
PART ONE



INTERNATIONAL CREDIT

The importance of credit when dealing in the international arena cannot be overstated. It is an area that many overlook until this neglect comes back to hit them in the face. Some companies start selling internationally with no one taking responsibility for the credit aspect until a disaster occurs. Then things change and change rapidly.

The first thing that credit professionals need to understand is that they cannot take their domestic credit policy and credit application and use it internationally and expect everything to work just fine—it will not happen. For starters, terms offered in the rest of the world are typically much longer than what domestic credit managers are accustomed to. Yet 60 days will seem short to most international customers. And as most credit professionals are painfully aware, the longer the credit terms, the higher the risk.

Thus, credit analysis on international customers needs to be thorough. The dimension of country risk also needs to be addressed.

Finally, the quality of the information is often not as good as domestic credit professionals are used to. Information may be outdated, is likely to be unaudited, and it can be sketchy. Many credit professionals get quite a shock when they find out the prices of international credit reports. They are not cheap. Neither are country reports. Yet both are important to obtain, as both issues will radically affect the ability to get paid—the goal of every credit and collections professional.

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International Credit Policy

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A workable international credit policy is the first step to ensuring the collection of international receivables. Although most companies have a formal credit policy for domestic sales, many do not have one for international transactions. They either use the domestic policy to cover international sales or, in shocking disregard of credit managers' ingrained common sense, fly by the seat of their pants. The result is granting credit, often on open-account terms, to international companies whose ratings would earn them a quick and automatic pass if they were domestic. Even those companies that have a formal policy have not reviewed it in eons. Given the ever-changing international landscape and technology innovations, international credit policies should be updated periodically—in any event no less frequently than every two or three years. Thus, establishing and enforcing a strict credit policy for international sales is a challenge facing many international credit professionals today.

GETTING STARTED

Just getting an international credit policy written down and accepted by management can be a big undertaking at many companies. Some start out trying to use the same policy they use for their local customers, only to find it does not work. For starters, financial statements in other countries do not generally conform to generally accepted accounting principles (GAAP). Then there is the issue of longer terms used in most countries.

Finally, U.S. companies are often competing with companies from other countries willing to sell on what at first appears to be more lenient terms. Only after a little analysis do managers discover that their competition might be selling on open account, having purchased credit insurance to handle the risk.

Often, a big selling job needs to be done internally just to establish a policy. "I had to convince management that the credit department was not only reviewing the customers' status but also analyzing the risk involved with our exposure" is not an uncommon complaint.

Management is not always the stumbling block. Sometimes the lack of a policy causes the apprehension. To alleviate this concern, write an international credit and collection policy.

ESTABLISHING THE POLICY

Once there is agreement that the policy needs to be established, the next debate typically revolves around what goes in the policy. Often, it is the same old credit-versus-sales debate. Many successful international credit policies work because they contain a number of options. Potential risk and the exposure to bad debt are just two typical concerns. Formulating a policy for establishing sound credit limits addresses these issues. Incorporate certain techniques not typically used with domestic sales. These might include credit insurance, the sale of certain receivables, the use of export factoring, forfaiting, and everybody's favorite: letters of credit.

Country focus also can be an issue depending on where sales are occurring. Companies might use more liberal credit terms in countries where they feel more comfortable. Of course, this approach may have problems, as customers in riskier countries typically are in greater need of more liberal terms.

Occasionally, a company will become concerned about one particular country and will establish a separate policy for sales in that locale. For example, one company, concerned about bad debts in China, established a separate policy for sales to companies in that country. The credit professional reports that normal terms are cash in advance. Based on time and finances, the company moves customers to net 15 as warranted.

ENFORCING THE POLICY

Getting a policy set down is one thing. As credit professionals are only too well aware, getting the sales force to live with it is another. The job is only half done until it becomes crystal clear to everyone within the company that the policy must be adhered to. "Protecting our assets," says one international credit manager of a consumer manufacturing company, "means not being too lenient with terms for customers that sales wants to sell." To make sure the policy is understood, this resolute credit manager says he states the company's credit position and function and ensures there is a clear understanding. While this is a little difficult in the beginning, the net result is a smoother-running operation.

Getting control is often easier said than done. The director of credit of another consumer manufacturing company devised a solution. "I put a form to-

gether,” he says, “that [guaranteed] no shipments could be made from our factories abroad without my signature.” Since he controlled shipments, he also controlled orders and, indirectly, collections—he would not ship if there was an outstanding invoice that had not been paid.

POINTS COVERED BY POLICY

When establishing an international credit policy, take into account the following general considerations:

- The longer time period for delivery, fund transfer (payment), and the credit extension period
- The need for terms that provide for security for the risks of time and distance
- The competition created by credit terms from the domestic market and other foreign competitors
- The competition from other countries having different costs and governmental policies
- The correct use of international terminology such as shipping and payment terms, especially the use of INCOTERMS
- The assessment of political transfer and event risk, including: identifying sources of information, establishing procedures for assessing and spreading the risk, and evaluating and verifying the sources and reliability of information obtained
- The assessment of customer risk

CUSTOMER RISK

The crux of any credit analysis is, of course, the ability and willingness of the customer ultimately to pay for the goods shipped to it by the company. This is difficult enough in the case of a domestic transaction. In the case of a company in another country, the process of analyzing credit becomes more difficult. Additional considerations are:

- *Identify, verify, and understand the customer's financial condition.* Establish customer categories for assessing their ability and intention to meet obligations. Determine the volume of credit and payment terms, credit limits, and the need for on-site assessment. Rarely are international credit professionals offered financial statements that are as thorough as those prepared according to GAAP.
- *Compare current performance with past performance.* To do this effectively, international credit professionals must understand and interpret foreign financial information, including balance sheets,

profit-and-loss statements, notes to the statements, auditor reports, and chairman statements. The move toward one international accounting standard should help with this.

- *Compare performance with other customers from the same country or region.*
- *Assess the customer's ability to pay.* The initial information gathering should include verification of information and references. Credit professionals should review and update these on a regular basis so that they will begin to understand the payment behavior and be in a position to identify warning signals of financial distress. Unfortunately, by the time these trends show in financial statements, the customer is in much worse financial condition and supplier chances of being repaid have plummeted.

EARLY WARNING SIGNS

The ability to recognize the indications of financial difficulty as early as possible is key to successfully limiting losses. Doing so is especially difficult when dealing with companies in other countries, as “normal” behavior patterns often are quite different from what credit professionals might be accustomed to when dealing with their domestic customers. Focus on the following when monitoring accounts for signs of trouble:

- Changes in the general behavior of the account
- Changes in the payment patterns
- News reports
- Financial ratio analysis
- Increase in the number of disputed transactions

Whether the last item is the result of financial difficulty or simply difficulty in the relationship may be irrelevant to the collection issue, and credit professionals need to hone in on this aspect as soon as possible. A good relationship with the sales staff will pay off in these instances, as they may be able to determine whether the problem with the customer can be fixed or not. The Internet also helps international credit professionals stay on top of the news. Newspaper summaries from papers in the local country may be available online. Some international credit executives have been able to spot bad news quite early in this manner.

REVAMP EXISTING INTERNATIONAL CREDIT POLICY

As mentioned, just having a policy is only half the battle. If it is not revised every few years—or more, under certain circumstances—it will become stale

and outdated and possibly even worse than having no policy. "How is this possible?" you ask. A policy that works in a country when there are no economic or political uncertainties would be a disaster once the political or economic arena worsened. Thus, a devaluation, an unexpected government overthrow, or a serious financial deterioration as occurred in the Far East in the late 1990s should trigger a review of the international credit policy.

WRITTEN POLICIES

A number of companies are establishing formal written international credit policies. They are requiring the sales force to adhere to these policies when selling internationally. Once a policy is put down in writing and management approves it, the credit professionals have some teeth when attempting to get it adhered to.

A number of respondents indicated that they got buy-in from the sales department when establishing their policies. Not only does this avoid friction when trying to implement the policy at a later date, it also is a good step toward building a stronger relationship with the sales department.

However, after a few years, pull out the policy, and make the changes to it as appropriate. Before going to senior management for approval, discuss the changes with those who will be affected. Also ask for input from those who might be affected and who should have some say. This would include the financial executives responsible for the area or products, the sales force, perhaps the export manager, and any other party touched by the policy. By asking their opinion, you are increasing the odds of their buy-in later on.

If you are making changes that are likely to cause some dissent, discuss these changes in advance with the affected parties and explain the reasons for the changes.

WHAT TO DO WHEN THERE IS NO POLICY

Despite all that has been written on the topic, a number of credit professionals find that their companies still do not have a formal international credit policy. Lack of such a policy not only causes confusion but also conflict. It also gives a manipulative sales force the ammunition it needs to jam questionable sales down the throats of the credit department. Credit professionals in these companies must do what they can to insist on a policy.

At a minimum, international companies should conform to domestic requirements. Even this provision is difficult to enforce, as other countries do not require financial statements that conform to GAAP. Additionally, often long time lags exist before such statements are available; once they are, they may or may not be audited and they may be written in a foreign language.

By insisting on a written approved international credit policy, credit managers will be in a position to establish some reasonable guidelines for all to

adhere to. If all members of the sales force are given a copy, no one can say that he or she did not know what the policy was.

It will not be an easy or quick process to get an international credit policy established and approved, but once the policy is written and approved it will be easier, but not easy, to enforce. Keep track of all transactions that are approved against the advice of the credit department. Track those sales to see if and when they are paid. Any time a large international debt is written off, make management and sales aware of the write-off and that this was not a transaction that credit approved. If this is done in a nonoffensive manner, eventually the point will be made and those who prefer no policy will cooperate. Strike while the iron is hot and have the policy written down.

INTERNATIONAL CREDIT POLICY TIPS

Based on conversations with hundreds of international credit professionals, here are the techniques that work best.

- Produce a coherent credit policy for selling international accounts and make sure the sales force and sales reps, if they are used, understand it.
- Begin accepting corporate procurement cards for international sales. Be aware, however, of the fees charged by most service providers and make sure prices cover these fees. Otherwise, you may be giving away all your profits. Procurement cards are a particularly attractive option for smaller sales and allow companies to sell to customers who might not meet ordinary credit standards. Most salespeople love this option.
- Develop a simple, but complete, credit application that can be faxed. Leave adequate space for the customer to fill in needed information. Then accept signed applications that are faxed back. Doing so will make you a hero with the sales department.
- For smaller accounts, use a scoring system to determine which method of account to use for each sale: letters of credit, open account, documentary collections, and so on. Some report success using this technique on larger sales as well. However, you may want to review large sales individually.
- Document your policies and procedures in a manual. Doing so will help the credit staff implement them. Give a copy to the sales department, if that is appropriate.
- Require letters of credit only when absolutely necessary. Companies that have demanded all customers provide letters of credit are beginning to rethink that requirement. Such requirements often lose sales as letters of credit are expensive for customers and a hassle for everyone involved. While proper in many cases, they are not always needed. By eliminating this requirement on small orders, some companies have garnered additional business with little additional risk.

- Within limits, let the selling unit closest to the market set terms. After all, these are the individuals in the best position to know what is typical for that country. The companies that have had the best success with this approach are those requiring these same units to follow up on late payments and those that pay commissions only after the company collects its money. Salespeople who have to wait for their money are going to think very carefully about extended terms.
- Limit export credit to companies with ties in the continental United States. While not everyone will agree with this approach, the few companies that do use it report they have better control over marketing conflicts. This might work for those firms that are just starting to export.
- Have the international credit policy formalized and approved by senior management. While this may take a bit of time in the beginning, it will save time and aggravation in the long run. More than one salesperson has tried to make an end run around credit by going straight to senior management about a credit decision. Doing so is more difficult if the credit policy has been preapproved. If your sales force is apt to try such a maneuver, make sure they understand the formal credit policy.
- Ship goods to a bonded warehouse for release to distributors in countries where international sales are to be made. (Only if the distributor's account is current, of course.) This approach offers freight payment savings as well.
- Upgrade credit policies when key personnel turn over. Several firms have reported stumbling blocks in the form of employees (some of them quite senior) who insist on doing things "the way we always have." Strike while the iron is hot and before newcomers get too entrenched in the old way.
- Rewrite the credit policy as simply as possible. One flexible credit pro reports that he "broke down rules of thumb, which confused everyone, into a few simple categories and then educated everyone involved." The old KISS (Keep It Simple, Stupid) approach really works.
- Get sales involved in the establishment of the new credit policy. Find out what gives them difficulty and see if they can be accommodated. Sometimes a simple adjustment in the credit policy can make their lives much easier. Often what is needed becomes clear if the credit manager goes on some sales calls with the sales force. The old aphorism about "walking a mile in someone else's shoes" certainly fits in this case. Many international credit managers who have done this come back with a new respect for sales.
- Hire agents who will get paid only after the company is paid. This will prevent reps from selling to companies that they know either will not pay or will pay only after a good deal of follow-up and trouble. No one wants to waste his or her time.
- Use a matrix that employs third-party credit reports to evaluate international customers' credit risk.

- Ship to new accounts only on cash-in-advance or letter-of-credit terms.
- Standardize guidelines regarding which companies you will sell to on open account. This will stop the ongoing conflict between sales and credit.
- Use letters of credit designed to meet established seller criteria.
- Incorporate into every international sales contract the letter-of-credit requirements, terms, and conditions of sale. Doing so saves both time and money at the negotiation stage.
- Begin using international accounts receivable insurance. Doing so generally permits companies to offer their customers longer terms and larger credit limits.
- Use credit insurance for marginal customers and those in high-risk countries. Doing so allows sales expansion when selling under standard credit terms would not.
- Begin to communicate consistently and on a timely basis with international customers when payments are late. By doing this with the consensus and agreement of the sales department, you will reduce conflicts and customers will begin to realize that they cannot play one department against the other.
- Develop a comprehensive handbook for the sales force that contains all necessary information, so they can quote accurately. Include matters such as letter-of-credit terms, lists of customers they may sell to on open-account terms, INCOTERMS to use, wire transfer information, and credit card use.
- Rewrite any old, staid policies so they are more user friendly. This does not necessarily mean loosening terms but rather rewriting the policy in a manner that is easy for the end user to understand.
- Do not let the sales force establish terms of sale. The credit department or someone who fully understands and appreciates the ramifications of such policies should handle this. One company that implemented such a policy was able to reduce its Days Sales Outstanding (DSO) by 20 days.
- Create a credit risk model to score customers' audited financial statement figures. Use this to ascertain whether specific customers can be offered open-account terms. Customers who do not meet the open-account standards can be offered secured terms.
- In order to give operating units more latitude in the decision-making process, involve the unit heads in determining whether to accept or reject "unusual" terms and conditions of sale.
- Develop innovative international financing programs to help the sales force meet goals without increasing credit risk. Some credit managers have used receivables discounting in order to offer extended terms. Doing so is especially important to those selling in the Far East.
- Identify customers who also work with other units of the company. Involve upper management in developing a unified approach to establishing credit limits for such entities so that reasonable amounts of credit are extended in total. The goal is not to overextend without realizing it.

ONGOING MONITORING

Luckily for international credit managers, the world is a continually changing place. We say “luckily,” because continual movement translates into an ongoing need for international credit professionals. Here is what should be done regularly:

- Don’t assume: “It’s a big company, nothing can hurt it.”
- Obtain updated information from trading partners to ascertain their liquidity and to determine whether they will have trouble meeting their obligations during the course of the next year. If you are having trouble getting new information, go back to the balance sheet statements that you already possess to ascertain the company’s debt position when you last reviewed its account.
- Divide accounts by country. Not all countries are in the same position; do not treat the entire Pacific Rim equally.
- Divide the companies into public and private and then look at their payment history with the company and with others, if available. Doing so may allow you to attribute risk appropriately in a market that has risk written all over it.
- Continue to ask for letters of credit if this was the practice in the past. Be careful about the issuing bank and the confirming bank. Analyze, or at least review, the position of the customer’s bank if it is involved in the transaction. Do not assume that banks cannot fail. The best protection is to use the services of an American or established European bank for letter-of-credit needs unless you have reviewed the local bank’s financial and political situation.
- Monitor the political situation in each of the countries where you are doing business. Many recent troubles stem from internal political and economic inefficiencies. The reaction to economic strife can be the reaction of one individual or family, thus, making it difficult to predict a stable pattern of behavior. This is especially true in the case of dictatorships.

An international credit policy is an integral part of a successful international credit operation. It is the first step toward avoiding bad debt write-offs and late-paying customers. Without an international credit policy, international credit executives will fight an uphill battle.

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