DEVELOPMENT BANKS AND NEW EXPORT VENTURES IN DEVELOPING COUNTRIES

John P. Byrne

Introduction

Developing countries are currently faced with increasing pressure to develop exports, particularly of non-traditional or industrial products. Development banks which are the primary, and frequently the only source of development capital in developing countries are being directed to give priority to export projects where these exist or to the identification and development of export projects where none exist. Export ventures pose new problems for the banking system in the developing world. In exporting, there are lower returns, higher risks, a greater requirement for working capital and fixed asset investment and a need for more flexible methods of financing. This paper is concerned with the particular aspects of the new export projects which must be considered by the banking system in the promotion and financing of such enterprises.

New Export Ventures

The marketing and the technical plans for a new export venture determine the amount and timing of financial investment which is required to initiate and operate the venture successfully. The term export venture is used here in its widest sense to include all export projects from the first time export venture to the continuance or increase of existing exporting operations. It is also used to include export ventures which require large fixed capital investment and those which require only working capital and/or foreign exchange.

Financial investment in any project has one of two forms: (a) Fixed Asset Investment and (2) Working Capital Investment.

Development banks in developing countries are the major sources of finance for industrial projects. These banks are to a large extent funded by international agencies and are usually restricted to supplying finance for investment in fixed assets. It is still considered even in developing countries to be the exclusive function of the commercial banking system to

*The author is Statutory Lecturer in Finance and Head of the Department of Banking and Finance at University College, Dublin.

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provide finance for working capital purposes. Because the commercial banking system of most developing countries is dependent on scarce local deposits as a source of finance, there is consequently a shortage of working capital for both new and existing companies.

By their very nature, export projects require considerably more working capital than projects which are established to supply only domestic markets. The export project is therefore more severely constrained by scarcities of working capital finance than the domestic venture. This inherent financial obstacle to the initiation and development of export projects is aggravated when excessive regulations and "red tape" delay export shipments and the exporter has to invest larger amounts of working capital to counterbalance these delays if he is to survive in his export markets.

Selling in a domestic market in a developing country is always easier than exporting. There are fewer problems of information, competition, transportation, distribution, standards, deliveries etc. Added to which, in most developing countries, there is often an unsatisfied domestic demand for many industrial products which makes exporting such products to highly competitive export markets even less attracftive to industrial producers.

Even when the pressure to generate export earnings in a developing economy leads a government to eliminate or reduce structural and bureaucratic obstacles to export, there still remains a high risk associated with exporting faced by all exporters from developed and developing countries alike, and which has caused many developed countries to introduce special forms of financial and non-financial support specifically for the export sector. Almost all the countries of Western Europe for example offer financial incentives to private investors to promote industrial investment, and in particular, investment in industrial projects based on exports.

Entering an export market usually involves very high initial costs. This relatively high expenditure is wasted if the follow-through phase of the project is not properly planned or financed. Domestic projects, which do not have the high entry costs to the market, can often correct poor performance after the introductory phase, but in export projects the investment in gaining the first foothold in the market can be entirely lost if there are defects in subsequent performance such as quality below international standards or delays in delivery.

Financial Planning in Export Projects

The high cost of export, versus domestic, ventures emphasises the importance of financial planning in the development of the export project. It is valuable therefore to look at the process of financial planning in an export project as being a number of conceptual stages, from forecasting to the development of the financial plan for the project.

Figure 1 shows the sequence of conceptual stages in the financial planning process and illustrates the iterative approach to the development of a financial plan for an export project. From this it can be seen that marketing and technical plans may have to be altered or revised when return is

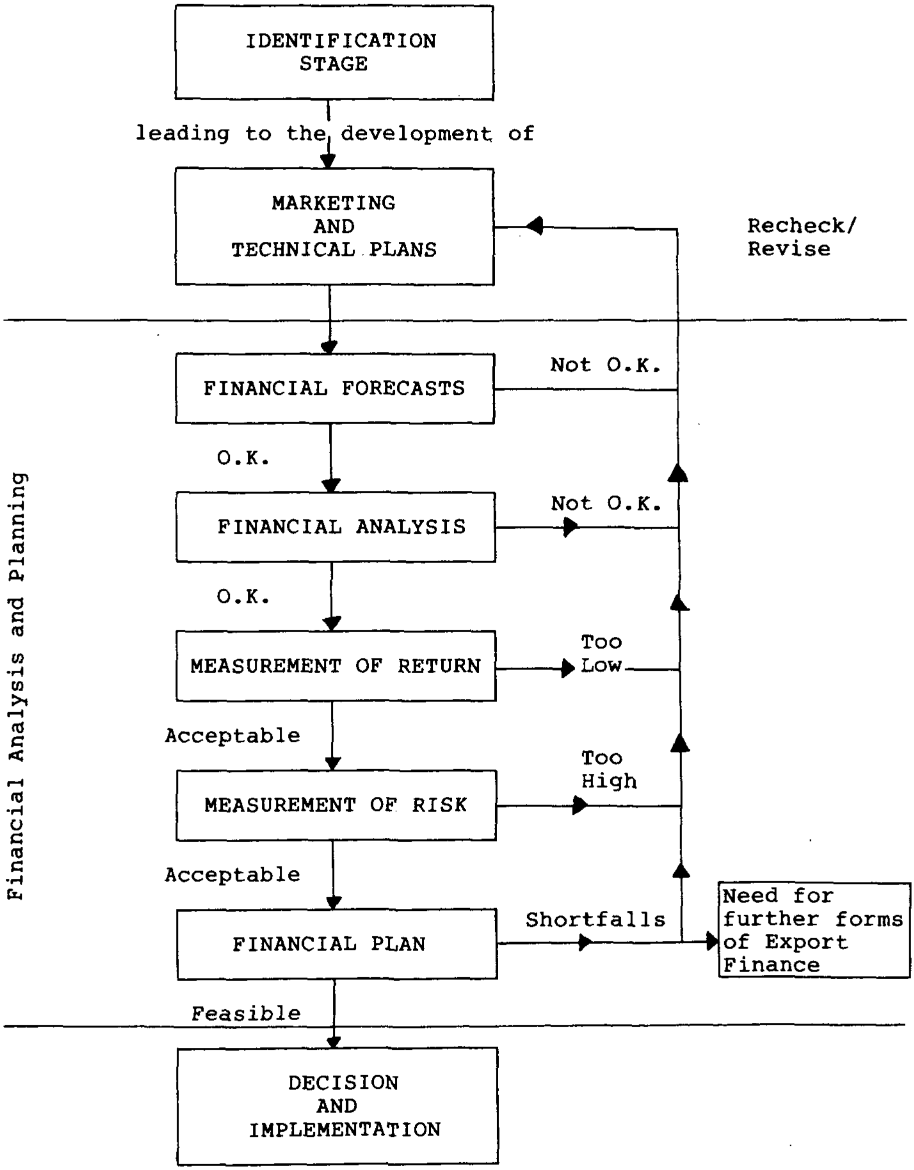

Figure 1: *Financial Analysis and Planning.*

too low, the risk too high, or simply when adequate sources of finance are not available. Frequently, a feasible financial plan cannot be evolved which gives a prudent balance of risk and return, and in such cases, the project is abandoned indefinitely or until circumstances become more favourable. It may be necessary for government to introduce special schemes to improve returns or reduce risk in order to promote export ventures.

As shown in Figure 1, the marketing and technical plans for a project precede the development of the financial plan. In practice of course, the marketing, technical and financial functions in a project are never so neatly separated, but in the initial stages of planning marketing and technical considerations are usually dominant.

An early question which arises in the development stage of the export venture is that of the size of the project. Establishing the size or capacity of the project is extremely important to its subsequent survival or success. Ideally, a project should grow in capacity as its market develops in size over time. However, it is seldom possible to have such a comfortable method of project development. Production costs usually vary with the capacity or size of the production plant. Markets, particularly competitive export markets, will only yield a certain price. In order to produce below the market price, the plant capacity may have to exceed a certain size. The output at this size may be too great to be absorbed by the market at the given price. To gain market entry for a large volume, the price may have to be reduced. This may make the project unprofitable and so more variations are necessary until a feasible size of project is determined.

The basic problem is to decide on the best combination of market price, volume of sales, plant capacity and production cost. This best combination will be the feasible combination which produces a satisfactory financial return at an acceptable level of risk.

Export projects have special features which differentiate them from projects based on domestic markets. In export projects, risk is higher because the supply and communications are over longer distances, the export market may have different standards and laws, delivery dates and consistency of supply are more important and the credit risk may be higher. These factors, which are not exhaustive, have four main financial effects:

(1) Additional fixed asset investment may be necessary to meet the normally higher product standards required by export markets.

(2) Significantly higher inventories of products and packaging may be required to maintain deliveries and consistency of supply.

(3) Credit risk may increase significantly, especially for the smaller exporter who may not be able to secure payment by letter of credit.

(4) Exchange risk may be introduced into the transaction.

The level of risk may be controlled by starting the export project as a small pilot operation and only moving to full commercial capacity when a foothold has been established in the export market but such a procedure is not always feasible.

Finally, if the return and risk in the project appear acceptable, the financial plans for the project can be drawn up with the emphasis on the short term feasibility of the financial plan as it is in the short term that most of the problems with projects tend to arise. One of the greatest dangers to a project derives from the restrictions in developing countries on local finance for working capital. In order to get the project started, many promoters understate their working capital requirements to match the amount of finance which is available to them from the commercial banks. This underestimation of working capital, particularly in export projects, leads to a significant number of failures and to the loss of all or part of the fixed asset loan of the development bank.

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