collective szabo wisdom®

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Dear Friends:

As another year fades into memory and the new millenium approaches, I sometimes reflect on the immense changes that have taken place in the ways we conduct business. The global marketplace continues to expand, offering opportunities never before possible. This issue's feature article is the first of a two-part series, which focuses on credit issues regarding doing business internationally.

On our calendar of upcoming events are the National Association of Television Programming Executives Convention in Las Vegas, Nevada, January 22nd through 25th; the Broadcast Cable Credit Association Seminar in Atlanta, Georgia, February 14th through 16th; and the Georgia Association of Broadcasters Radio TV Institute in Athens, Georgia, February 20th through 22nd. And speaking of events, thanks to all of you who helped us make the season bright at the annual Szabo holiday party. Great fun once again!

Best wishes for a very Happy New Year!

Pete Szabo, President
Szabo Associates, Inc.

Doing Business Internationally–
Know the Risks to Reap the Rewards!

Today's rapidly expanding global marketplace offers ample opportunities for profit; however, without careful evaluation of the risks involved in conducting business internationally, a perceived "golden opportunity" can quickly turn into a costly mistake.

The two questions credit managers seek to answer when deciding whether or not to extend credit to a potential foreign customer are the same as for a potential domestic customer: (1) Is the customer able to pay? and (2) Is the customer willing to pay?

When doing business in the domestic marketplace, the credit manager must look only as far as the potential customer to answer these questions. When doing business internationally, however, the definition of risk must be expanded beyond **customer** (commercial) risk to also include **country** risk. In fact, country risk should be analyzed prior to evaluating elements of risk associated with the individual customer. If the country risk is deemed too great to assume, then it is pointless to pursue data on the customer. If the country risk is deemed acceptable, however, then the nature and extent of the country risk can help drive the method of customer risk analysis as well as the terms of credit extension.

COUNTRY RISK

When you accept or approve credit to a foreign customer, you also accept the risk of the customer's country. To a credit manager, *country risk analysis* means determining the "country credit-worthiness" in terms of the ability and willingness of a foreign government to make available to local companies foreign exchange necessary to service their foreign currency denominated obligations or debts to foreign suppliers. The process can best be accomplished by three options: gathering information in-house and analyzing it internally, paying for the services of an outside consulting company, or a combination of the two. Analytical approaches include obtaining statistical data, developing historical trends and growth patterns, and listing strengths and weaknesses. Some typical sources of information are governmental agencies, banks, the Finance Credit and International Business (FCIB), economic and political reporting services, newspapers and magazines, and internal company reports.

The amount of information required to perform country risk analysis depends on such factors as the number of active foreign customers sold within one or two years, the total number of active foreign customers in each country, the total accounts receivable exposure per country outstanding at any one time, the total amount of credit sales per year per country, your company's credit terms and collection policy, and your company's strategies over the

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Doing Business Internationally

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next three to five years. Generally, country risk analysis becomes a more formidable task as your trade account and country receivable exposure grows. Credit managers should carefully weigh the costs/benefits and the risks/rewards of the three options for analysis.

Many credit managers and companies make the mistake of trying to eliminate country risk rather than to manage it. By eliminating the risk, they often demand the most stringent credit terms available in international trade. The aim of country risk analysis is to anticipate change in country creditworthiness rather than merely react to it, and each company will have its own specific strategies, objectives, and motives for choosing whether or not to extend credit and what the credit terms will be.

Assessment of country risk takes into consideration the probability of delayed payment or credit loss, which can result from any one or a combination of four broad country risk conditions: (1) the resource base, (2) government policy, (3) external accounts, and (4) political risks. It is important to remember that they are interrelated and often overlap with each other.

Resource Base. The term refers to natural, human, and financial resources. *Natural resources* cannot in themselves make a positive contribution to a country's ability to earn or save foreign exchange with every country. While many countries do, many do not. *Human resources* refers to the extent to which a country's population can contribute to productive economic activity. It takes into consideration such factors as health, literacy, productivity plans in the public and private sector, availability of technical and managerial skills, and the presence of an entrepreneurial class. *Financial resources* refers to a country's ability to save, which translates into a higher proportion of investment it can meet with its own resources. A country's resource base must be regarded in terms of historical trends rather than simply present circumstances, and its implications depend on the quality and effectiveness of government, public, and private sectors over a period of time.

Government Policy. Government policies can and do strongly influence the economic and business climate of any country. A government's political philosophy affects economic policy as well as the degree of regulation or assistance it exerts on internal commerce and external trade. Aspects to consider include the quality of the economic and financial management process, long-term development strategy, and short-term policy measures. Regarding the latter, particular attention should be given to fiscal, monetary, wage-price, and foreign exchange rate policies.

In recent years, government restrictions have been imposed in many countries for economic reasons. One particular restriction, a fixed exchange rate for the currency, can cause serious problems for foreign creditors. Fixed conversion rates, used to protect weak currencies from decline in the world market, eventually lead to massive devaluation and currency weakened to the extent that the country cannot pay for its imports.

External Accounts. External financial conditions relate to (1) balance of payments, (2) external debt, (3) international reserves, and (4) potential access to external finance. A negative balance of payments means that the value of imports exceeds the value of exports and must be financed either through foreign reserves or borrowings. If a country's external debt level becomes unmanageable, the foreign creditor's risk of incurring blocked funds increases dramatically. Heavily indebted countries can become poor credit risks overnight if their balance-of-payment position suddenly becomes negative due to declining world prices of a major export. Countries generate foreign reserves from export earnings and foreign borrowing. Reserves should be sufficient to permit payment of normal trade-related liabilities without undue delay and also to provide some cushion in case of unanticipated adverse developments. In this regard, it is also important to evaluate a country's potential access to external finance—the country's drawing ability from the IMF, borrowing capacity from the World Bank, regional development banks, bilateral official sources and international commercial banks.

Political Risks. Analysis of the political outlook of a country is at least, if not more, important than analysis of economic and financial matters. When analyzing political risks, look for reasonable assurance that if political change comes (and it always does come, at some time), it will be orderly and there will be reasonable continuity in basic economic and financial policies. Assess the possibility of a moratorium on (or even a rejection of) external debt. Changes in leadership can also change the way in which the international investment community views the country's economic future. Wide fluctuations in currency markets can occur. Also, when government policies threaten to destroy investments and property of commercial investors in a country, capital flight is inevitable, which usually results in the country's government restricting the flow of currency and a disruption in international trade.

FOREIGN EXCHANGE RISKS

The result of country risks is *foreign exchange risks*—the ability and willingness of the foreign government to make enough foreign exchange available to its citizens, foreign residents, private and publicly owned companies, and government owned agencies to pay their foreign currency denominated liabilities or debts.

Over the past 50 years, there has been a huge increase in cross-border flows of goods, services, and investments. While fueling global economic growth, this increase has also made companies highly vulnerable to fluctuations in foreign exchange risks. That vulnerability has been exacerbated by the dissolution of the Bretton Woods Agreement in 1971 and the resultant floating of currency, which has caused foreign exchange markets to be plagued by growing instability. Like any other commodity, currencies follow laws of supply and demand, which are subject to political and economic conditions. Exchange rates can fluctuate wildly, sometimes several times in one day, severely complicating a company's short-term financial and long-term strategic decisions.

Foreign exchange risk includes both a country's sovereign and transfer risks, in addition to exchange controls.

Sovereign risk refers to the inability of a government to raise sufficient amounts of foreign exchange to service its foreign currency debt obligations. Credit managers should not assume that risk is diminished simply because a credit sale is to a foreign government entity. When a country experiences adverse country risk conditions, the government entity is likely to be subject to many of the same adverse conditions as private sector companies. Government entities often have access to decreasing foreign exchange reserves; however, that access varies among government and country owned or operated industries.

Transfer or convertibility risk refers to the inability of companies in the private sector to raise foreign exchange, even though they are in good financial condition. A vast majority of international trade is carried on in U.S. dollars because many nations use the U.S. dollar as their base reserve currency. Many companies invoice their export credit sales in not only U.S. dollars but also other hard currencies (major trading currencies) and some soft currencies as well. Since the foreign purchaser must convert its local currency into U.S. dollars or another billing currency to pay the bill, the transaction incurs a transfer risk. In other words, the invoiced currency may not be available when the purchaser tries to pay the bill. When feasible, you can solve the problem by arranging for collection in advance or by transferring the risk to a third party.

Exchange controls refer to government-imposed controls, the underlying purpose of which is to stabilize the country's currency. Credit people must be aware of exchange controls that affect extension of credit, payment terms, and collections within normal credit policies. For example, exchange controls may prevent a foreign buyer from remitting U.S. dollars to the seller.

In Summary. Credit managers should never underestimate the importance of country risk analysis because political and economic instabilities of countries have had and will continue to have a tremendous impact on the trade of goods and services between nations. Country conditions that could affect the foreign customer's ability and willingness to pay maturing debt obligations in a timely fashion should form the basis for choosing whether or not to proceed into customer risk analysis. In our next issue, we'll discuss customer risk as well as legal and regulatory issues regarding international business. ♦

"IF THERE ARE ABOUT 5 FRANCS TO A DOLLAR, DOES THAT MEAN I GET 5 TIMES AS MUCH FOOD, OR PAY 5 TIMES AS MUCH FOR IT?"

Why We Work the Way We Do
Media Know-How

One of the advantages of being the first and largest collection firm specializing in media is that we have the opportunity to learn our specialty so well.

Our training program covers not only collection subjects—diplomacy, negotiation, credit law—but also the unique world of media.

Our representatives work every day with people in the media business. And because we're organized in specialized divisions, our people work most in the specialty they know best, whether it's newspaper, magazine, television, radio, cable, out-of-home media, or any of the related industries.

We learn the latest terminology, techniques—even the latest excuses for slow pay.

As a result, our representatives become adept not just at collection but at media negotiation as well. All too often, slow pay can be a result of disagreements over contracts or the handling of discrepancies. We come into the picture as a fresh voice with fresh solutions.

Another way we keep learning about media is through participation in media organizations. You'll find our people appearing as speakers or seminar participants at meetings of trade associations in each of the major media. We're regularly asked to author industry publications on media credit and collections.

When we're not writing reports, we're gathering them. We have the most comprehensive media credit and collections library we know of. It not only helps keep all of our people informed, but it's available to our clients as well.

All of this helps us keep pace with the rapidly evolving media business. So no matter what develops in the future—interactive media, user-defined media, whatever—we'll be there to establish credit guidelines and make the collections. ♦

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