

DO YOU KNOW?

Surviving the Global Down Turn and an Uncertain Credit Climate

The global finance crisis has added not just a credit crunch and potentially higher costs of financing for credit lines, as if that were not enough of a challenge. The turmoil in financial markets which began with subprime mortgage lending and its securitization, has alerted businesses who trade in global markets to examine their risk profiles and check for potential exposures.

As risk assessment has been elevated to the forefront of business planning, the role of the CFO has been thrust into prominence. The flight to safety by global investors has rippled through the finance industry and triggered the banks' review of their lending practices. Maintaining the banking relationship to assure availability of capital is an urgent and important business foundation, now more than ever. Keeping the balance sheet within bank covenants can play a much more a critical role now in getting a credit line renewed than was true a year ago. For a CFO these days it is of paramount importance to keep the enterprise steady and its working capital supplied at reasonable cost, while minimizing risk.

A business climate of lowered expectations has colored previously assumed certainty of getting paid as even long term relationships can undergo a tightening of terms. Suppliers may revoke previous payment terms and require faster payment. Established buyers may shrink from down payments without a standby letter of credit. Both will put pressure on working capital. A review of the business' financial posture may lead to postponing planned, discretionary cost items in favor of conserving cash. A pro-active collection policy that tracks outstanding receivables and shortens the payment cycle converts a prime business asset into cash that supports higher inventory turns.

In uncertain times, caution dictates a review of all business practices that could create exposures in sourcing and selling globally. A comparison of all the payment terms and coordinating them with projected sales and risk evaluation may lead the CFO to revise the company credit policy. Of the traditional four main ways to get paid for export sales, open account terms are generally considered the most risky. Exactly when sales terms may need to be more competitive, the risk of liberalizing payment terms may seem too great in roiling global markets. Credit reports on overseas buyers helps qualifying them for open account terms. This takes care of the commercial risk. While the political risks related to the buyer's country and political condition still remain and could impact the ability of even a solid buyer to make payment.

Both, commercial and political risks, can be mitigated with insurance. A relatively unknown tool, credit insurance may now be timely and appropriate. Combining open account terms with credit insurance is a fast-growing practice to mitigate the commercial and political payment risks, supports sales goals, credit policies and bank financing conditions It offers certainty and reduced risks in the collection of receivables and has for U.S. exporters several important implications:



1. Knowing that if there is a default on a foreign account receivable, the insurer typically will pay 90-95% of the invoiced amount.
2. The ability to support additional and larger orders as compared to offering only cash-in-advance or letter-of-credit payment options which make demands on the buyer's working capital.
3. Borrowing against the insured foreign accounts receivables increases liquidity as now a prime business asset is counted in the bank's determination of a company's borrowing base; unlike uninsured foreign accounts receivables which are usually considered ineligible and typically deducted in lenders' calculations.

What is the cost? For a small business [under \$5 million in open account sales to foreign buyers] the cost is only 65 cents per \$100, or 0.65%, of the invoiced amount under the Eximbank small business multi-buyer policy, at present available at a 15% reduced premium for small exporters.

A brokers list for this specialized product can be downloaded from the SBA web site: http://www.sba.gov/idc/groups/public/documents/or_portland/or_exportcredits.pdf.

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