FINGERTIP
TRADE LIMITED

Managing the Risks of International Trade

Who is this briefing for?

You should read this briefing if you are responsible for planning and delivering the export strategy in your company. You should make sure that the information in this briefing is read by your sales and marketing force, your finance management team, your credit manager and the sales ledger controller.

What does this briefing tell me?

If you want to exploit the export potential of your business, this briefing will help you put in place procedures to minimise the risks involved in international trade.

What types of risks will I have to manage?

Customer Risk:

You will need an assessment of the credit worthiness of your customer. This should include checking the following:

- the identity of your customer. Do they exist as a legally established business in the country of import? Are you dealing with someone who has the authority to bind your customer;
- the usual period of credit offered in your customer's country;
- the credit limit you are prepared to offer your customer;
- the trading history of your customer. Are they a prompt payer? Have there been any changes to their normal payment patterns?
- are your exports compatible with your customer's normal business profile?
- can your customer pay the bill?
- insolvency. Remember that a customer's insolvency can involve you in a pre credit risk, where losses can occur if your customer becomes insolvent during the manufacturing process or at any time before or after the despatch of the export consignment.

You can obtain the information needed to carry out these checks either yourself or through a reputable credit agency or credit insurer.

Country Risk:

As well as your customer, their country can pose separate risks that you will need to manage. Country risks traditionally fall into five areas:

- sovereign. The willingness or ability of the government to pay its debts. This is affected by the political climate within the country (the legislature, judiciary and government institutions); internal and external threats to the country; international trading performance including balance of payments record; the level of national debt and the amount of foreign exchange reserves. Other political decisions can also frustrate your export sales; these include the imposition of embargoes, tariff or other quotas, and import or export restrictions.

- private. The ability of the private sector to pay for its imports. This situation is affected by the state of the domestic economy, the commercial institutions in the country, and the competence of banking and financial services sector.
- natural. Some regions of the world suffer from regular climactic catastrophes (for example annual flooding, drought, earthquakes and other disasters). When these occur they can severely disrupt the operations of both the business sector and the government.
- fashion and finance. International trading patterns often create a fashionable region or country as an export market. In these circumstances trade finance is often readily available, allowing you to offer good credit terms to your export customers. However, fashions change and countries can quickly go out of favour for both exports and trade finance.
- other. These include transfer risks such as the inconvertibility of the local currency; transaction risks such as late or non-payment, and transition risks for emerging markets where the threats are the effectiveness of the liberalisation programme, failure to complete economic structural reforms and any possible destabilising influences.

Credit Risk:

Perhaps the first question you should ask is 'Can I afford to give my customers credit?' To decide how much credit you are prepared to advance you must consider :

- the amount of credit outstanding in your trading accounts, both overseas and domestic;
- what do you know about your customer and what is the maximum amount of credit you should NOT exceed;
- can you carry any financial shortfall? What will be the impact on your business if your customer delays payment or does not pay at all?
- how will you finance the credit period you offer? This means do you have sufficient money to allow you to offer credit terms in export sales contracts as part of your business cycle.

Foreign Exchange Risk:

When you trade internationally you will most likely be dealing in more than one currency. This means you are exposed to fluctuations in the foreign exchange market. You can learn how to manage this risk by referring to the set of SITPRO Briefings on International Payments.

Other risks:

If you manufacture goods to order you must include in your export strategy a contingency that will help you manage the risk of a frustrated export - this is when your customer refuses the goods. You should have a plan to either resell the product to another market or realise a salvage value for your goods.

You must also have procedures in place for the collection of your invoice amount. Under your contract you may have to collect your money in your customer's country. This does have its risks as collection maybe more uncertain or expensive, so you will have to consider the legal system in their country. Your contract may, however, allow you to take legal steps to recover your debt in another country, including your own.

How do I manage these risks?

You can do the job yourself or employ the services of a comprehensive credit management and insurance provider. If you decide, for sound business reasons, to do the job 'in house' then you must have the resources and knowledge to:

- gather credit and other trade information about existing, and potential, customers;
- research the country and associated risks;
- examine the need for credit insurance, identify the most appropriate policy and investigate competitive products and services;
- manage the credit insurance policy and maximise any benefits

If you decide to go down this route, you will have to consider the financial and other impacts on your business. These include senior management ownership of the credit management strategy; the allocation of sufficient time, resource and money to do the job, and a review of your export catalogue prices.

You must remember to include the costs of 'in house' risk management and extending credit terms in your export quotes. Otherwise, a profit can soon turn into a loss as administrative costs eat into your bottom line.

What types of risk management and insurance services are available?

Classically, these are the approaches adopted by the business sector, based on the pattern of trade of the exporter.

Type of business

- supplying goods to markets and customers on a regular basis;
- a large 'one-off' sales contract;
- the supply of capital or semi-capital goods for major overseas projects;
- the provision of services such as surveys or feasibility studies;
- smaller or new exporters.

Products and services

Depending on your type of business, the following products and services are available to you:

- a partnership with a Credit Insurer to identify and assess your business prospects and cover the risks on your exports. The service can be tailored to meet your needs, by covering all your sales ledger, or just your accounts with larger customers, or by having a geographic limit, or by product line, or indeed in many other ways;

- a specific insurance policy structured for a particular deal. Such a policy will take into account any factors unique to the sales contract which is being covered. Specific policies are ideal for contracts whose size or duration fall outside the normal pattern of your trade. Also they are suitable for the sale of capital or semi capital goods on extended credit. Insurance for individual contracts can be obtained from credit insurance companies but the main supplier of this service, particularly for capital goods contracts, is the Export Credits Guarantee Department (ECGD);
- smaller or new exporters can use a Managed Credit Insurance scheme as a way of contracting-out the credit control functions (obtaining country information, checking customer details and credit limits, chasing overdue payments and making claims). The cost of these services are often included in the premium for the scheme.

Where do I obtain these services?

You can approach specialist credit management and insurance providers, or your insurance adviser (broker, agent or intermediary). A list of credit insurance companies can be obtained from SITPRO, British Chambers of Commerce and the Association of British Insurers. Details of specialist advisers can be obtained from organisations such as the British Insurance Brokers Association.

With their worldwide networks credit insurance companies have years of experience and expertise in analysing and covering the risks involved in international trade. In addition to covering commercial debts and indemnifying you if your customer fails to pay, they can provide you with guaranteed cover which could improve your cash-flow, provide confidence to maximise your export sales and may enhance your borrowing power.

The use of credit insurance imposes on your company a disciplined and professional approach to trade risk management. Adopting this solution can help reduce your bad debts, improve your competitiveness in the global marketplace and increase your profitability.

Are there any other options open to me?

There are other financial solutions to you credit management risks:

- do nothing, and carry the risk yourself. The extent of the risk you are prepared to take will determine if this option is appropriate;
- factoring or invoice discounting;
- forfeiting;
- secured payment terms (for example, Letters of Credit);
- insurance-backed financial packages.

How much will it cost me?

Like all insurance cover (premises, employer's liability, business interruption) you will have to pay for your risk management and insurance services. Policies based on a specific risk are available and premium is usually on a 'one-off' basis. Premium is calculated according to the specific risk in question, credit period offered, your customer's country and the duration of the risk from the insurer's perspective.

There are also credit insurance policies and managed schemes that will cover all of your export turnover. Premium is usually annual and assessed against your estimated insurable turnover (the sales on credit covered). With your credit insurer you will have to agree your target export turnover for any one year. Typically, you can expect to pay between 0.35% and 0.65% for this type of policy, dependent on your products, the number of customers and range of your export markets, your export trading experience, and your own credit management system. As with all insurance cover, you should spend time researching the market and getting quotes from a range of credit insurance providers.

The costs quoted are based on typical policies available for small or new exporters wishing to cover sales with fairly short delivery and payment profiles. Costs will rise for specific policies where the horizon of risk for the insurer might be 2 or 3 years as in the case of ECGD cover for capital goods projects.

Conclusion

Credit insurance is an important risk management tool to help you protect the payment of your overseas accounts and unlock the full potential of your export business. You should carefully consider including it in your global trading strategy