Alternative Cross-Border Financing for the Middle Market

An Interview with David Hu, Managing Partner and Co-Founder of IIG Capital

IIG Capital is focused on providing middle market and smaller-sized companies with alternative forms of short-term financing for qualified trade-related and commercial finance transactions. Its financing solutions have been used to supplement traditional bank financing or on a stand-alone basis when traditional financing has not been available. Through its varied and international background and experience, IIG Capital's management has applied its knowledge and expertise to develop customized financing solutions for a wide range of trade finance scenarios.

David Hu is one of the founders of IIG Capital. With over twenty years of experience in finance, cross-border transactions and emerging markets, Hu shares his perspective on cross-border financing and how his firm works within this market.

Q: What is IIG Capital's specialty?

Hu: Although IIG Capital is actively involved in all aspects of domestic and international trade finance, we specialize in cross-border trade finance, focusing on the financing of the sale of goods and services from country to country. Specifically, we focus on the sale of commodities, financing their movement from emerging markets to developed countries. Our customers are typically middle market and smaller sized companies and include importers in developed countries, exporters in emerging markets, and traders. As such, financing cross-border transactions is an important part of IIG Capital's product offerings and capitalizes upon IIG Capital's core expertise — the emerging markets.

Q: Why does IIG Capital focus on emerging markets?

Hu: We view the emerging markets as one with vast potential for trade finance as these countries generally have a greater need for the type of financing in which we specialize. Over the last few years, overall capital flows have decreased dramatically and, as a result companies in emerging markets are facing larger gaps in the capital needed for financing. The situation is even more dire for smaller companies. This creates significant opportunities for IIG Capital. While other institutions may shy away from transactions involving these countries, we gravitate towards these markets. Our team has been closely involved in these markets for decades. Combining our experience with a vast network of local relationships facilitates our ability to conduct quality business in these countries.

Q: What industries does IIG Capital target?

Hu: We do not target any particular industry because our approach is very opportunistic. Rather, we typically target market segments involved in commodities. Generally speaking, when we structure deals, we often take title to the goods and commodities are typically easier to liquidate in the case of default. We avoid financing perishables. We also avoid financing live animals because we do not want to expend additional resources to keep them fed and in good shape until they can be sold. In other words, we will not finance any collateral that eats. In addition, we can also provide receivables financing. However, we avoid financing government receivables of any sort. If there is a dispute of any sort, we are not equipped to deal with the government bureaucracy involved in sorting things out. Aside from those few areas we avoid, there isn't much that we would not consider financing.

Q: How are your transactions structured?

Hu: There is no standard recipe for trade finance transactions. We believe each one is unique. We will work closely with the company in structuring the transaction to best fit its needs while mitigating risks. We don't follow a boilerplate approach and extend credit just for credit's sake, which is the typical approach banks employ. Our process starts with a solid understanding of the client, its business, finances and character, followed by the details of the transaction and a full evaluation of the risks involved. For example, let's consider a credit-worthy Argentine company who exports juice concentrates to U.S. multinationals. Up until last year banks would have provided credit to the Argentine company. However, given our understanding of the risks of doing business in Argentina, our approach is completely different. We would finance the export of the concentrates, including the warehouse and shipping phases. In both cases, we will have title of the juice concentrates until released to the U.S. multinational. Because the U.S. company has an acceptable credit rating, we will take the payment risk on the accounts receivable.

Although we are financing an Argentine company, we have transferred the sovereign risk of the transaction from Argentina to the U.S. In terms of credit risk, we have also

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transferred it from the Argentine company to that of the U.S. multinational company.

Q: What kind of due diligence do these transactions require?

Hu: No matter who we are working with, our mantra is "Know Your Client". We start out by looking into the history of the company, the character of its management and the company's standing within the industry as a whole, which we obtain through bank and trade references. We will review their financial statements — all of these are the usual banking procedures. In fact, information requested on our credit application is very similar to what banks request. But that is where the similarities end. Whereas banks have rigid credit underwriting guidelines, IIG Capital actually expects clients to be weak credits. Otherwise, they could go to a bank. IIG Capital focuses on the client's ability to conduct its core business and complete transactions because our focus is transactional. In other words, we finance transactions; we don't necessarily finance the client's overall working capital needs. We mitigate the client's lack of good credit by transferring the risk to either the goods or the ultimate buyer of the goods.

We also use the due diligence process to determine whether the client is real because the single most significant risk we face is fraud. Just recently, there was a $600 million metals trading fraud perpetrated against several major U.S. and international banks. Our due diligence procedure, designed to guard against such occurrences, can take as little as a couple of weeks to as long as two to three months. The time needed depends largely on the quality of the information available about the company. Once the initial due diligence on the client is complete, we determine the most appropriate structure for the transaction, which may identify discrepancies in the business flow of the client. Although our due diligence process is extensive, it is less bureaucratic than a typical banking situation because we are smaller, more focused and more nimble than most banks. The client can also speed up the due diligence process by providing transparency and disclosure.

Q: Where are the opportunities for this type of financing?

Hu: There is a wealth of opportunity in specific regions of the world and within certain industry segments. For example, in Latin America, as a region, there is access to financing exports by banks and government agencies, but there are also many companies, industries and countries in distress that don't have access to such sources. The opportunities lie in being innovative and flexible enough to providing clients with transactional financing without taking on the risk inherent in direct lending. Additional opportunities exist with traders, exporters or importers dealing in commodities that do not have access to enough bank financing. Therefore, they are more likely to accept terms that ensure that the transaction is done with substantially less risk than the circumstances might suggest.

Q: Who are the major players in cross-border trade financing?

Hu: Banks have always been the major players in trade finance and still are, but IIG Capital works with an important segment of the market that banks generally stay away from. These are not necessarily lower quality clients or transactions, but banks, given their rigid approach, may perceive them as such. Because we structure these transactions to mitigate risks, we are also able to generate a better return and risk profile on these transactions than a bank typically can.

Q: What kind of competitive advantage does IIG Capital have compared to other financiers and factoring companies?

Hu: With respect to banks, they are going to be increasingly hindered by the Basel II Accord from the Bank of International Settlements, which will translate into substantially higher cost of capital in doing business with smaller merchants and in emerging markets. On the other hand, most domestic financiers and factoring companies maintain a regional or industry focus. Moreover, many of them are only interested in doing business within the U.S. and most generally do not do structured transactions.

By contrast, IIG Capital's flexibility in doing both factoring and structured transactions allows us to exploit opportunities in both of these areas. Maintaining a global approach is also a source of competitive advantage by yielding a broader array of opportunities so that we can focus only on those deals that provide the appropriate risk/return profile. ■

David Hu is Managing Partner and co-founder of IIG Capital, LLC. Prior to co-founding IIG, Hu served as Managing Director-Head Trader of Emerging Markets Fixed Income at Smith Barney, Inc. and Nomura Securities International, Inc., and Senior Trader of LDC debt at American Express Bank Ltd. In these capacities, he had significant involvement in the trading and sales of emerging markets debt and related instruments and the management of substantial proprietary portfolios. He also played a significant role in the underwriting of numerous transactions on behalf of corporations, financial institutions, and government entities. Previously, Hu worked at Mellon Bank N.A., where he structured cross-border trade transactions and served as an analyst in the bank's Metals and Mining Credit Group.

Hu holds an MBA in International Management from The American Graduate School of International Management. He earned his undergraduate degree in civil engineering from the University of San Carlos in Guatemala.