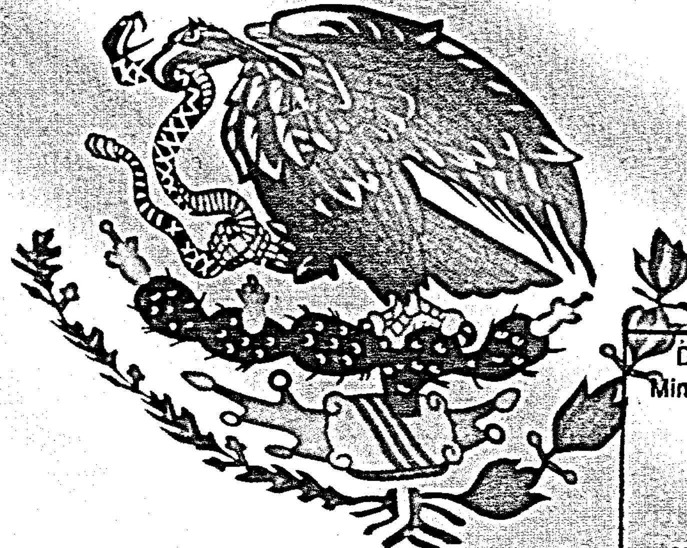
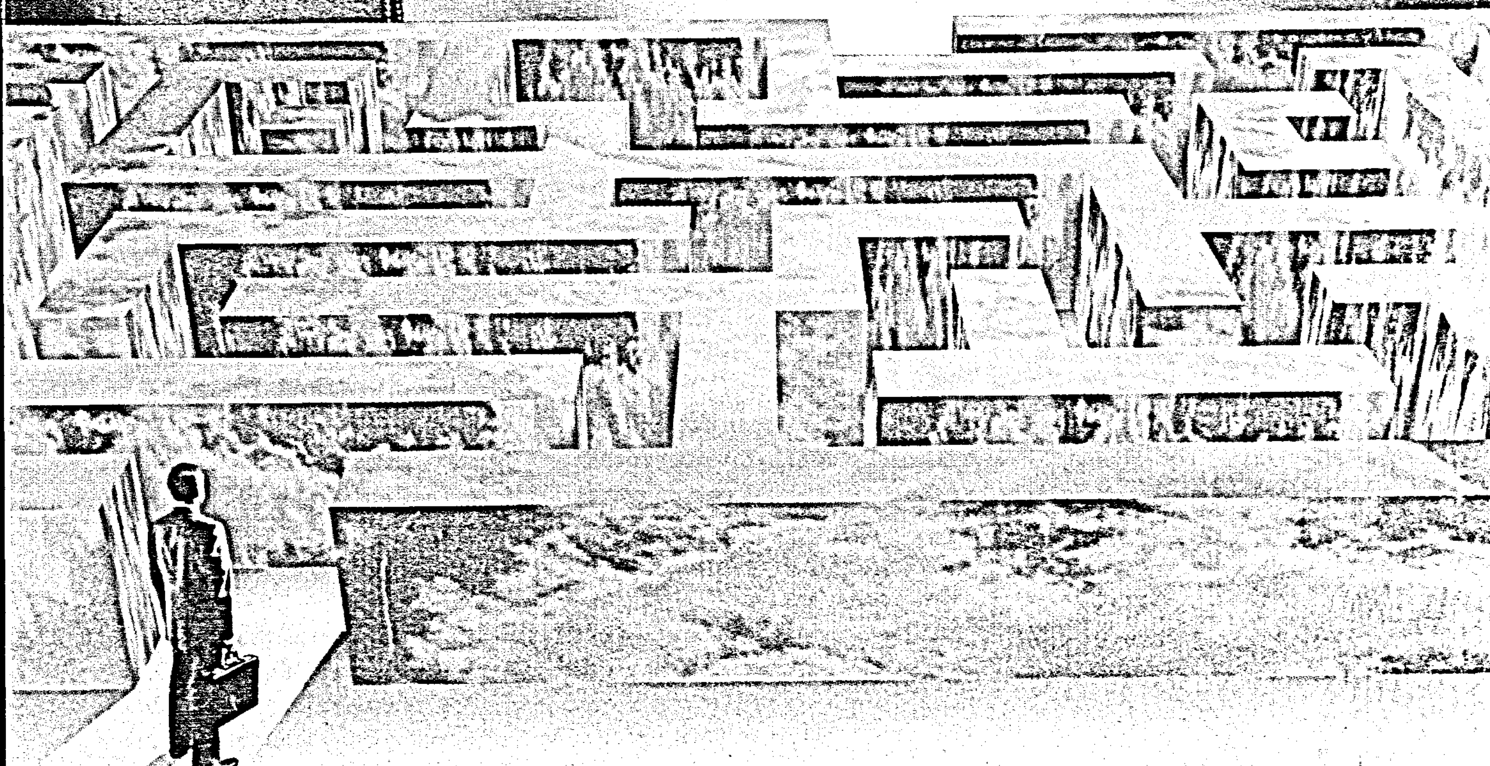
MEXICO



Finding the Funds

by Frank A. Campbell



Department of Foreign Affairs and International Trade
Ministère des Affaires étrangères et du Commerce international

Export Development Corporation

So, you've heard that selling Canadian products to Mexico is easier now than it has been for a long time. You've put together that great business plan and now you have a problem. Where will you find the money?

"One of the big pitfalls," says Ed Pelger, Project Executive from New Brunswick, "is not having adequate resources both in time and in terms of money to properly enter the market."

Fortunately, there is more good news. This is an excellent time to finance your Mexico deal. According to a Canada-based representative of a Mexican bank, "Financing is available if the risk is good."

In the words of Jeffrey L. Schneider, Bank of Montreal representative in Mexico City, "Abundant short-term export credit is available."

One diplomat based in Mexico was more guarded in his assessment. "If you compare the situation with one and a half years ago, banks are a little more cautious because of the slowdown in economic growth during the second half of last year. But if you compare it with 1982 to 1988, when little was happening, one might say this is a fabulous time."

There are many reasons for this, one of which is key: the North American Free Trade Agreement (NAFTA). Canada's two-way trade with Mexico in 1993 was nearly $4.2 billion.[1] The figure could be even higher in future since Mexico's 85 million people import US$5 to US$6 billion each month.

Numbers like these capture the attention of Canadian banks. Mexican financial institutions are also keen. Rich Mexicans who stashed their money away in New York and other northern cities during the 1980s are bringing that money back home in one of the more dramatic turnabouts in the history of international finance. In 1992, there were net capital flows of US$23 billion: that's money in search of good projects.

[1] Except otherwise indicated, monetary values are expressed in Canadian dollars.

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Growing For The Gold

Not that the way to Mexico is paved with gold. Financing may be available, but only the serious, the committed and the patient need apply.

Alf Chaiton, Vice-President, Program Development of the Forum for International Trade Training (FITT), puts it this way: "The one thing you don't want to do is to go to your banker and say, 'NAFTA's been signed. There's got to be great opportunities in Mexico. Give me a line of credit.'" He adds: "You've got to be able to demonstrate that you have a sound business plan and not pie-in-the-sky dreams."

As with domestic business, relations with your banker are important. "If you have the right relationship with your bank and if you have a good transaction, they're interested." Your Mexican partner's relations with his or her bank can also be critical.

The secret, Chaiton advises, is to remember that "you need commitment to be successful in international business." Such organizations as FITT, among other things, help to develop that commitment by Canadian firms to the international marketplace through proper preparation.

Gilles LeBrun, Director of Training and Counselling at the Federal Business Development Bank (FBDB) and Co-ordinator of the Bank's Montreal-based New Exporters Club, stresses the importance of a well-prepared business plan and a sound financial plan. "Always bring it back to the basic dollar sign," he says.

"We'll advise people; sometimes, if their projects are too big for them to handle, we warn them. Other businesses are too cautious, they should go further and they need assurance — so we're there to help them."

A Mexican bank official describes a "good risk" simply as a company that makes "good profits," has adequate assets and is growing. Peter Wren, the Toronto-based Managing Director of the Bank of Montreal's Trade Finance Division, expands: "Banks are going to look at the operating capabilities of the business, the cash flow, the quality of the principal people in the company, their experience level — and things like that." Another bank official stresses the importance of financial commitment. "They must have equity participation; then, the bank will look at the project."

Generally, knowing where the money will come from can be critical to getting the deal. One reason for this is Mexico's interest rates, which are quite high by Canadian standards. If your Mexican buyer pays for your products from an overdraft, this could mean interest rates of up to 20 or 30 percent. Regular financing could attract interest of 23 or 25 percent or more, notes Chaiton.

Mexican banks have the misfortune of paying more for capital — and the luxury of charging wider "spreads" — than their Canadian counterparts. Where Canadian T-bills fetch interest rates hovering around 3 percent, the Mexican equivalent could go as high as 11 or 12 percent.

If you can point your partner in the direction of cheaper credit, that increases your attractiveness to him or her. So, before you begin any serious negotiations in Mexico City or Monterrey, have a one-on-one with your banker and an officer of the Export Development Corporation (EDC).

Not all Mexican partners look to Canadian sources for finance. Claudio Escobar, Manager of the Mexico Division of Lumonics, Inc. of Ottawa, says that the firms in Mexico importing lasers from

Lumonics have been mainly multinationals and large Mexican companies. They all either finance the purchases from their own resources or arrange financing with American financial institutions.

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EDC - Many Services To Suit Your Special Needs

However, Escobar always brings the existence of these Canadian sources to the attention of his customers. One of the best sources he mentions is the Export Development Corporation. "Mexico," says the Corporation in its 1992 Annual Report, "is a significant market for EDC's customers. In fact, in 1992 EDC supported more than 50 percent of all visible Canadian merchandise exports destined for Mexico."

Even a commercial banker noted: "EDC is an important vehicle to provide financing for the sale of Canadian goods and services to Mexico."

According to Financial Services Officer Doug Ward, EDC is able to select from its wide range of services to provide a custom-made arrangement to suit the needs of a client. The services fit into two broad categories: insurance and financing.

In 1992, Mexico became EDC's fourth-largest insurance market as volume doubled to $324 million. The Corporation's credit insurance would protect your cash flow in case of payment default. Often, your bank will accept EDC credit insurance as collateral for lines of credit. The Corporation can provide you with export-credit, bulk-agriculture and documentary-credit insurance.

EDC can also facilitate the purchase of capital goods by providing your customer with medium- and long-term credit. A Corporation brochure announces: "For most capital goods, EDC will generally finance up to 85 percent of the Canadian supply in an export transaction."

Your Mexican customer gains access to Canadian financing through one of a dozen lines of credit EDC has established with Mexican organizations. At their peak, these lines had a total value of well over $800 million.

Most of these lines are with banks. However, there are also two with PEMEX, the state-owned oil company. Through one line, GH Bettis Ltd. of Edmonton, Alberta, sold US$281 750 worth of gas hydraulic operators to PEMEX.

An EDC line of credit with Banco Nacional de Mexico provided a loan of $1.4 million to Cementos Tolteca, S.A. de C.V. to purchase DC electric motors, related spare parts and services from General Electric Canada Inc. of Peterborough, Ontario.

EDC financing has many advantages for you and your customer. One is the option of fixed-rate financing with repayment periods varying from 2 to 8 1/2 years. Applications to use the lines of credit with Mexican institutions are processed with particular speed and ease because the terms and conditions are pre-established. An EDC document, *For Canadian Exporters: Lines of Credit in Mexico,* outlines the steps you need to take.

First, contact an EDC official in one of the EDC offices conveniently located across Canada. They will need some financial and technical data about your company and, if available, a copy of the draft commercial contract.

A Mexican bank holding an EDC line of credit will check into your partner's bona fides then send EDC an application for financing. Loans vary from US$50 000 to US$5 million. "We'll analyze the application and the transaction," says the EDC document, "and together with the bank we'll quickly indicate whether the deal can be financed by EDC."

A draft disbursement order is then sent by EDC to the bank. "You will be paid once you have sent to EDC all documentation outlined in the disbursement order. EDC pays you directly on behalf of the Mexican bank."

Your customers are also likely to appreciate the easy flow of this arrangement. Even more, they will like the interest rates. With service charges added by the local Mexican bank, the rate to your customer could be as much as 15 percent, but this is significantly lower than local rates.

Federal and provincial officials, when approached by businesses about the sale of capital goods to Mexico, believe, as one puts it, that "the best advice we can give them is to go to EDC and their Canadian bank." No wonder.

Experienced private-sector leaders, both users and non-users of EDC's funding, recommend it highly. "Use EDC," says Brent Raddysh, General Manager of the Regina-based Sweeprite Mfg. Inc., "It is a very knowledgeable organization when you are talking foreign receivables."

Ontario-based Husky Injection Molding Systems Ltd. of Bolton has relied heavily on EDC. Husky's Commercial Manager Jim Wilson notes: "They've been very competitive and extremely helpful to a lot of our customers down there. We would have had a lot of difficulties ... had it not been for the EDC."

Interestingly, even Canadian commercial banks sometimes refer clients to EDC. Although both want to do business in Mexico, their complementary interests often make them partners rather than competitors. For example, a commercial bank often provides backing for the 15 percent down payment on a deal while EDC takes care of the other 85 percent.

Your Friendly Neighbourhood Bank

In any case, EDC's medium- and long-term financing is only available for trade in capital goods. If the product you take to the market is a consumable one, your best bet is your friendly neighbourhood bank. They will put you in touch with their international centres.

Part of the good news is that your friendly neighbourhood bank, more likely than not, is interested in the Mexican financial market.

Bank of Montreal's Wren reflects on the series of events starting with the 1982 beginning of Mexico's — and the world's — debt crisis. He declares that while at least there may still be "some bumps here and there," the general view is that Mexico has turned the corner and is on its way to becoming a stable economy. "We withdrew somewhat and became less aggressive, but banks are back there now."

He adds: "Customers are going there and ... generally banks will follow customers."

Frank Fernandez of Merrill Lynch Securities notes that there is no "landrush" among Canadian and U.S. banks to establish operations in Mexico. However, a number of Canadian banks have already made a beginning by appointing representatives in Mexico. These include the Bank of Nova Scotia, the Royal Bank of Canada, the Bank of Montreal, and the Canadian Imperial Bank of Commerce (CIBC).

Most Canadian banks, says Raddysh of Sweeprite, are very helpful and have people who deal specifically with letters of credit and foreign currency transactions. "We worked with a few different banks running the letters of credit through for a Mexican deal and things have gone very smoothly."

Most experts believe that you should talk to your banker before you make your first exploratory visit to Mexico. Drop in on either EDC or someone in the international department of a commercial bank. If your branch does not have such a department, ask to be referred to a branch — or a bank — that does.

One outcome of this initial contact might be some tips on how to structure your financing. Another might be to receive a letter of introduction to the bank's Mexico representative in case your exploration and negotiations are successful and you need help putting the finances together. A third reason for this interview might be to get money to use as equity in the business. Any one or more of these outcomes could help make your future trips to Mexico more meaningful.

...you can sleep comfortably knowing that once the goods are correctly documented and shipped, you will be paid.

So We Don't Need Mexican Banks?

Of course, with the EDC providing medium-term credit and the Canadian banks taking care of short-term needs, there is no need for Mexican banks in this equation, right?

Wrong!

Even with the possibilities opened up by the NAFTA, a working paper by the New York-based Americas Society notes that Mexican banks "have enormous inherent advantages over foreign competitors, due to their existing branch networks, high name recognition and cultural familiarity with the local market."

Far from counting out the Mexican banks, you need them for at least three reasons. Take the letter of credit, or LC, the instrument through which your customer is likely to pay for your products, especially in the early stages. The establishment of an LC begins with a conversation between your customer and his or her banker.

Raddysh urges caution; he believes that a Mexican bank should be chosen with care. "It gets down to the importance of finding a reputable distributor who can arrange the financing through a reputable bank in Mexico."

He has been told that there are some not so reputable banks, "and you have to be careful about that." The advice of your partner therefore is key. "For ourselves, if we had to go in without the middle person, we would need to do our homework to ensure that we were very comfortable with all parties involved."

If, despite the letter of credit drawn on the Mexican bank, you have some doubts about getting your money, have the LC confirmed by a Canadian bank. They won't confirm the LC unless they are confident about the stability of the Mexican counterpart. In any case, by issuing the confirmation, the bank shifts the risk from Mexico to itself. So you can sleep comfortably knowing that once the goods are correctly documented and shipped, you will be paid.

Naturally, this kind of peace of mind comes at a price. But confirmation commissions are minimal, between 1/4 and 3/8 percent on the total amount and 1/8 percent for the negotiation, or payment.

Much of the business done by EDC and the Canadian commercial banks in Mexico is carried out through that country's banks. For example, the funds provided by the Mexican bank to your customers to pay for your export might come from one of those EDC lines of credit we talked about. Or a Canadian bank might lend the money to the Mexican bank.

Only Mexican banks will provide you with loans to buy real estate, for example, or to finance costs for a joint venture. Also, if your business involves the export of Mexican goods to Canada and other countries — let's say you're setting up a manufacturing enterprise there — you will find that Mexico, like Canada, has programs and agencies to help. Programs include export loans with preferential rates.

One institution you will want to learn more about is Bancomext. Despite its name, Bancomext is more than a bank: it is like EDC and the Canadian Trade Commissioner Service rolled into one.

Just as two privately owned Mexican commercial banks, Banamex and Banca Serfin, have offices in Canada, so does Bancomext, in Toronto, Montreal and Vancouver. The head of a Bancomext office is a trade commissioner, who can provide you with valuable information about doing business with Mexico.

The government-owned agency can advise on the best place in Mexico to locate your particular business. Or set up appointments for your visit to the country. Or even have someone accompany you on your interviews. All for free.

"Actually, what we are is a trade development bank," says Marcela Orozco, Assistant to Bancomext's Trade Commissioner in Montreal. The bank lends money for export promotion, to buy raw material or to expand your Mexican plant. It would also provide "buyer's credit" to a Canadian company to buy Mexican products, just as EDC would lend to a Mexican company to buy Canadian goods or services.

You can gain access to credit available to Mexican companies by establishing a joint venture. However, even a company wholly owned by you would usually be entitled, once registered as a Mexican firm.

If you think all this cash is there just for the taking, you're mistaken. As usual, it helps if, in addition to contributing technology, you have some equity, some financial stake in the business. And, as one Canadian banker puts it, "Mexican banks ask lots of questions, more so because they don't know you."

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Finding Interest Rates That Fit

Whether you're shopping for your banking services in Canada or in Mexico, there's one thing you must never forget: you pay. Interest, commission and fee payments are part of the cost of doing business, but shop around for the best rates.

Much depends on how much leverage you have. According to Bank of Montreal's Wren: "If a company is doing well, they have good cash flow and they have a unique or proven product, then the perceived risk is lower and that obviously will affect the rates."

The kind of security you can offer may also make a difference. "If the customer is willing to provide treasury bills or cash or some form of liquid security, then banks are obviously going to lend at a lower rate because the risk is much less," Wren says.

Shopping around is particularly important if you are borrowing through the Mexican banking system, where the rates and fees are so much higher. Even smaller businesses can save money if they are willing to invest the time.

One financial adviser suggests a simple strategy. Go to three or four banks and ask for bids. Tell them you're talking to a number of their competitors — and watch the results.

Remember, though, that you can get what you pay for. Rather than assuming that the lowest interest is the best, consider such factors as the reliability of the institution. As one banker puts it, "Make sure you understand the basics of pricing and be aware if lower prices are offset by lower services or increased risk."

Ironically, it is sometimes the smaller company that is in the best position to shop around for the lowest interest. A bigger company might be more concerned with such additional factors as trade services, investment advice and cash management, employee payments and so on. For a smaller company with few employees and fewer financial decisions, the cost of borrowing money might be the one crucial factor.

Little Things Cost A Lot

Talking about cost: one of the themes heard constantly from experts on business in Mexico has to do with the importance of such steps as visits, feasibility studies and exhibitions.

Asked about these preliminaries, FITT's Chaiton says: "The little things can cost a lot of money. A rule of thumb is that you will probably need up to six visits at $3000 per visit over 18 to 24 months before you can reasonably expect to have a small to medium-sized transaction."

Isn't that a bit discouraging?

"It just means you have to know what you're doing," Chaiton reassures. The competition is quite strong, so you have to work "a little harder" in the beginning. The million-dollar question is, "Can you find a market niche and can you develop a solid working relationship with a Mexican partner to take advantage of those opportunities?"

The GeoFITT Mexico program, which is a brand new private-sector countrywide training program, is linked to the Department of Foreign Affairs and International Trade's (DFAIT) NEWMEX (New Exporters to Mexico) program.

Participants save in two ways, according to Chaiton. Companies pay $1500 for the FITT training and $950 to participate in DFAIT's NEWMEX trade mission. Normally, this could easily cost as much as $5000, and an individual visitor would probably not be able to match the high-powered business program that DFAIT organizes. They also "save a few visits," he says, because of the level of contact and preparation which GeoFITT/NEWMEX makes possible.

DFAIT's Program for Export Market Development (PEMD) provides up to 50 percent of the costs for a number of activities. These range from visits and participation in foreign trade fairs to the payment of legal fees for marketing agreements and the establishment of permanent sales offices.

Businesses should take the same care in developing proposals for government funding that they do in seeking funding from private banks. However, since these agencies' prime concern is not profit for themselves but success for you, it is safer to approach them earlier in the process and even seek their help in putting a proposal together.

If you don't know where to start, talk to the people at your nearest International Trade Centre or provincial trade office. They'll point you in the right direction.

Tools For The Job

Most, if not all, provinces have agencies that provide either financial help for the ambitious potential exporter, or can put you in contact with federal agencies with such export programs as Access North America.

New Brunswick's Ed Pelger says the Department of Economic Development and Tourism works with banks and other institutions to provide interested businesses in the province with information about Mexico — and, for that matter, about other countries as well.

Other tools available to you include financing trade without resort to any financial institution; in other words, the supply of goods on "open account." But be careful.

Some of the larger Mexican firms also prefer to sell on this basis rather than tying up their funds in letter of credit arrangements. In the words of Neil Rennie, General Manager, Trade Finance Division with CIBC in Toronto: "As Mexico becomes a better credit risk and its larger companies become better known by their suppliers here, they will move away from letters of credit." However, experts warn that Canadian businesses must be very cautious about agreeing to part with their products and services on this basis.

Mexican companies have raised over $8 billion through more than two dozen international offerings since early 1991.

EDC has credit insurance programs to help exporters when selling to buyers on open account terms. The risk of the buyer not paying is mitigated under the insurance and the Canadian bank may discount receivables or provide operating lines of credit with the insurance as collateral. Close to 20 percent of the support provided to exporters by EDC in 1993 was in short-term (up to 180 days) open account transactions.

One way of getting your goods and services sold — and paid for — is to take advantage of funding available through international development agencies. There are really two ways of doing this. One is to find out what projects are being funded and to enter bids under those projects. In the case of Mexico, the World Bank, the Inter-American Development Bank and the International Finance Corporation are three good sources. So, too, is the Canadian International Development Agency's popular Industrial Cooperation Program (CIDA/Inc.).

You can take advantage of CIDA/Inc. for joint ventures or other business linkages between Canadian and Mexican companies. Depending on what you're marketing, this may or may not be a fruitful approach.

Experts point to a seldom-considered means for raising funds. It relates to the growth of the Mexican capital market. Mexican companies have raised over $8 billion through more than two dozen international offerings since early 1991. Canadian financial institutions have not been very active in this area and interested companies might have to work with some of the U.S. securities firms such as Lehman Brothers, Goldman Sachs, and First Boston.

If you're interested in this method, visit a reputable investment house firm. Needless to say, this form of raising capital is more easily available to a large, well-known Canadian firm than to one making its debut in the international arena.

Safety First

Whether your company is new and small or old and large, David McFadden, of the Toronto law firm Smyth, Lyons, Torrance, Stevenson and Meyer, suggests that legal assistance be a high priority. This does not mean, he says, that you "necessarily have to have lawyers with you every moment of the day," but it is wise to be advised of pitfalls before it is too late. "I have heard some horror stories where people had gone out and been entertained by Mexicans, only to have been presented with agreements that weren't what they expected."

Getting the advice of a good tax accountant seems to be a sensible idea, although McFadden describes as "helpful" the fact that Canada has a tax treaty with Mexico. "I've got to tell you the laws there are changing so fast — the investment law, the tax law, the environment law. They're really changing monthly so you have to keep up-to-date to know where you stand."

Good insurance is an important element in your protective equipment, especially when you start shipping products or providing services. EDC, of course, has an extensive menu of coverage; nonetheless, you should shop around. Take time. Check. Here, as in Mexico, you need to make informed decisions before spending your money even — or especially — if it's received on credit.

One of the great things about doing business in Mexico today is that there are no exchange control regulations. And the repatriation of profits seems not to be a problem. But get good legal and accounting advice.

Small Is Beautiful?

How does all of this advice apply to small businesses? Is the Mexico game too big for the small firm? Most people in the field seem to think not. In fact, it would be a great pity if such firms were to be excluded since small and medium-size firms are one of the main driving forces of the Canadian economy.

One expert believes the crucial consideration is who the buyer is. If a small Canadian firm is exporting to a small Mexican firm, "everyone gets nervous," he says.

Not necessarily so, thinks Bank of Montreal's Jeffrey Schneider. "Any size company can access EDC's programs or take advantage of the services of a Canadian bank." He explains that "for a letter of credit our risk is the Mexican bank, not the Canadian exporter."

Wren admits the kind of profile — cash flows, experience, and so on — that makes a company attractive to a bank may be difficult for a new company. Where that company represents the "risk" to the bank, "traditionally they'd have to put up some other form of security — cash deposits; could be bonds; could be a mortgage on the house, the property, the business; inventory, receivables — things like that."

EDC seeks to help small businesses in many ways. It does this, for example, through the lines of credit awarded to Mexican financial and other enterprises

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and by lowering the minimum loan size to the smallest permitted by arrangements with other export credit agencies. EDC's Small Business Insurance also supports exporters selling to Mexican buyers on open account or irrevocable letter of credit terms.

Many programs introduced or supported by the Canadian government to promote business with Mexico tend to attract mainly small and medium-sized enterprises.

Some people believe that small size might be a distinct advantage in certain cases. When you become big, they tend to ask why you can't finance yourself. For small companies, the opportunities are greater.

Marcela Orozco of Bancomext, however, boasts: "We can help people — from those who want to open a mom-and-pop operation to large corporations."

Don't Reinvent Mistakes

What small companies cannot afford is to repeat the financial and other mistakes of others. In fact, this is true of all companies.

There may be enough money floating around for investment. But in the tough nineties and in Mexico's costly credit market, there is not enough to squander in the costly exercise of reinventing the bad judgement of your predecessors. Jeffrey Schneider advises: "Learn as much as you can from both success and disaster stories of companies that have gone before."

This advice is crucial. No, the road is not paved with gold. Access to the Mexican market and to sources of funding requires studious diligence, great patience and plain common sense. But with these attributes and a little good luck, you may find the effort worth your while.

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