A closer acquaintance

OPERATING IN NEW TERRITORIES AND EXPANDING FUNDING OPTIONS ARE BOTH ACTIVITIES THAT CAN BE ENHANCED AND MADE MORE SECURE. THIS IS PROVIDED THAT CORPORATES HAVE ACCESS TO SOUND TRADE CREDIT INFORMATION ON SUPPLIERS AND CUSTOMERS, AS MASSIMO FALCIONI EXPLAINS

Corporate treasury management is a key enabler for any sized successful business, including the core disciplines of cash-flow management and control, funding and risk management. The financial crisis has, of course, heightened the profile of treasury, increasing its influence and perceived value within multinational organisations as well as SMEs. Coface's anecdotal evidence based on contact with corporate CFOs in the Middle East is that companies are looking more and more for innovative financial solutions to manage cash flow and funding to facilitate implementation of business development strategy. A particular area of focus is credit-risk management.

One of the key questions within treasury management is: should we use debt or equity to finance our business operations? The answers depend on many aspects – some relate to the business model, others to local market conditions, but all of them have one element in common: it is possible to fund day-by-day working capital by leveraging corporate assets. Banks everywhere are reducing or rationing their lending while trying to create corporate liquidity and credit-risk management solutions. So corporates are looking at one major asset that can be used in this way – trade receivables.

Offering credit on open account

In reality, trading by offering credit on open account is a key element to developing the top line of a business and accelerating its growth. It is an important source of funding, too, often far ahead of banks and financial markets. A monitored, secured portfolio of receivables provides an additional guarantee, which can ease access to additional funding from banks and factoring companies, without impacting on existing credit lines.

The current access to finance in the Gulf Cooperation Council, however, is limited and assessing debtors represents quite a challenge. As in many countries in the world, there is no obligation for companies to publish their financial statements. Consequently, choosing new trading partners when expanding to new territories becomes a risky challenge and the trade receivables stock cannot be fully leveraged for additional funding through discounting or invoice finance.

Access to reliable credit information is therefore an absolute essential if companies are to explore new business opportunities and markets, such as Africa, where reliable financial information is as yet very scarce. In this context, associating with a trade credit information specialist can be beneficial.

Credit analysis

Country-by-country credit analysis should begin at macroeconomic level to understand the business environment of the country as well as risks relating to particular business sectors and segments. That should be followed by an assessment of risks specific to each company. Based on such information, specialists are able to make informed credit opinions, which are used by banks, insurance companies, government export credit companies, Exim banks, corporates and SMEs.

All these stakeholders can then select their customers through a protective and preventative system based on assessments of the financial health of a company along with continuous monitoring of its creditworthiness and an understanding of its payment practices. The key is accessing skilled and competent analysis of sectors and economic trends through a worldwide network of enhanced information centres to help avoid or at least minimise losses for the users of such information. Early planning is crucial. Through the information cycle, companies can anticipate payment arrears and base future actions on their customers' risk profiles to take the right decision.

Furthermore, companies may protect their trade receivables against potential losses arising from payment defaults by their customers around the globe by transferring the risk to trade credit risk insurers. This allows them time to focus on the growth and development of their business and its profitability by reducing exposure to the commercial risks of losses from trade account receivables.

When it comes to buyer payment defaults, most of these tend to arise from temporary situations, such as a cash-flow issue or a pending payment, while others are due to wider economic impacts, such as a decrease in demand or price. The primary aim of collection efforts should be to resolve the issue amicably between both parties.

Collecting payment

The supplier should make all efforts based on his trading experience to recover his payment. Failing that, an insurer's collection experts can step in to collect the payments from the debtors. Their knowledge of local customs and practices should greatly aid the speed and efficiency of the collection process. With years of experience behind them, trade credit insurers are often able to implement tried-and-tested techniques to maximise the chances of recovery.

Though trade credit management has many benefits, it is still in its infancy in the Gulf, and we understand from insurers that lack of knowledge is a major drawback in this market. Many CFOs still opt for a bank letter of credit (LC), despite this being a more costly, restrictive and time-consuming approach. In comparison, Western countries have used trade credit- and political risk-protection policies since the end of 1920s.

> "One of the key questions is: should we use debt or equity to finance our business operations?"

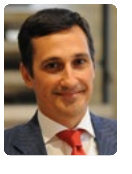
The growth of the trade credit-insurance market in Europe and North America was partly due to the fact that the percentage of total trade flows backed by LCs decreased. Trading with credit on open account terms became more widespread and many sectors showed higher interest in protecting their receivables, boosting trade flows and opening new routes in terms of export economy. However, we believe that credit insurance is quickly gaining traction in the Gulf region thanks to better understanding of the issues. The outlook is especially positive for Gulf countries, which are diversifying their economies and leveraging on growing trade flows, both domestic and export.

We have seen a growing interest in the past three years in the United Arab Emirates, Saudi Arabia and Qatar from both large multinational companies and SMEs. New players have entered the market applying for insurance licences, confirming an increasing demand from treasurers for modern and innovative credit-management solutions. Some of the key international credit-insurance companies, which partner with their local fronters by reinsuring the related risk exposure, are registering double-digit growth in both customer portfolio and risk exposure, too.

The estimated growth in market size year-on-year in terms of gross written premiums reflects this emerging interest as does:

- investment from information companies, banks and chambers of commerce;
- credit insurers strengthening their information/risk-monitoring databases and organisation capabilities in the region;
- increased specialised offers from insurance brokers; and
- interest from the banking system to fund or factor trade receivables backed by a credit-insurance policy.

Treasury departments can benefit enormously from such comprehensive and up-to-date information, which allows them to focus on real prospects, and to develop business relationships based on both trust and facts besides avoiding the high cost of setting up an innovative and modern credit-management department.



Massimo Falcioni is CEO of Middle East countries at Coface