CFO innovation INSIGHT SURVEY

RECEIVABLES AFTER THE CRISIS:

Asia's CFOs & Elevated Risk

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CONTENT

KEY TAKEAWAYS

CFO Innovation Asia surveyed 184 CFOs, finance directors, controllers and other senior executives from Singapore, Hong Kong, China, Malaysia and other jurisdictions in Asia from 3 to 18 March 2011. The key findings include the following:

On the face of it, late payments or outright defaults appear to be a manageable problem in Asia. Nearly seven out of ten respondents say receivables equalled only 40% or less of their company's current assets at the end of 2010. Three out of ten peg the proportion even lower, at 20% or less. But this is likely a function of the high levels of cash on Asian balance sheets, as revealed by Moody's research, rather than an indication of timely payments.

Indeed, a large majority of respondents say their company has been experiencing delayed payments. Seventy five percent of the executives surveyed say payments are late by up to 15 days (35%) or by more than 15 days (40%). Companies in Asia are also seeing an increase in requests to stretch payment terms – nearly half (49%) of respondents report this to be the case. For now, the bills are eventually paid. Just 17% report an increase in defaults in 2010 compared with pre-crisis levels.

Little wonder that many companies remain worried despite the apparent end of the global financial crisis. The majority of respondents (51%) say they are more concerned today about late payments or outright defaults compared with before the Great Recession in 2008. Only 11% say they are not worried. However, a substantial 39% report that their company's level of concern is unchanged from before the crisis.

To protect themselves, enterprises in Asia are reducing their exposure to customers they judge to be less creditworthy. Most respondents (80%) indicate that this is the preferred approach. Moving away from open account in favour of letter of credit is a far second (19%), followed by taking out trade credit insurance (17%). But companies that turn away orders run the risk of losing market share and foregoing opportunities to grow the business.

The low usage of trade credit insurance may be due to limited knowledge about this product. The majority of respondents (51%) say they are not familiar with credit insurance as a risk management tool. But it seems that knowledge breeds satisfaction. Those respondents who know credit insurance say their experience with it is net positive (67%). The insurance company they deal with apparently meets their expectations, which include charging reasonable premiums (80%) and providing information about counterparty creditworthiness (70%).

Going forward, companies in Asia will focus on requiring advance payment to mitigate payment risk. This strategy is singled out by 40% of the respondents surveyed. Taking out credit insurance is the second most cited strategy, although it is far behind at 18%. Fifteen percent will require customers to open a letter of credit.

Receivables in Asia do not appear to be unduly high

In times of great uncertainty or crisis, customers try to conserve cash by delaying payments, among others, which result in high levels of receivables on company balance sheets. At first glance, this does not appear to be the case in Asia, which had not been hit as hard as the West by the global financial crisis.

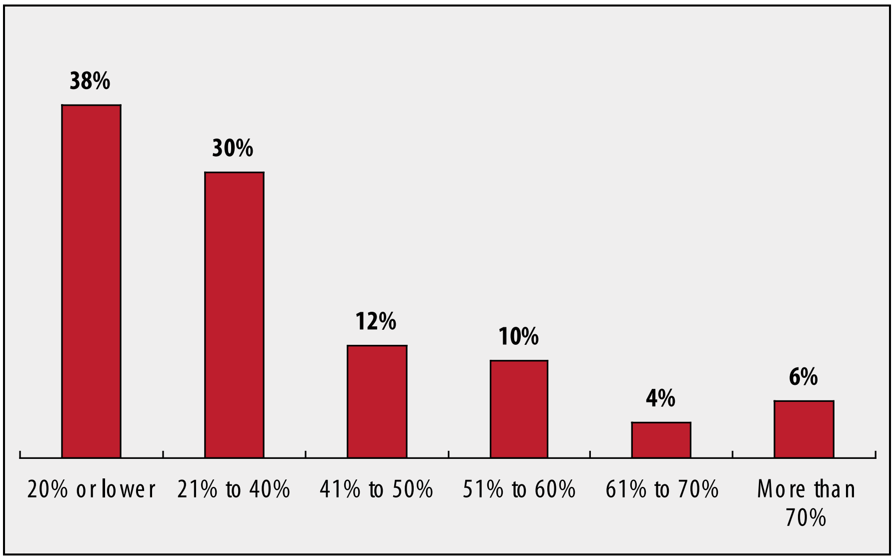
Asked the amount of accounts receivable as a percentage of current assets at the end of last year, 68% of the executives surveyed from Singapore, Hong Kong, China, Malaysia and other places in Asia put the number at a manageable 40% or less. Thirty eight percent peg it even lower, at 20% or less.

This appears to indicate that companies in Asia are getting paid on time and have avoided the expensive situation of having a large part of their cash tied up in receivables.

But it is likely that the primary reason behind what appears to be a relatively low level of receivables is the fact that enterprises in Asia have amassed huge cash hoards. In an analysis of 120 non-financial corporates last November, Moody's Investors Service found that these companies' cash, cash equivalents, deposits and short-term investments topped US$230 billion as of 30 June 2010 – nearly 60% higher than in 2008.[1]

[1] Special Report, Moody's Investors Service, 15 November 2010.

At the end of 2010, how much in receivables did your company have as a percentage of current assets?



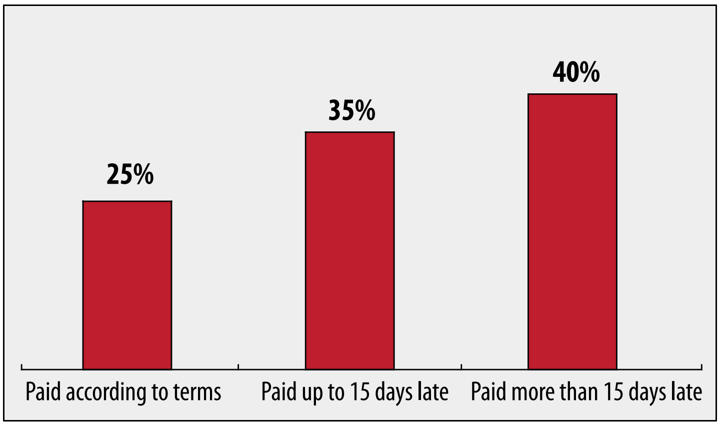
N=184 respondents

Customers are delaying payments

This interpretation is bolstered by the fact that 40% of respondents report customer payments that are late by more than 15 days, while another 35% say payments were delayed by up to 15 days. Only 25% of the executives surveyed indicate that customers are generally paying on time.

Admittedly, late payments are not a new phenomenon in Asia. Even before the global financial crisis, many companies in China, for example, have been habitually delaying payments, particularly since they pay in cash. This does not appear to be a function of financial distress, but a practical way to manage finances in an environment where bank borrowings can be difficult. Because they eventually get paid, suppliers tend to be resigned to the situation, especially since they, too, delay payments to their own suppliers.

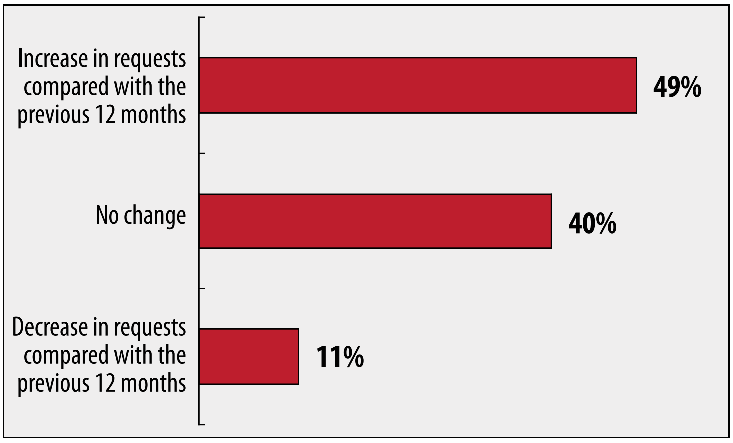
How would you describe your customers' general performance in terms of payments?



N=178 respondents.

Nevertheless, 49% of respondents are seeing an increase in requests to lengthen payment terms compared with the previous 12 months. Only 11% detect a decrease in such requests. Forty percent say there has been no change in the number of requests to change terms.

What has been your experience regarding requests by customers to lengthen payment terms?



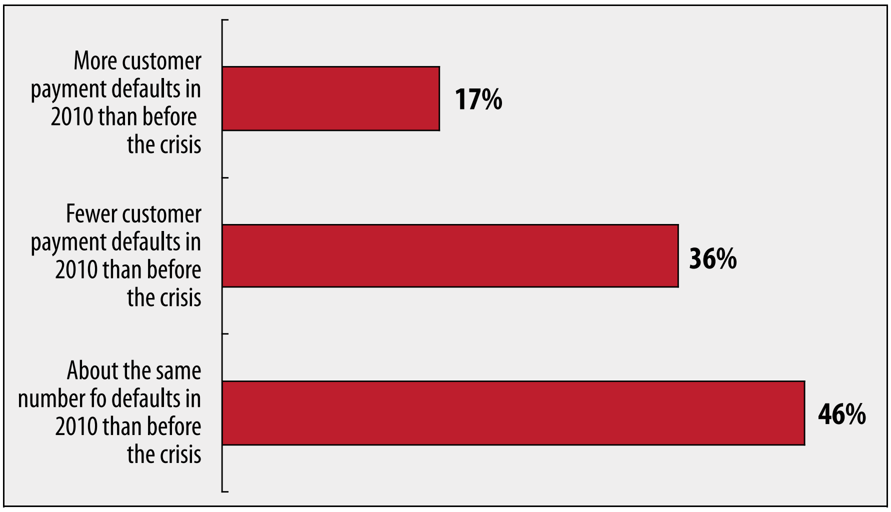
N=179 respondents.

Saving grace: Outright defaults not surging

Companies can draw comfort at least from the fact that customers eventually pay their bills, albeit after taking some time to make good on them. Only 17% of respondents say that their company was hit by outright defaults in 2010.

Nearly five out of ten (46%) say the number of defaults generally stayed the same last year compared with before the crisis. Thirty six percent even say that fewer customers have defaulted on their obligations.

How would you describe defaults in 2010 compared with before the global financial crisis?



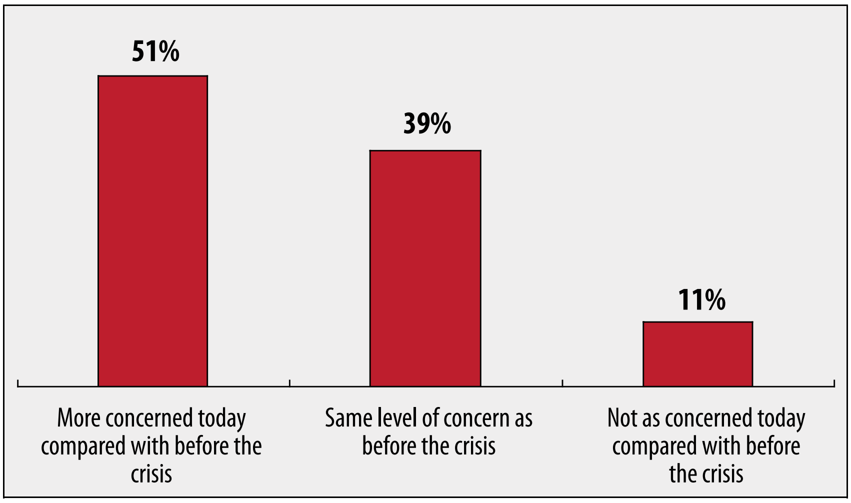
N=179 respondents. Total does not add up to 100% because of rounding.

Lingering worries about counterparty risk

Asked to compare their level of concern about delayed payments or defaults today compared with the period before the Great Recession of 2008, 51% of the executives surveyed say they are more worried these days than before.

Only 11% are not as concerned, with 39% saying they are less worried now than they were before the global financial crisis.

How concerned is your company about delayed payments and defaults?



N=179 respondents. Total does not add up to 100% because of rounding.

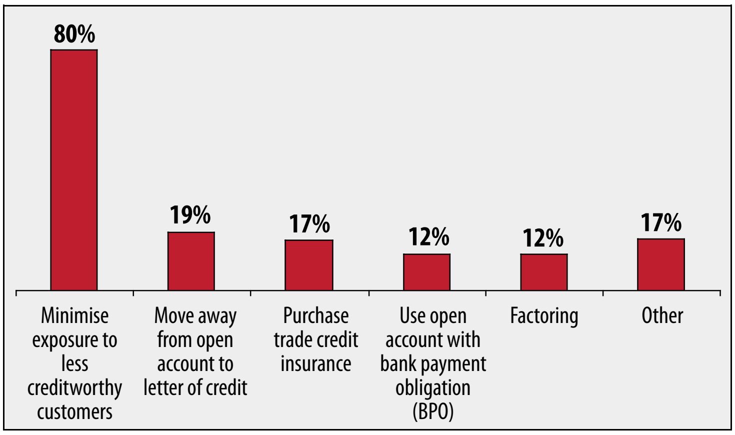
The higher level of concern today compared with the pre-crisis period is not surprising, given the continuing unemployment and budget problems in the U.S. and the economic crisis in Greece, Ireland and Portugal, which threatens to spill over to the rest of Europe. Fieldwork for this research was completed before the massive earthquake, tsunami and nuclear accident in Japan, but the fallout on global supply chains will almost certainly add to the worries.

Avoidance theory: Minimising exposure

Respondents were asked how their company has been managing the elevated risk from the global financial crisis. The overwhelming majority (80%) say they are cutting back on exposure to customers they consider less creditworthy.

From anecdotal evidence, this typically means lowering credit limits of smaller customers in crisis-hit markets (including the U.S.) and turning away new buyers that the company does not know or whose credentials it cannot vet from information available to it.

How is your company dealing with heightened risk of late payments and defaults?



N=130 respondents. Total does not add up to 100% because multiple answers are allowed.

The problem with turning away business is that the company runs the risk of losing market share and could also pass up opportunities for future growth. As new businesses spring up in China, India and other Asian markets, the overcautious company that insists on dealing only with the tried-and-true may lose out.

A secondary tactic, according to respondents, is to return to letters of credit. In recent years, global trade has moved away from this financial instrument, which is basically a bank-backed payment guarantee. Instead, some 80% of global trade is now conducted on open account, a relationships underpinned by trust between the parties involved.

Requiring customers to take out a letter of credit may be a limited strategy. "If you ask your buyer to open a letter of credit, it's better for you because you've got a secure payment instrument," says Richard Green, Asia Head of Trade and Political Risk Practice at Marsh, a global insurance broker. "But what you've done is create a problem for your buyer, because your buyer will have to go and get a letter of credit and that will use up his banking lines."

The company may have the whip hand in a crisis environment, but not in markets that have resumed growth, which is where most of Asia is now. And for all their fiscal problems, the US and European economies are expanding again.

"What you don't want is to make life too difficult for your buyers," says Green. "If you do that, they'll buy from someone else."

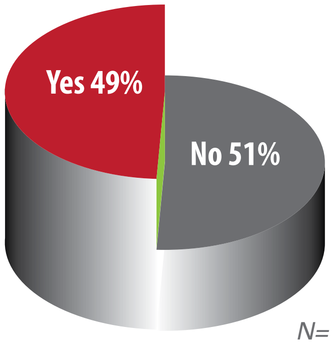
[2] Interview with Connie Leung, Director, Payments and Trade Markets, Asia Pacific, SWIFT, 16 November 2010.

[3] Interview with Richard Green, Asia Head of Trade and Political Risk Practice, Marsh, 17 February 2011.

Credit insurance: Not clear on the concept

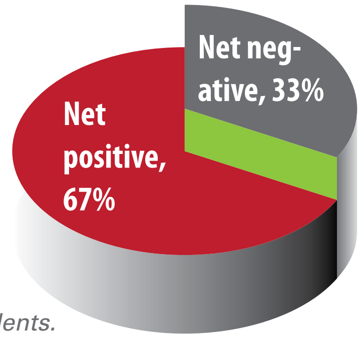
Companies in Asia are also taking out trade credit insurance as a way to deal with elevated counterparty risk. Just 17% of respondents say their company is doing this – but that may be because only half of them are familiar with this type of insurance as risk management tool.

Are you familiar with credit insurance as risk management tool?



N=176 respondents

What has been your experience with credit insurance?



N=89 respondents.

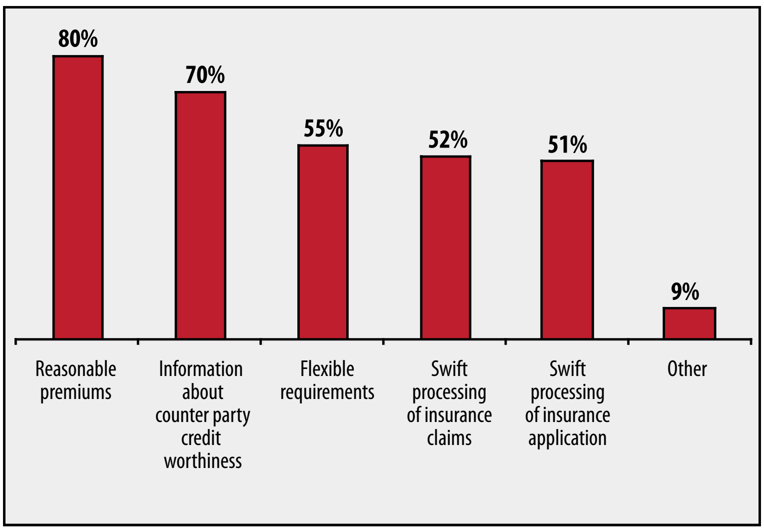
Interestingly, familiarity appears to breed broad satisfaction when it comes to credit insurance. Respondents who said they were familiar with credit insurance were asked what their experience has been with the product. Nearly seven out of ten say the experience has been net positive.

These respondents' broadly positive experience with credit insurance suggests that their insurance providers are, by and large, meeting their company's expectations.

The foremost expectation is reasonably priced premiums, cited by 80% of respondents. This is followed by the insurer providing credit information about counterparties (70%), which is usually inferred from the exposure limit set by the insurer on a particular counterparty or its decision on whether or not to extend coverage.

The other expectations focus on flexible insurer requirements (55%) and speedy processing of insurance claims (52%) and coverage applications (51%).

What are your expectations of credit insurance?



N=89 respondents.

The way forward

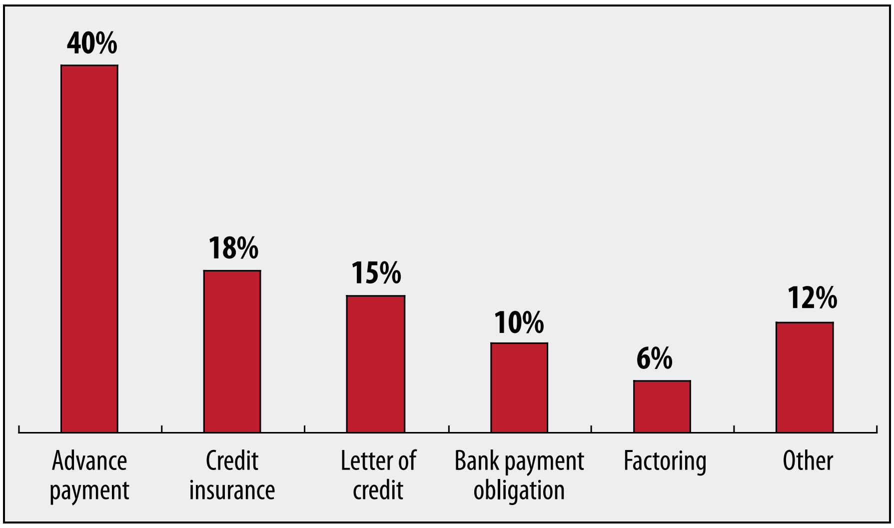
Asked to single out one key strategy that their company will use to mitigate credit risk in the next 12 months, 40% of the executives surveyed say their firm will require advance payment from customers. Eighteen percent will purchase credit insurance, while 15% will rely on letters of credit.

It seems that many companies in Asia have decided that it is better to be safe than sorry, and the best way is apparently to ask customers to front part or all of the payment due. The plan to require a letter of credit is in the same safe-not-sorry vein.

They run the risk, however, of customers moving on to other more flexible payment policies. Companies with strong brands or differentiated products may believe that they have the upper hand, since their customers have little choice – at least for now. But there are always competitors looking for a way in, and generous payment terms may help them do just that.

For CFOs, the challenge is to strike the right balance between prudent risk management of receivables and efficient and flexible customer service for future growth.

In the next 12 months, what is the one key strategy that your company will use to mitigate payment risk?



N=175 respondents. Total does not add up to 100% because of rounding.

Sponsor's Perspective

This survey provides some key information on the attitudes of businesses in Asia and one of the primary reasons why we sponsored the research was to gain a perspective directly from businesses in Asia on the effects of the global crisis on payments procedures and their approach to credit management. Essentially, we were keen to understand how companies were dealing with the trading issues after the crisis and what lasting impact it had upon their business.

Clearly, the opinions, views and experiences of Asian businesses provide a valuable method of gauging the current business climate and attitudes to business risk, while also helping identify any issues where we can help support companies in the region, especially as we also have a number of operations in Asia.

Resilient businesses hold on to cash

There's no denying that businesses in Asia have fared better than most, particularly those in Europe, during the recent global crisis and they have also been the first to show real signs of strong growth. Part of this resilience could be attributed to the large amounts of cash that Asian businesses hold, which according to a report by Moody's, has grown by up to 60% since 2008.

This 'cash-rich' situation not only has the effect of reducing the level of receivables as a proportion of assets, but also acts as a buffer for Asian businesses and has helped protect them against the non-payment domino effect that plagued European and US businesses.

Nevertheless, there is a clear indication in the research that Asian business is becoming increasingly concerned about the growing trend towards delayed payments. While it is difficult to generalise as individual countries in Asia, like those across the rest of the world, will have their own business cultures and operate within differing interpretation of 'acceptable delay', the figures make for interesting reading.

Late payment concerns on the increase

Just over half of all respondents indicated that they are now more concerned about late payments than they were before the global crisis, which suggests that either payment delays are becoming more common or there is a residual concern, as a result of the experiences during the recession, where Asian export trade to the US and Europe was severely affected.

However, there are clear indications within the CFO Innovation study that payment delays, in general, are increasing with almost half of the respondents reporting that requests for extended payment terms are also growing. With the research showing that 40% of payments are more than 15 days overdue it's not surprising that concerns about delayed payments should feature prominently in the findings.

Late payments can penalise businesses further, by costing them money to explore and secure other finance streams, which enable them to maintain cash flow, such as potentially expensive bank finance, loans and other options.

Naturally, payment practices are of specific interest to Atradius as we provide credit insurance to protect businesses against the risk of payment default when trading on credit terms in domestic and international markets. Although credit insurance policies typically cover up to 90% of the value of the outstanding receivables, it is clearly in everyone's interests to secure payments on time and in full.

To help gauge payment practices and the trends in payment delays, we undertake our own studies, which are published in our regular series of detailed Payment Practices Barometer (PPB) reports. These detailed documents are freely available from our website and the latest study has just been published.

While the current PPB study focuses on Europe, it provides a basis against which to compare some of the findings of the CFO Innovation report on a broad basis and see how the two regions differ.

While in Asia the research shows that 75% of all payments are outside the agreed terms, the average figure for Europe is just 25%. However, this average conceals some significant variations between countries, which shows that it's not only useful to know the regional trend but also the specific data for each country.

Of the nine European countries surveyed, the Netherlands, Denmark and Sweden all had late payment levels of 10% or less, while at the other end of the scale, 50% of payments in Italy were late and in Spain the figure stands at 79% with 55% being more than 60 days late.

Restricting customer credit could put Asian business at risk

While the European figures provide an additional perspective and comparison to the late payment experiences in Asia, it is the way that Asian businesses are dealing with this issue and protecting themselves from late payment that could raise some cause for concern.

A key finding from the CFO Innovation study shows that 80% of all respondents are reducing their exposure to customers that they judge to be less creditworthy, which is arguably a sound approach, but only when the information on which these decisions are being made is robust and up to date.

However, when this research result is combined with another, which indicates that advance payment will become an increasingly common feature of Asian trade, then there is a clear risk that by adopting these strategies, some Asian companies could limit their growth, lose market share and become uncompetitive by insisting on up front payments and restricting credit terms.

Cash and non-credit sales in Asia may be typically higher than the world average, as indicated by our own Payment Practices Barometer research in mid 2010, which showed that Hong Kong was around 8% higher, while China was 15% higher on foreign sales and 18% on domestic.

Even so, the further tightening of credit could have a negative impact on many Asian corporations, where their desire to avoid late payment default creates other issues that could restrict the business.

While the CFO Innovation study confirms that almost 70% of those that use trade credit insurance regarded it as making a positive contribution, our interest within Atradius was drawn to the finding that around half of all respondents were "...unfamiliar with credit insurance as a risk management tool."

In some respects, this unfamiliarity with trade credit insurance could indicate a key reason why some Asian businesses are considering the potentially restrictive strategies of up front payments and imposing tighter credit conditions on customers.

Credit insurance is designed to enable businesses to trade on credit with customers where an agreed insurance credit limit is in place. This means that credit terms can be offered to maintain competitive appeal and avoid the 'up-front' payment obstacle.

Also, the issue of reducing exposure to risk by not dealing with customers regarded as less credit worthy can be overcome, as the depth of information Atradius holds provides a much more robust basis on which credit decisions can be made.

Inevitably, there will be those businesses where credit should be limited, but the decision will be made on sound financial and non-financial data rather than just recent payment history. Irrespective of this, in any business where its sales covered by credit insurance, the risk is already pre-approved and even if something does go wrong, they can still claim on the insurance policy.

Credit insurance can provide a solution

To give an indication of just how widely credit insurance is used on a global basis and the scale of our involvement, Atradius has been providing credit insurance for over 85 years and has annual revenues of more than €1.5 billion (US$ 2.2 billion).

Our global team of around 3,300 people deliver credit insurance services through our 160 offices located in 42 countries and we have people on the ground that are fully conversant with local business practices and cultures to provide robust expert support. We also provide our customers with access to financial information on 60 million companies worldwide and we make in excess of 20,000 trade credit decisions every day.

In Asia alone, we have over 50 years of experience in providing credit insurance expertise through our offices in China, Singapore, Japan and India and through our agents in Taiwan and Thailand. Also, for over a decade we have had a presence in Hong Kong, which has been our regional headquarters for Asia since January 2007.

The CFO Innovation study provides a range of thought provoking information as well as a key snapshot into the current attitudes of Asian businesses as they rapidly emerge from the recession. Clearly, there is a lot of positive activity in each country, but surprisingly, perhaps, there are also concerns about payment and credit, even though the growth rates are the envy of the rest of the world.

About This Report

Fieldwork for this online survey was conducted from 3 to 18 March 2011. Cesar Bacani, CFO Innovation's Editor-in-Chief, devised the questionnaire, analysed the results and wrote the report.

A total of 184 respondents from Singapore, Hong Kong, China, Malaysia and other places in Asia participated in this survey. They are CFOs, finance directors, controllers and other senior executives who work in a range of companies in terms of turnover, employee numbers and industry.

Respondents are personally based in the following markets...

Singapore	27%
Hong Kong	20%
China	17%
Malaysia	15%
Indonesia	5%
Philippines	5%
Thailand	3%
India	2%
Australia	1%
Taiwan	1%
Other	4%

...hold positions with the following titles...

CFO/Finance Director	39%
Finance manager/other finance	21%
Financial controller	20%
CEO/Chairman/Owner	6%
Vice President Finance	4%
Other C-level executive	3%
Treasurer	1%
Other	6%

...work in companies with these employee numbers...

Fewer than 50	9%
51 to 200	24%
201 to 500	25%
501 to 2,000	19%
2,001 to 5,000	10%
More than 5,000	13%

...have the following in annual turnover...

Less than US$100 million	41%
More than US$100 million to US$500 million	33%
More than US$500 million to US$1 billion	9%
Over US$1 billion	16%

...and engaged in the following industries:

Electronics/software/high-tech	14%
Transportation/travel/hotel	12%
Consulting/other professional services	12%
Banking/finance/insurance	7%
Telecommunications	6%
Industrial equipment	6%
Chemicals	5%
Pharmaceuticals/medical products/ bio tech	4%
Media & entertainment	4%
Food and restaurants	4%
Energy/oil/gas	3%
Property and construction	2%
Consumer durables, including white goods	2%
Retail	2%
Healthcare	2%
Automotive	2%
Metals & mining	1%
Other	13%

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