is the fact 41.7% of them recorded annual export amount not exceeding USD 50,000. EXIM Bank supports firms with transaction amount of USD 50,000 per deal. And sound SMEs can also access credit loan. However, most of the SMEs perform only less than the threshold thus outside the scope of the assistance target.

Moreover, SMEs with no past export/import performance, credit ranking or security should provide a payment guarantee, real estate or negotiable securities. To expand assistance, therefore, the threshold should be lowered. EXIM Bank, in this context, will need to take a more proactive attitude to provide trade finance by, for example, reviewing the business feasibility for SMEs with a lower credit rank or investigating importers' credit status, etc.

2. Problems and Improvements of Export Factoring Scheme

1) Problems

The factoring service of EXIM Bank has problems as follows.

First, it only stays at non-notification invoice discounting and not the full service factoring.

Second, as international factoring service allows pre-payment and credit risk transfer, it is appropriate for SMEs. But its main target is large companies as Samsung and LG, distancing itself far away from foreign factoring services for SMEs.

Third, EXIM Bank has started the factoring service since 2005 but the

product has not been effectively promoted, leaving many SMEs unaware.¹³⁾

2) Improvements

To activate the factoring service, the author proposes several improvements.

First, to offer a full service factoring, there should be personnel who understands international payment practices, export finance, cash flow, etc. as well as Int'l Business Contract Rules. Therefore, EXIM Bank should nurture experts in this area. To this end, the Bank needs to organize a trade finance expert training program.

Second, currently EXIM Bank provides factoring service mostly to large companies whereas other countries focus on SMEs. As the international factoring is for SMEs in its nature, the Bank should lower its threshold for service provision.

Third, the factoring service should be more actively promoted through webs or SNS to inform and more benefit for SMEs.

3. Problems and Improvements of Forfeiting

1) Problems

EXIM Bank's forfeiting products have some problems.

First, even though international trading practices have shifted from L/C to remittance in export payment, the Bank's target is still L/C for forfeiting.

Second, the Bank's forfeiting is a primary forfeiting market where exporters' bonds are bought. A secondary forfeiting market to trade forfeiting bonds, in this sense, has not been activated.

13) Han, Ki Moon, "A Study on the Use of Int'l Factoring System -Focusing on SME Export Financing", Dept of International Trade Sungkyunkwan University, 2009, p. 141.

Third, the service is also less than effectively promoted to exporters.

2) Improvements

EXIM Bank's forfeiting trade finance product can be improved as follows. First, it needs to consider primary note, B/E, standby credit, Aval and negotiable instruments as well to grant effective assistance to SMEs when L/C has less and less utilized in international payment system.

Second, the Bank should play more than a primary forfeiting market entity. It also needs to facilitate the secondary forfeiting market.

Third, since SMEs are familiar with trade insurance but not with forfeiting application, they need systematic education and proactive public promotion.

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ABSTRACT

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The SMEs export plunge has been affected by the European financial turbulence, US financial instability, developing countries like China entering foreign markets, a weak yen, etc.

EXIM Bank, in this context, will need to take a more proactive attitude to provide trade finance by, for example, reviewing the business feasibility for SMEs with a lower credit rank or investigating importers' credit status, etc.

Moreover EXIM Bank provides factoring service mostly to large companies and should lower its threshold for service provision to SMEs.

Finally EXIM Bank should play more than a primary forfeiting market entity. It also needs to facilitate the secondary forfeiting market.

Key Words : Export Financing, Export program for SMEs, Bill of Exchange, Export Factoring, Export Forfeiting