CHAPTER III

OPPORTUNITIES AND RISKS ININTERNATIONAL TRADE

INTRODUCTION

At the request of the conference organisers, concentration will be mainly upon short term business which constitutes the bulk of international trade. Accordingly there will be no reference to business conducted on medium to long term credit.
Technicalities will be referred to only briefly. The focus will be on those issues with which managements should be concerned.

OPPORTUNITIES AND RISKSFew opportunities are without risk. However many risks do not necessarily represent opportunity.
To a significant degree they are indivisible elements in the larger picture.

Before turning to a consideration of specific Risks and specific Opportunities several observations of a more general nature, but which bear upon the specifics.
Exploiting opportunity, having first identified it, depends partly on the nature and magnitude of the risks you are prepared to assume.

The identification and exploitation of opportunity in International Trade should flow from the Basic Objectives of your enterprise eg. is International Trade to be Y% of your total revenues or 3Y%? Is it to come from developed countries or undeveloped countries? What is the Maximum Risk Exposure you will accept? The answers will obviously influence strategies and outcomes.

But the first imperative is that the Objectives are clearly defined.
Successful outcomes will rest to an extent upon the Resources committed to the objectives.
The most vital Resources are Capital, Strategic Alliances and People.

Sound capitalisation is fundamental. Although it states the obvious, many have failed to recognise that thin capitalisation may cause the enterprise to falter and perhaps topple in adverse winds. Conversely, sound capitalisation gives both a solid base to the business and an important flexibility - such as the chance to try new markets and to assist in the diversification of your sources of revenue, whilst keeping to the business you know.

Strategic or Operational Alliances often play a valuable part in international trade. Knowledge of local trade and conditions in a foreign country is invariably an advantage and may help cement a profit or avoid a loss! Local partners of good repute and substance are frequently the difference between success and failure offshore. Such partnerships may well be at different levels - Strategic where you are seeking to establish direction and purpose, or Operational for the day to day needs of the business and vital linkage to your home-based staff.

However the most important resource is your people. Successful enterprises usually have quality staff, well selected, well trained, well motivated and rewarded, but above all they will be well led. In tomorrow's world it will be more important than ever for leaders and their people to have the knowledge, intelligence and flexibility to recognise changing economic and industry trends - which will occur faster than in today's world. Then, having recognised them, to devise successful strategies for change.

RISKS

What is the nature and magnitude of the risks in International Trade? How are they to be managed? It is tempting to assume that all risks are external. The fact is that some of the principal risks are internal - with your own enterprise.
They include: failure to clearly identify the Objectives of the enterprise; undertaking business risks with which the business is unfamiliar; setting unrealistic revenue and profit targets, especially in the short term, and finally but not exclusively; having the wrong people in positions of responsibility.

All of these risks are controllable if management is effective. Unfortunately, inadequate management has sometimes ignored or failed to perceive these risks. They can have serious consequences for profit, asset values and at worst, may imperil the very existence of the enterprise.

A common fault in the management of risk (in addition to the failure to understand the risk!) is failure to place monetary limits on the exposure of the enterprise to any one country, industry or buyer. Compounding this problem is the difficulty of recognising the interrelationships, which may exist between different buyers to whom there is an exposure. Ideally your enterprise should be able to withstand the failure of your major debtor risk. This however is a test, which many creditor companies would not survive.

The external risks are perhaps more apparent, if only because they are further away and we are able to focus more objectively upon them.
By definition International Trade involves dealing with buyers in foreign countries whose culture, legal system, and economic well being may be quite different from
that to which you are accustomed. Accordingly your knowledge, whether of country, industry, or buyer may not be of the order you would expect of a domestic transaction.

International Trade will frequently involve a greater degree of uncertainty and unpredictability than domestic trade, and your ability to influence or control outcomes will almost certainly not be of the same order.

It is interesting to note that in the period from 1990 to 1995 a significant change took place in the direction of the exports of Thailand and of all of its major export markets. In 1990 Industrialised Countries (excluding Japan) accounted for 50% of Thailand's exports and from 41 % for Singapore to 59% for Japan. By 1995 these figures had fallen to 36% for Thailand, 35% for Singapore and 48% for Japan.

Perhaps not surprisingly, exports to Asia, including Japan, had risen sharply. In 1995 they accounted for 53% of Thailand's exports (39% in 1990), 55% of Singapore'51 % in 1990) and 44% of Japan (31 % in 1990).

These figures, a representative few, give some indication of how significantly the risk element attaching to the direction of a country's trade had shifted in a short period. Intra - Asian trade had become much more significant than trade with the non Asian world in the relatively brief period of five years.

Adversity can arise with bewildering speed. The events in Asia during recent weeks provide a graphic illustration. The global market place is with us, and nowhere is there a haven from economic or commercial damage.

The rate of change in economies, industries and enterprises is rapid, and not likely to become less so in the near future. It is profoundly important that the risk of change is both anticipated and recognised --- and then turned to advantage.
In today's world, external events are more likely than ever to influence not only international trade but also, and possibly more significantly on occasions, domestic trade.

Globalisation will continue to bring many benefits. It will also create risk. One example is the increasing demand for more liberal terms of payment, Buyers who would in earlier days have almost automatically paid by Letter of Credit are now quite often calling for terms - and, not infrequently, on Open Account. There is little doubt this development is exposing more Exporters to more risk, a risk that can be mitigated by the use of Credit Insurance.

From the technical perspective of a Credit Insurer the specific risks in International Trade fall into two broad categories, Commercial Risk and Political Risk.

Commercial Risk covers the, Insolvency of the Insured Buyer and the Buyer's Protracted Default. The latter comprises only a modest percentage of Commercial claims against Credit Insurers. Coverage is usually for 85% of loss, incurred - With individual Insurers varying this percentage by 5% up or down.

Political Risk covers loss arising from events in the Buyer's country such as war, civil riot or commotion, exchange transfer delays or blockage, and cancellation of import licences. Insurers usually cover approx. 90-95% of the amount of loss incurred due to Political causes.

The majority of claims paid by credit insurers are caused by commercial events. Moreover, from an historical viewpoint, political events causing loss are far more likely to arise in the less industrialised countries. Examples of political events causing claims for credit insurers in recent years have been: conflict in Kuwait; the collapse of the Soviet Union; and banking difficulties in Turkey, Venezuela, Argentina, and Bulgaria.

It is a fact that the distinction between Commercial Risk and Political Risk is becoming a little blurred around the edges. A significant devaluation of the currency of the buyer's country may well have a serious impact on the buyer's ability to meet import costs in his now, devalued currency - a commercial event caused possibly by political developments after the goods were imported.

Traditionally the bulk of Political Risk support has come from Governments standing behind their State owned insurer. However there has long been a private reinsurance market for Political Risk provided partly from Lloyds and partly from the general reinsurance market. There are some indications that the private market may be developing a larger appetite for Political Risk than has been the case for many years. Should this prove to be the case then the demand for such cover may increase still further to capitalise on the additional capacity available.

THE ROLE OF CREDIT INSURANCE IN MITIGATING RISKBriefly put, credit insurance provides policyholders (trade creditors) with protection against loss arising from the insolvency of their trade debtor, or from loss arising from defined "political" causes of loss. Europe was the birth-place of credit insurance. It remains the dominant force to the present time, although strong growth has occurred beyond Europe.

The industry is represented by two world wide bodies. The Berne Union of Credit and Investment Insurers, and the International Credit Insurance Association. Both were formed in the 1920's. The Berne Union membership is composed mainly of Government Departments or Agencies, or corporations in which Governments have a majority shareholding. Of the Berne Union membership of 46 (from 38 countries) most are public enterprises although some of the largest members are from the private sector. The ICIA membership of 45 (from 28 countries) includes a number, which are also members of the Berne Union.

Between them they insure an estimated 10% of exports from member countries. ICIA members also insure an estimated US Dollars 1000 Billion of domestic trade.

It is undoubted that credit insurance has become an important facilitator of trade. This is perhaps not surprising given that credit insurance protects cash flow, profits, assets, and not infrequently the very existence of the policyholder.

It is however important to recognise that credit insurance is not a substitute for effective credit management. Rather it is a particularly useful aid to the competent credit manager. And, most importantly, credit insurance cannot turn a bad risk into a good risk. Credit insurance is also a valuable marketing and sales weapon, an aspect of the industry which has not been sufficiently well presented by the industry, and which accordingly, is not clearly recognised by industry and commerce.

Credit insurers have access to economic, industry sector and credit intelligence on a worldwide basis, so not unreasonably they should be able, and are indeed expected, to add value. Additionally the credit insurer would be expected to have formidable export, and where appropriate, domestic trade sector expertise.

To illustrate the point, Trade Indemnity was the UK's largest privately owned credit insurer, covering in excess of US Dollars 100 billion of trade credit annually of which approx. 25% was export business. Of its 800 staff approximately 130 were engaged in Underwriting or Risk Management for both, Domestic and Export business. They were expected to have trade sector competence (if not expertise), and, for the export business, a strong knowledge of international trade practice and country risk.

A final point before turning to Opportunities is that a close working relationship between the policyholder and the credit insurer is important. The relationship is closer than that of many bank / customer relationships - usually with beneficial results.

OPPORTUNITIESInternational trade is the economic life force of many nations. It has grown strongly and consistently for many years. In particular it has grown strongly in Asia, where the rate of growth has outstripped that of North America and Europe by a wide margin.

Despite recent upheavals, it is more than likely this story will be repeated over the longer term.

The emergence of China in the next two decades, as an economic powerhouse will itself impact significantly upon world trade, and Asia's role in particular.

There are numerous other influences. Trade barriers are gradually being removed. The wealth of nations is increasing. New middle classes are emerging. International barriers are being lowered. Overseas investment by many countries is increasing. Globalisation has become a fact of life. Bul perhaps most importantly of all, we have entered a new information / communication revolution which will transform economies, trade and enterprises to a degree we cannot at present imagine.

Each of these developments will create opportunities in international trade. More specifically the ability of an enterprise to be competitive will create opportunity - or lose it! But so it has always been. In future however the pressures to be competitive on an international basis will be far greater.
As an example let us consider some of the opportunities, which may lie ahead for Thailand - somewhat similar considerations would apply to other Asian countries.

A brief backward glance is educational. Thailand's rate of export growth has been exceptional by world standards, but in line with most other Asian countries. However, as mentioned earlier, most of the growth has occurred within Asia. Of the increase in Thailand's exports from 1990 to 1995 some 63% went to other Asian countries, 28% to the U.S.A. 4.2% to the Middle East, 3.6% to Eastern Europe, 1.1% to Africa and less than 1% to the South Americas.

Whilst these figures suggest that opportunities have been captured, they also highlight an undue concentration on two geographical areas. Penetration of Continental Europe is extremely low. Given the size of that market, and the greater dynamism which one would expect from acceleration of the E.U., there would seem to be attractive possibilities in that part of the world. Neighbouring Eastern Europe also has a very low penetration by Thailand. There are some markets which would present opportunity, Poland and Slovenia for example, but their scale and time horizon would be decidedly more modest than those of Western Europe. A somewhat similar observation may be made of the South Americas.

Developing opportunities takes time, money and effort. We are back to the Resources issue discussed earlier. There is good reason to believe that if the resources are made available, and if an innovative approach is taken to product development and the establishment of alliances, then Thai exporters should be able to diversify their markets to a greater extent than evident in recent years. However we must not expect too much too soon. This is a strategic and tactical error made frequently by Western companies seeking out opportunities in Asia. There is no substitute for sound medium long term planning accompanied by stringent financial objectives and controls.

None of this is to argue for pessimism within the Asian region. You are now experiencing what many of us elsewhere have gone through, and unpleasant as it may be, there are numerous examples of such adversity leading to enhanced strength. There is good reason to feel that Asia will continue to represent one of the major areas of opportunity for Thailand's exporters.

Finally it is impossible to ignore the United Stales - one of Thailand's major export markets, and one which will continue to provide attractive opportunity, The world's largest economy has considerable underlying strength and flexibility It will surely remain a vital area of opportunity.

What are the risks for exporters in developing these opportunities? First it can reasonably be said that the U.S. and Western Europe represent very low risk from a political cause of loss standpoint. The same cannot be said of Eastern Europe, Africa, the Middle East or the South Americas, where stability, both political and economic, is of a somewhat lower order. Bearing in mind that in the near future both the U.S. and Western Europe could have interesting potential for Thai exporters, this assessment, if valid, is encouraging.

Whether the potential can be captured will depend on the results of research. For example, are your products appropriate, if not can they be adapted for the export market, what is the likely level of demand, what is the level of competition - these and many other questions need to be examined. Your country's Trade Offices often have good market intelligence, international banks should provide helpful advice, and of course so should credit insurers. These avenues, together with your own research, will help you decide the quality of the commercial risks (as distinct from political risks) you face in developing a new market or more business in an existing market.

Many payment problems for exporters arise from either their excessive optimism about their buyer, based on years of satisfactory payment experience, or from relative ignorance about a buyer new to them. Both of these hazards can be lessened, by a combination of research, effective relationships with Trade Offices and international banks, and perhaps most especially, credit insurers.

A potential for Thai exporters to diversify their markets does seem to exist, and interestingly, if Western Europe is seen as a target, it is an area about which a great deal is known, thereby, one hopes, lessening the risk of engagement.

THE ROLE OF THE CREDIT INSURER IN EXPLOITING OPPORTUNITY

The Credit Insurer should be an essential element in the strategic considerations of any enterprise engaged in international trade. It has the capacity to enable the enterprise to step more broadly and yet more safely in the international arena. Skilfully used, credit insurance should assist in the diversification of markets, (thereby reducing any overdependence on any one market), in product innovation and in the broadening of the customer base. It can and has done all of these things, with enterprises of all sizes.

It has been said earlier that credit insurance protects cash flow, profit, and assets.
It also provides valuable market intelligence and an unrivalled quality of credit and risk assessment.
Close and effective cooperation between Credit Insurer and Policyholder should give the Exporter the potential to make increased sales to existing customers, to develop new customers in existing overseas markets, and to open up new markets.

The principal commodity possessed by Credit Insurers is Risk Capacity, which can be more effectively utilised by the Exporter and the Credit Insurer working in harmony.

The Banks have an important role to play. They are obviously heavily engaged in International Trade. Not infrequently Banks will have as collateral security policies of credit insurance, effected by the Exporter and assigned to the Bank. Whilst it is interesting to observe that Exporters seem to make more effective use of Credit Insurance than domestically oriented enterprises, there is still a good deal of room for better use to be made of Credit Insurance by both Banks and Exporters. Essentially, Banks should be able to lend more support to the Exporter, with a greater degree of security via the Credit Insurer, than would normally be the case in an uninsured transaction.

Competition is creating demand for credit. Many buyers who would previously have paid by Letter of Credit are now demanding terms - and quite often on Open Account. Credit Insurance has a particular value in such circumstances, enabling the Exporter to offer credit terms with the comfort of the Insurer behind the transaction.

Credit Insurers therefore have a practical and valuable contribution to make to the development of opportunities in International Trade. But there is ample scope for more to be achieved.

LOOKING AHEAD

It has often been said that there are only three certainties in life - Birth, Death, and Taxation. There is however another - Change.

The rate at which change now takes place is often literally breathtaking, and so on occasions, is its magnitude. But change so often brings with it Opportunity. Part of the challenge is to recognise the change and then to see how it can be turned to advantage.

The communication and information revolution which we have entered is but one example of tomorrow's opportunities. The emergence of China as an economic giant will be another. So too will opportunity flow from the continuing privatisation of Government enterprises - as will the changing nature of enterprises themselves in the coming decades.

Some of these opportunities will arise in International Trade. They cannot and should not be ignored. But Exporters, Banks and Credit Insurers will need to exercise imagination, intuition and innovation to seize the initiative. This may well require the leaping of a few conceptual hurdles, especially on the part of Credit Insurers and the Banks. But an ability to look beyond the horizon will be an invaluable asset.

The Export Community should regard credit insurance as a potent financial management and marketing and sales weapon. Credit Insurance is a dynamic, not a static weapon. Skilfully brandished it has the potential to Protect and Promote enterprise.

Those present today are either engaged in or about to embark upon careers in International Trade. It is in my experience a highly stimulating career, one which offers not only intellectual challenge but also the immense satisfaction of daily practical application.

There is one special challenge, which has both intellectual and practical application. It is to seek ways for the international community of manufacturers, traders, bankers and credit insurers to work more closely together. In so doing you will truly capitalise on opportunities whilst mitigating your risks.