Credit Management – Beyond our Shores

For those considering expanding their business overseas, one should be aware that export credit is more risky and expensive. Josef Busuttil shares his expertise on how to manage the situation.

> “Granting and extending credit carries an element of risk, the risk of customers paying late or not paying at all”

‘Alas, my fortunes are all at sea’.

‘The Merchant of Venice’ by Shakespeare was so right in 1597, but even more so today considering that we live in a globalised economy where the world has truly become one big market.

International trade is inevitable in today’s economy. One country depends heavily on others more than ever before, as modern countries are specialising in their particular industries and are becoming less self sufficient in order to benefit from economies of scale.

This commercial scenario entails firms to be more vigilant and competitive in order to meet customers’ changing needs and expectations at an international level. Therefore, successful firms are investing in producing and providing goods and services that add value to customers, whilst customers are constantly shopping around for the best products at the best prices. Hence, firms are committed to sell on credit to gain and sustain competitive advantage in their markets, as credit is in demand by customers.

Nevertheless, firms that sell on credit argue that credit is not only risky but also expensive. Granting and extending credit carries an element of risk, the risk of customers paying late or not paying at all. Credit also costs money to granting it, managing it and completing the credit sales by collecting the money from the customer efficiently.

Granting credit to foreign customers when exporting goods and services is even riskier and more expensive. Other factors have to be factored in the exporting business equation – a longer cash cycle, increased risk of the foreign market, limited control over the foreign customer base, different culture and legislation, and bureaucratic payment methods may also be the case. Exporting to a developing country carries more risks and costs than exporting to a developed country!

Therefore, export credit requires more resources in terms of additional working capital, to finance the longer cash cycle as well as skilled and competent credit practitioners to manage it effectively and profitably. Foreign agencies and intermediaries may also be hired to ensure the smooth running of export business transactions. But all this comes at a cost to the exporter.

One may think that an exporting firm can increase the price of its goods to compensate for the extra risk and cost involved in export credit sales, but this may not always be possible due to competitive pressures. Hence, the firm should be better equipped to minimise the risks and costs involved in export credit sales, and this requires good credit management practices and procedures which may consist of the following:

a. Asking the customer to complete a credit application form is critically important in export credit sales. This ensures that the exporting firm obtains all the required details about the foreign customer. ▶

b. The exporting firm should then verify the details provided by the customer and not only analyse the credit worthiness of the customer but also evaluate the market and political risk of the country where the customer operates. Obtaining a credit rating report from a reputable credit rating agency is always commendable prior to granting credit.
c. Once all the details of the customer are verified and the necessary information is obtained, the firm should then analyse the ability of the customer to pay and the country's associated risks, which may include political, economic, infrastructural and technological risk amongst others.
d. Based on the customer's analysis and the cost of goods at point of sale, the terms and conditions of sale should be determined by the exporting firm. These terms and conditions should be made clear with each and every foreign customer to ensure that both parties are well aware of their obligations and responsibilities towards each other. Making terms and conditions clear would minimise future disputes and encourage repeat sales by the customer. Thus, minimising the cost of future sales and increasing long-term profit through customer retention.
e. Besides the terms and conditions of sale, the firm should also reach a payment agreement with the customer. This would involve the currency of payment, the method of payment to be used by the customer and which country's law is applicable. The exporting firm may also stipulate clauses relating to 'retention of title' and 'interest on late payment' as deems fit. Who should pay for any charges incurred, should also be specified and agreed to by both parties.
f. The exporting firm should then be accurate in the export documents used to ship the goods into the foreign country and to get paid from the foreign customer as agreed by the parties. A number of documents are required by the foreign authorities, the banking system and the importer to comply with the exporting procedure, which involves evidencing the sale contract, clearing goods from customs, and effecting payment for the goods exported. Insurance may also be necessary and makes part of the exporting documents.
g. The exporting firm may also want to minimise the risk involved in export credit. An Export Credit Insurance Policy may assist the firm in determining the credit limits offered to the customer. This may make sense if the firm is doing business with a new foreign customer and lacks adequate information on the customer and the customer's market. An Export Credit Insurance would also help the firm's cash flow and profit in case the foreign customer defaults in payment. It is commendable that the exporter is conversant with the insurance policy wording to make sure that the policy covers the export credit risks of the firm adequately and as expected.
h. For better effectiveness and efficiency, the exporter may well opt to hire a local agency or representative in the foreign country. Having local representation, the exporting firm would benefit from obtaining the necessary information about the customer and the market on a hands-on basis and on an ongoing process; better coordination of the exporting procedure in particular with the banks and customs; and better customer service, which may also involve settling customers' disputes and overdue follow-ups.

> "Only good export credit management practices can secure sound cash flow and long-term profit"


Josef Busuttil

Only good export credit management practices can secure sound cash flow and long-term profit. A qualified and experienced credit team is extremely important in export business in order to avoid mistakes which may result to being expensive to the detriment of the firm's profit and cash flow. Only competent and motivated credit staff would deploy the appropriate export credit strategies and procedures that consequentially would result in more satisfied foreign customers, repeat export credit sales, efficient payment by customers and better profits. ■

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