

International credit guarantees and credit analysis¹

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ABSTRACT

This study aims to demonstrate the practices of international credit guarantees, credit analysis and financial institutions requirements in Brazil if the company that is requesting the credit do not present or have weak financial books. As this situation depends on the context, the lender can provide facilities in reason to obtain credit granting, but can also create difficulties to a particular company that requests lines of credit to several business purposes. A case study was done in a French multinational manufacturer of machinery and equipment for the beverage industry. It was verified that the company A belongs to the same economic group of the companies B and C, that caused difficulties in the approval of credit lines due to environmental problems of company B and the high volume of credit demanded by company C; however, the Comfort Letter presented by Financial Holding D was a decisive factor to the financial institution credit decision. The power of bargaining of the economic group through its operation volume was a decisive factor to the flexibility of credit analysis, although the companies policies of the economic group are restrictive in the presentation of accounting and financial information to third parties. Thus, as a solution, it proposes that the holding company of the economic group offers guarantees so that it supports the credit risk of the economic group.

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KEYWORDS

Credit analysis. Comfort letter. Stand by letter. Credit guarantees. International credit.

INTRODUCTION

In Brazil, the acquisition of a foreign bank by a national bank in 2016 has brought several operational and financial issues for some clients, mainly due to system migration errors and operational process changes.

Companies that had a solid relationship with the foreign bank, in commercial and systemic migration, several agreements, procedures and fees previously agreed upon, have become invalid as of the migration occurred in October 2016.

One aspect of great operational and financial impact for clients was the change in the national bank's credit policy and credit analysis, whether due to the conservatism of the local bank, the lack of similarity with international collateral practices, or even the understanding and Legal limitation of Brazilian legislation.

A company with the fictitious name of Mondex Brazil, has its headquarters in France, with up level a holding company in Switzerland, had its guarantees suspended by the national bank and its credit limit was immediately canceled, impacting its cash flow, because the company strategy is to be financed by third capital, and also the Holding company's overall strategy, all subsidiaries in several countries of the world should be leveraged and financed by bank loans.

The cancellation of the limits by the bank also occurred with the other three sister companies in Brazil, although these were less impacted because they have relationship with other banks and other credit lines, a fact contrary of Mondex Brazil, which had only one account in this foreign bank, which was incorporated by the national bank.

Securato (2007) explains that in order to mitigate credit risks and their impact on financial institutions, banks created the Basel Committee in 1974, formed by the central banks of the member countries of the Group of 12 (G-12): Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Spain, Sweden, United Kingdom and United States.

An important improvement of this group was the introduction of a capital measurement system called the Basel Agreement, which forecasted the introduction of a credit risk measurement system and the adoption of a minimum capital limit to be maintained by the banks, and 8% of the risk-adjusted assets of the institutions.

The merit of the agreement was widely recognized in the 1990s, and its indications have come to be accepted by more than 100 countries.

Ong (1999) states that the first objective of the Basel Agreement was to make the international banking system stronger and more stable by creating a minimum standard of risk based on adequate capital for the portfolios of each financial institution, thus reducing the risk of the financial system without compromising competitive differences between countries.

The 1988 agreement was not the first to attempt to regulate risk at banks. In the 1970s, US market regulators tried to regulate this segment, although the concept of minimum capital ratios was not yet used. In the 1980s, regulators became more concerned about capital ratios, mainly due to the reduction of the financial indices of the country's main banks.

The main objective of capital regulation is to prevent lapses and to increase the credit risk of financial institutions, since, in order to reduce the number of bank failures, a sufficient amount of capital must become a reserve in order to absorb future losses that can occur, thus protecting and reducing the losses of depositors and creditors in the event of bankruptcy.

For Alexander (1998), the easiest way to reduce the probability of credit risk is for the borrower to be guaranteed by another company, the borrower and the company being independent of each other, thus greatly reducing the risk of default. Generally, the guarantees are made by the parent companies to their subsidiaries. "The purpose of the guarantee is to prevent unforeseeable factors occurring after the granting of the loan, making it impossible to settle the loan" (SANTOS, 2000, p. 33).

The bank credit, in its various forms, is granted to the borrower, taking into account trust, merit and opportunity, and trust is the basis of all credit operations, because it is through it that the borrower is expected to present

credit analysis, and will subsequently make the agreed payments; as regards merit, it is understood that any suitable and balanced company deserves credit and the opportunity refers to the win-win game, in such a way that the operation is profitable for the bank and advantageous to the customer/borrower (BERNI, 1999).

The entity under study was chosen due to practical issue handle for the authors in the laboral activities, since it presents the central problem addressed in it. Gil (2008, p. 94) states that in this method, “the researcher selects the elements to which he has access, assuming that they can somehow represent the universe”. In order to preserve the identity of the company, the fictitious name Mondex Brazil was adopted. This is a Brazilian branch of a multinational company operating in the beverage industry equipment segments, which was established in Brazil in 2013.

CONTEXT AND INVESTIGATED REALITY

According to *El País* (MENDONÇA, 2016), in Brazil, after a period of a few years of euphoria and economic optimism during the Lula and Dilma governments and after a series of corruption and economic deceleration scandals, the country entered a recession, commercial activities declined, the level of default increased. Companies' credit risk increased, causing financial institutions to tighten credit analysis.

Mondex Brazil, based on the guidelines of its parent company, works with its highly leveraged operation through bank loans.

The loans requested to the foreign bank were supported by a Comfort Letter issued by the Group's Holding in Switzerland, and the entire operation of the holding subsidiaries worldwide was supported by this negotiation.

With the incorporation of the international bank by the national bank, the credit limits were canceled impacting the operation of the company Mondex Brazil.

The Brazilian bank's justification for canceling all the credit operations of the affiliates here in Brazil was that the guarantees submitted previously were linked to the bank's parent company abroad, and with the merger of

the bank, these guarantees were not transferred to the new parent company. National bank, with new operations, and the amounts already taken were without credit guarantees.

A particularity of the companies that belong to the economic group of Mondex Brazil, is the prohibition on the part of the Holding in presenting and divulging any type of financial information.

Among these companies is Mondex Brazil (fictitious name), a French multinational active in the segments of equipment for the beverage industry. In 2013, it established a branch in São Paulo to execute the projects on its global relationship clients installed here in Brazil.

DIAGNOSIS OF THE PROBLEM AND/OR OPPORTUNITY SITUATION

Established in Brazil, Mondex Brazil used all the infrastructure of its affiliates and the guarantee support already established to its affiliates offered by the Holding in Switzerland, including the bank account was opened in the main relationship bank of the economic group.

Whether through Basel, or Internal Credit Policy, the national bank for the purpose of conducting a new credit analysis, requested for Mondex Brazil its financial statement for October 2016 and the Balance Sheet and Profit and Loss Account for 2015, as well as the related companies, the consolidated reports of the parent company in France and the holding company in Switzerland.

The first impasse faced by Mondex Brazil was the restriction in the presentation of its financial and accounting statements, as well as in the disclosure of the information of its affiliates and parent company, since they are limited companies and do not have the mandatory disclosure of the financial statements to the market.

Another problem presented by the national bank was that the credit analysis should be carried out in full by the economic group, not only taking into account the needs of Mondex Brazil, as well as the values demanded by the related companies are much higher than values claimed by Mondex Brazil, the credit analysis of the economic group will be even more careful and conservative.

There is also a legal case of a related company related to an environmental liability, which may prejudice the economic group's credit analysis.

To obtain credit in a financial institution, several documents are requested from the company by the bank, including the entity's financial reports, as, according to Matarazzo (2010, p. 79): "The financial statements comprise all transactions carried out by a company, translated into currency and organized according to accounting standards".

Financial institutions use some credit risk classification models in their lending processes that assign certain parameter measures to measure their default risk, which is the main indicator of the debtor's ability to pay its debts (BRITO; ASSAF NETO, 2008).

Santos (2000) clarifies the credit C's that must be taken into account in a credit analysis:

- *Character*: indicates the intention of the borrower to honor the obligations assumed, being identified by the creditor through commercial references, consultations and analyzes of credit agencies and companies, such as Serasa, SPC among others, and by the Concerned.
- *Conditions*: are the external and macroeconomic factors in which the company is inserted.
- *Capacity*: means the entrepreneurial capacity of the people who integrate the company, as well as the potential to produce, market and the ability to pay according to the cash flow that the business activities provide.
- *Capital*: the assets and resources that the company has in its financial structure.
- *Collateral*: are the guarantees presented by the borrower of the credit to the creditor.

There is also the conglomerate, which expresses the need to consult and analyze the economic group to which the company belongs, since some financial impact on any of them can be reflected in the payment capacity of the credit borrower in question.

The verification of the six C's of credit as we have seen previously goes much further than the analysis of documentation and financial and

accounting numbers, and especially during the credit visit many subjective aspects are taken into account, and this ends up being the analyst's day to day of credit when in the field, and this sensitivity is the main differential of the credit professional.

According to Berni (1999), it is usually classified the credit concession in two basic characteristics of risk, being the risks of first category and the risks of second category. First-category risks are those in which operations are backed by collateral, generally backed by collateral, which are generally relatives, partners and administrators of the borrowing company. The risks of second category are those that are covered by collateral, whose value is equal to or greater than 125% of the credit granted.

For Shimko (1999), financial institutions are increasing the management of credit risk, mainly by exposing the risk of the portfolio of companies, and the macroeconomic and industry factors as a whole have a direct impact on this analysis, making risk composition of the market and by the level of loss expectation and risk capital. The expectation of losses is the basis for the management of the reserve policies, since the greater the expectation of loss, the greater the reserve should be, which in turn directly influences the cost of the operation and if the credit policy is adequate. Therefore, the diversification of business segments and portfolios helps reduce the risk of losses on financial institutions.

SITUATION-PROBLEM ANALYSIS AND RECOMMENDATION

Mondex Brazil requires third-party capital financing to support its cash flow, but due to the company's internal compliance restrictions, it is not allowed to present its financial statements, nor of its affiliates and parent company.

Even with efforts to negotiate longer payment deadlines with suppliers and ask customers for payment advances, according to the cash flow forecast, in mid-December 2016 there will be a cash shortfall and consequently will not be able to honor with the obligations with suppliers, employees and the tax authorities.

Thus, analyzing the need for the company to obtain credit for working capital, the internal policies of the economic group of Mondex Brazil and

the policies of credit analysis practiced by financial institutions, the following solution is recommended: The Holding/Headquarter should:

- issue a Confort Letter and a Stand by Letter of Credit endorsed by an international bank to serve as guarantee in obtaining credit, thus being little relevant to the analysis of corporate or fiscal financial reports;
- provision of mobile or real estate guarantees by the parent company in a way that supports the credit risk of Brazilian banks.

By adopting one of these measures, the national bank would grant the credit because the client's risk of default, measured on the basis of the financial reports, would be mitigated by the guarantees given.

Such procedure will allow the granting of a credit to Mondex Brazil and its sister companies, however, there will be an increase in financial expenses due to the Stand by Letter of Credit rates guaranteed by an international bank.

While the credit analysis by the national bank is not finalized in order to avoid default by Mondex Brazil, it is recommended that the parent send an intercompany loan to Mondex Brazil.

TECHNOLOGICAL/SOCIAL CONTRIBUTION

This technological report aimed to study the means for a company that has the same characteristics as Mondex Brazil to be able to obtain resources within the country to conduct business and foster jobs, helping economic and technological development in the national market.

The current economic situation in Brazil and the credit scenario of financial institutions have declined sharply, leaving the credit analysis even more conservative due to the increase in credit risk.

In a globalized world it is important that companies in general have knowledge of the forms and instruments negotiated in international standards, because in this way there will be a greater promotion of business and the generation of value.

CONCLUSION

Regarding the granting of credit by financial intuitions, it is suggested that, in order to take decisions on the granting of credit, an analysis and reflection should be made not only of the entity's accounting and tax reports, but also of any context and qualitative aspects of the project in which the company is inserted.

Also, this study contributes to international practices of credit support that is common in the international business environment, sometimes uncommon here in Brazil.

Finally this technical report showed that the analysis of relations between related parties can facilitate, on the one side, when there is one of the parties with a great bargaining power to the extent that it supports the guarantee of a credit operation, and on the other hand, any company in the economic group has any restriction on the granting of credit, all affiliates of the economic group may be prejudiced in their analyzes and operations.

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RESUMO

Este estudo tem como objetivo demonstrar as práticas de garantias internacionais de crédito, análise de crédito e requisitos de instituições financeiras no Brasil se a empresa que solicita o crédito não apresenta ou possui livros financeiros fracos. Como esta situação depende do contexto, o credor pode fornecer instalações em razão de obter concessão de crédito, mas também pode criar dificuldades para uma determinada empresa que solicite linhas de crédito para diversos fins comerciais. Um estudo de caso foi feito em um fabricante multinacional francês de máquinas e equipamentos para a indústria de bebidas. Verificou-se que a empresa A pertence ao mesmo grupo econômico das empresas B e C, que causou dificuldades na aprovação de linhas de crédito devido a problemas ambientais da empresa B e ao alto volume de crédito exigido pela empresa C, no entanto, a Carta de conforto apresentada pela Holding D foi um fator decisivo para a decisão de crédito da instituição financeira. O poder da negociação do grupo econômico por meio do volume de operação foi fundamental para a flexibilidade da análise de crédito, embora as políticas das empresas do grupo econômico sejam restritivas na apresentação de informações contábeis e financeiras a terceiros. Assim, como solução, propõe que a holding do grupo econômico ofereça garantias para que ela suporte o risco de crédito do grupo econômico

PALVRAS-CHAVE

Análise de crédito. Carta de conforto. *Stand by letter*. Garantias de crédito. Crédito internacional.

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