Credit Supplementation Institutions: Going Beyond Guarantee for SMEs.

The small and medium enterprise (SME) sector is well recognized for its contribution to employment, innovation and economic dynamism and is considered as an engine of growth and an essential part of a healthy economy. Small firms have been the chief source of creating new jobs in many countries. It would not be an exaggeration to mention that the overall health of the economy depends, to a large extent, on the health of the SME sector in a country.

Internationalization and international entrepreneurship among small and medium sized enterprises (SMEs) is a topic of considerable relevance, principally owing to the observed growth effects of cross border venturing, and the demonstrated capacity of SMEs to drive economic development at national, regional, and global levels

Why internationalize?

To most, the word internationalization denotes big business carried out on a global scale, but even the smallest companies can internationalize successfully with limited resources if they play their cards right and find partners who can take them places they couldn't reach on their own.

When a company decides to internationalize, it's usually motivated by the possibility (or necessity) of increasing sales,

- diversifying its operations (and associated risks),
- getting closer to its clients,
- reducing costs (labor production or supply),
- Compensating for the decline or saturation of the home market.

Although they are perfectly valid, what all of these arguments have in common is that they are "reactive," that is to say, internationalization is seen as the solution or the answer to a fact or a set of circumstances that is changing the normal course of business.

These may include the deterioration of the margin, a market that is stagnant or isn't growing or a client who wants services and products in another country.

However, there are other reasons of a more proactive nature for incorporating internationalization into the competitive strategy of the company. For example,

- taking advantage of the development and growth of other markets,
- moving certain activities in the value chain to more competitive regions, be they costs (delocalization of production to countries with lower manufacturing and labor costs) or in capacity (externalizing various processes from client services to call centers or research and innovation),
- exploiting economies of scale and reach, or simply to gain knowledge: about other clients and markets,
- The capacity of competitors at a global level in a particular industry or sector and even the cultural diversity typical of teams in global companies.

This last argument, to gain knowledge, rarely appears in the list of reasons why a business goes international. And yet it is of crucial importance because those companies that don't work in international markets become less competitive and more vulnerable. For this reason, it's imperative for companies to work abroad and to be exposed to the need for excellence that international competition brings.

Come what may, internationalization as a strategy for creating global value goes far beyond measures taken to offset a difficult set of circumstances. Furthermore, it has been shown that it makes companies bigger, more productive and more resilient in adverse cycles

What competitive advantage are we trying to gain?

If a business isn't able to offer better value than its competitors, even if it's selling at a higher profit (note the significant difference) or at a lower price (leading on cost) it will not be able to sustain a competitive strategy. While this is true in any market, it is especially relevant in the global context. Choosing between, in the short term, different ways of entering a market and, in the medium and long term, how to consolidate, is a key consideration when it comes to international expansion.

Whether it is simply a case of exporting or of investing abroad, there is a wide range of options. Exports may be direct, indirect or both; investment may be in the form of a joint venture or through buying 100 percent of a local business and setting up a local operation.

It is also possible to grow abroad through franchises, agreements and licenses and to delocalize activities through foreign sub-contractors and suppliers. It is not an easy decision and it hinges on a range of factors. Entering a market simply to sell is not the same as entering to use it as a manufacturing or supply base, nor is using a country to optimize manufacturing costs the same as going there to develop R+D.

One size does not fit all. Each company is unique, each project is different and every country is a world unto itself. Nor is the decision to internationalize a straightforward one, but a long and complex process. It requires planning and a high degree of flexibility, the ability to adapt and, above all, patience.

Each company must make its own way, in line with its resources, although much can be learned from others that have gone down a similar road. There will be obstacles to overcome. You will have to adapt to the different culture, language, religion and administrative norms of the country as well as different modes of consumption, competition and distribution.

There will also be internal challenges such as a lack of resources and the need for a firm commitment to the internationalization project across the company. Internationalization brings great opportunities but also great risks. However, in the long run it is probably more risky not to internationalize at all.

Late or non-payment of receivables can be a powerfully destructive force in the life of an SME. While so many businesses go to the time and trouble to protect plant and property, but not credit debtors are not protected by credit insurance.

Yet receivables can account for 40 per cent or more of a company's assets – and in many of the world's most developed economies, its standard practice to protect that precious share with Trade Credit Insurance (TCI).

What is Trade Credit Insurance?

Many SMEs are not able to continue their upward drive because they have suffered heavily due to bad debt, stemming out of inadequate credit management of their portfolios. Even a single financial default can disrupt the success of an SME – clouding the company's outlook for the foreseeable future. How best to take proactive action to prepare any SME which is highly vulnerable to such disruptions in its business life cycle?

Usually the largest or the second largest item on a trading company's balance sheet is the outstanding receivables. In spite of this, it's quite normal to witness businesses protecting their tangible assets such as property and plant, while at the same time neglecting their receivables which, at times, can represent 40 per cent or more of their current assets.

Trade Credit Insurance (TCI), also known as business credit insurance, export credit insurance or simply credit insurance, is one of the many risk management tools employed by businesses to protect their trade receivables from non-payment or delayed payment.

TCI in effect shields both the cash flow and the profitability of an SME. While TCI is often known for protecting foreign trade (and in this capacity it's often known as Export Credit Insurance), there is also a large segment of the market that uses TCI for safeguarding domestic accounts receivable as well.

Why do SMEs need Trade Credit Insurance?

SMEs need TCI for a variety of reasons, some of which are mentioned below:

Protection against default

TCI insures business receivables that in turn provide the businesses with confidence to provide better terms to the buyer(s) and hence it facilitates a win-win situation for the TCI policy holder and their client(s). The seller is assured of payment and therefore no adverse interference with their cash flow is expected. The buyer(s) on the other hand, receives better, easier and longer payment terms. By insuring the receivables against non-payment or late payments, SMEs ensures to protect its cash flow and its profit against default.

Sales Growth

For an SME, TCI underpins the confidence to escalate business development knowing payments are assured. Business expansion can be done through greater penetration with existing clients and/or initiatives to discover new markets altogether, which, in the absence of TCI, were not possible earlier. Without insurance many trade transactions have to be concluded on a pre-paid or cash basis, or not at all. Having such coverage in place therefore permits an SME to sell more goods on credit terms, take advantage of peak sales periods, and develop new product lines or territories with greater peace of mind. It's because of these reasons that TCI is known to contribute towards increased sales growth to existing and new customers.

Improved cash flows

Without adequate protection provisions, late payments or non-payments pose a considerable threat to future liquidity of an SME. When an SME insures its receivables against non-payment or late payments, it is basically ensuring its cash flows, since now it can sell on credit, discount its receivables and greatly benefit its cash flows.

Managing credit and hedging risks

TCI can act as good financial instrument to hedge risks. Most insurance companies that underwrite TCI policies do so for numerous clients, guaranteeing huge customer debts in many countries globally. Hence they are able to manage and retain a database of hundreds of thousands of companies around the globe with data related to payment experience, financial updates, seller experiences, countries risks etc. When an SME insures its outstanding receivables, the credit insurance company is therefore able to use all this needful knowledge to extend, reduce or decline credit for that SME. This in turn greatly benefits an SME in managing its own credit portfolios, since now an SME is able to find out more about the creditworthiness of its own customers by researching the database provided by the insurer. As a result, the SME is now able to oversee its credit exposures far better than would be possible in the absence of such information.

Bank loans

It's ironic that in spite of SMEs' significant contribution to the economy it is estimated that very small percentage of total bank loans are able to find their way into the SME sector. (Although the trend is changing and we have been witnessing greater interest by banking industry in the SME sector in recent years). The fact is, it's natural for SMEs to be considered as a higher risk, on the basis of the view that small operators have a higher probability of failing. Many risk-averse banks are still providing credit only with stringent conditions attached to SMEs and at times even refuse loan facilities to the SME sector.

One of the major reasons is that an SME can't offer the solid collaterals or hard assets that could be offered to banks as security. In the presence of TCI, banks are more willing to provide finance since the TCI policy can be considered as one of the risk mitigation tools. When TCI covers the accounts receivables of SMEs, the trade debt is transformed as collateral, which can help SMEs to obtain bank loans or influence the size and terms of the bank loan available to them.

The concept of credit insurance which started in Europe about a hundred years back, spread to other parts of the world in due course. It may be said that credit insurance is the youngest branch of insurance. In Sri Lanka, Sri Lanka Export Credit Insurance Corporation (SLECIC) was established in the year 1979 by the Government of to strengthen the export promotion drive by covering the risk of exporting on credit. In the initial few years itself SLECIC realized that a more important problem faced by the exporters, which needed to be addressed, was that relating to availability of timely and adequate finance and bank needs risk protection to enable them to grant liberal credit facilities to exporters. The role thus expanded to facilitating finance for exports by providing credit insurance to banks and financial institutions against failure of exporters due to insolvency or protracted default.

Since their beginning, ECAs have had the ability to overcome obstacles to business transactions. But today, they have to remove obstacles for their very existence. The role

that ECAs assume the way they choose to shape themselves in the future will determine their future viability. In that regard, they need to dispel the conventional role of a pure export credit and insurance provider and adopt a mandate framed in todays and tomorrow's terms a mandate that responds to today's trade dynamics.
They need to take a broader look at the market they serve, yet employ more dexterity in delivering support to their customers. Unlike the past, the ECAs face greater challenges today and they need to respond a lot more quickly.

When SMEs need to promote their products they could use ATA Carnet System to take their samples to international fairs and exhibitions.

What is an ATA Carnet?

The ATA Carnet is an international customs document that allows the holder to import or export goods temporarily, up to one year, without payment of normally applicable duties and taxes, including value-added taxes. So long as the goods are re-exported within the allotted time frame, no duties or taxes are due. The normal national tax and other charges applicable in case of failure to re-export all goods listed on the Carnet results in the need to pay the applicable duties

Presently there are 72 participating countries in which the ATA Carnet System is in force

Typical articles include antiques, machinery, machine tools, catering equipment, clothing and footwear, toys, computers, office equipment, electric generators, electrical/electronic and scientific equipment, surgical and dental equipment, jewellery and precious metals/stones, sound equipment, audio-visual, photographic and filming equipment, lasers, musical instruments and records, aircraft, films, motor vehicles, racing engine machinery, heating and lighting equipment, agricultural machinery, furniture, crockery Works of art, race horses, theatrical effects and sets, sporting goods, yachts and display stands.

The goods not covered by Carnets include disposable items or consumable goods, including food and agriculture products.

How the ATA Carnet System works?

Each country in the ATA chain has a single guaranteeing organization approved by its national Customs Authorities and World Chambers Federation (WCF) .The guaranteeing body is entitled to issue Carnets .The ATA international guarantee chain provides reciprocal guarantees assuring customs administrations that duties and taxes incurred in case of misuse will be paid –for example, if goods are sold instead of re-exported

The ATA Carnet operates under international Customs Conventions administered by the World Customs Organization (WCO) .The International Chamber of Commerce (ICC), World ATA Carnet Council manages the system in cooperation with the WCO.

User of ATA Carnet

It applies to three broad categories of merchandise -- commercial samples, professional equipment and goods for display at exhibitions and fairs

The user of ATA Carnet may be an individual or a company registered in Sri Lanka

- Travelling Business/Sales Executives
- Technicians
- Fair Exhibitors & Professional individuals and teams such as film crew, Surgeons, Architects, Artists, Engineers, Educationalists, Entertainers etc.
- If the Carnet is to be used by any other person ,he should carry a letter from the Carnet holder on his behalf provided he holds a letter of Authority

Goods which qualifies the ATA Carnet System

It is used to importer export sales promotion literature, inexpensive samples for distribution, designs and works of art for exhibition, and machinery and equipment for display or demonstration.

- Samples of value)
- Professional Equipment's *)
- Goods for presentation use for temporary exportation
  At Exhibitions or Trade Fairs)
  *Equipment for press or for television broadcast, cinematographic and tools, photographical, engineering, surgical, electrical, archaeological, musical, sporting, computing, entertainment equipment etc…

How to Get an ATA Carnet?

Carnets are issued by chamber of commerce and similar business organizations affiliated to the ATA International guarantee chain .The World Chambers Federation (WCF) ,which brings together the chamber members of the Paris –based International Chamber of Commerce (ICC)is responsible for administering the chain .Accordingly ,International Chamber of Sri Lanka has the authority to issue Carnets in Sri Lanka

Advantages of ATA Carnet System

- ATA Carnets reduce costs to exporters by eliminating Value Added Tax (VAT) and customs duties
- Carnets holders are not required to post securities with Customs
- Carnets simplify customs border crossings and cut red tape by allowing importers and exporters to use a single document for all customs formalities

SLECIC'S Guarantee Scheme

The Corporation 's Direct Guarantee covering the ATA Carnet System is a demand guarantee to ICC-SL ensuring the due performance by the applicant/exporter .If the goods covered under the ATA Carnet were not re-exported within a fixed period, the issuing guarantee institution will become liable for the sum for which the claim is made by the customs authorities .

Our guarantee covers ICC-SL, against any loss sustained by them arising from the failure of the exporter to fulfill the requirement of payment of Import duty abroad, favouring exporters to participate in trade fairs and Exhibitions. Further, the Corporation uses its discretion to issue these Demand Guarantees to ICC- SL.

Due to satisfactory performance of the Direct Guarantee Scheme and to cater to the new demands of exporters and market conditions modifications were made to the existing scheme where necessary.

CONCLUSION

Export credit insurance can indeed be a tool for the promotion of trade between countries and a means by which individual companies can extend credit to their buyers without an undue fear of financial loss. It is a specialised field but there are plenty of specialists who can assist in assessing risks in unknown countries and provide information on how business is conducted, so a credit insurer in both a developed and developing market does not need to be taking risks in the dark.

Also countries themselves can benefit themselves and their exporters, since trade is a two-way street, by ensuring that their legal systems and controls are in place and that they themselves are attractively placed for doing business.

Countries can assist exporters by providing political risk cover in pursuit of their trade relationships with other countries but also benefit their own importers seeking credit terms by implementing the measures I have outlined above

The global crisis has sharply brought to focus the importance of Credit Insurance as a risk mitigation tool in home trade as well as cross border trade. With the increase of world trade, many companies are entering new markets and extending their supply chains across multiple regions – all of which further increases the need to protect themselves from risks involving commercial trade debts. Credit insurance thus can be a very effective tool in accelerating cash-flows, improving working capital and protecting the balance sheet. In the midst of a global recessionary climate, with an increase in the number of insolvencies forecast and the tightening of credit across the board, credit insurance is more important than ever for a business' success.

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