WEATHERING THE STORM

HOW CAN TREASURERS ENSURE THEIR BUSINESSES CONTINUE TO EXPORT AND IMPORT THROUGH THE EURO CRISIS? RAY ZABARTE EXPLAINS

The challenges and uncertainties within the eurozone have been at the forefront of treasurers' minds for some time. In March 2012, a survey of corporate treasurers by Barclays found that as many as 40% thought that at least one country would leave the eurozone over the next year. It is clear that treasurers, in their role as risk managers, are preparing contingency plans to deal with fast-arising risks from the eurozone.

Nevertheless, it is important to keep the problems in perspective: trade has far from collapsed as a result of the sovereign crisis. The total value of goods exported from the eurozone to the rest of the world was €164.9bn in March 2012, up from €157.9bn in March 2011. At the same time, the eurozone's monthly goods trade surplus increased from €1bn to €8.6bn.*

It is worth highlighting that some of the countries in the front line of this crisis (such as Greece and Portugal) account for no more than 2-3% of that total trade. Companies trading with these economies need to ensure that adequate contingency plans are in place since some have already had their profits hampered by weakened demand.

We are seeing a significant number of clients reassess their individual trade flows and counterparty risks while taking a more holistic approach to their end-to-end trade and working capital needs.

In guiding their companies through the crisis, treasurers should consider the following four areas: planning, credit risk, supplier management and operational risk.

*EUROSTAT NEWS – MAY 2012

Planning

Establishing a working group with a membership of senior directors and managers to make decisions is an important start. It can't be a talking shop and needs to look at the issues from a group-wide perspective. Taking the planning a stage further, treasurers should not discount preparing to take advantage of opportunities that may arise due to a country's possible exit from the eurozone.

Credit risk

First, exporters should calculate their gross credit risk in terms of direct exposure to customers, but then look at what risk mitigation tools the business already has in place, such as trade credit insurance covering political and default risk and letters of credit (LCs). It may be possible to add other elements to protect the gross risk against risk of default such as bonds, guarantees and standby LCs. For insurance specifically, treasurers should check policies and test that their company complies with the terms of the insurance in place. If anything is unclear upon re-reading the policy or reviewing the procedures from compliance, then now is the time to consult the broker or insurer.

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Exporters need to look at their relationships with customers and their treasurers need to understand whether the terms of trade are open account or more secure forms. They could look to renegotiate existing contracts to give added protection. For instance, companies could try to alter the terms of trade by asking for full or part prepayment before they fulfil an order, or perhaps introduce new conditions such as requesting LCs where they have not previously been in place. If the company already uses LCs, the next step is to ask for confirmation of LCs, which will give the business added comfort that it will receive payment from those existing contracts. By using confirmation, the exporter effectively mitigates the risk of bank failure and political risks.

Legal risk

It is also important to be clear which country's legal code governs the contracts, since if any country were to exit the eurozone, a myriad of legal complications may arise, especially in the area of cross-border trade. There would therefore be a heavy reliance on a thorough legal review of new laws and the companies' capability with the new currency.

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Supplier management

Importers need to look at their supply chain in detail and beyond their direct supplier base. Even if key suppliers are not based in the eurozone, companies further down the chain could be. For every supplier that is potentially affected, the working group should decide whether they are core or non-core and then develop contingency plans accordingly. If there are serious concerns, could your company purchase from another source or simply do without?

As well as looking at alternative suppliers, one sensible aspect of commercial planning will be to engage with current suppliers and talk to them about the contingency plans that are in place to ensure that they can continue to provide your business with what it requires. For instance, how confident are they that they will have the finance in place to complete your contracts? If treasurers have any lingering concerns, it may be possible to consider additional forms of mitigation such as performance bonds, which could provide financial compensation in the event of non-delivery. This is a major step to take and could well jeopardise long-term supplier relationships, so should only happen after carefully weighing up all the other options and likely consequences.

Operational risk and communication

If companies are trading with areas that are at risk of political turmoil or unrest, then protection of their stock is paramount. A number of retailers have recently taken quite extreme action within a difficult environment; many have begun to draw up plans to shutter stores in affected countries in case of civil unrest.

But businesses need to look beyond just stock in store to stock in transit, and in warehouses, to ensure sufficient stock protection is in place. This can be done by physical means or by taking out adequate insurance cover.

It is also important to consider how the measures for weathering the storm are communicated throughout the whole organisation. The sales and procurement teams will need to be briefed both on the planning that is being conducted internally and on the messages they can give to customers, the market and suppliers in terms of how the business is approaching the situation. Like all other elements, this should be a detailed process with scripts and frequently asked questions produced to ensure the agreed policies and procedures are consistent and correct.

Where to from here?

Previous currency crises, such as those in South America, Asia, Turkey and Korea, show us that while these trade shocks do happen, they do eventually end. A change in currency should not necessarily be the end of a business relationship.

As companies continue to contemplate what may happen at the macro level, treasurers are asking practical questions and finding realistic answers to prevent any currency crisis from becoming a corporate disaster. That dialogue must continue.

For more on surviving the eurozone crisis, see The domino effect, page 38

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