CREDIT INSURANCE

A QUICK START GUIDE

TABLE OF CONTENTS

TAKE RISK SERIOUSLY

Taking calculated risks is part and parcel of running a successful business.

It means recognising an opportunity, acting quickly and being aware of what is at stake and taking steps to mitigate the risk. Unfortunately, there is one considerable commercial risk that many companies take for granted until it is too late.

Offering credit terms is essential to really compete and win new customers. However, it means that a company's trade receivables – the money it is owed on account – could typically represent 35% of its balance sheet. It's simultaneously a major asset and a huge potential financial liability when you consider the serious threat that a large bad debt poses to the company's health and even survival.

If you are reading this guide, it's a good sign that you take this risk seriously and already have some mitigation measures in place. However, in the current unsettled economic and political climate, you may be considering other ways to protect your business, including the option of a credit insurance policy. This Quick Start Guide to Credit Insurance provides straight forward information about what credit insurance is, how it works and what to consider when obtaining a policy for your business. We've tried to keep it jargon-free but where this is unavoidable, you'll find a definition in our glossary of credit insurance terms.

The guide is not exhaustive – we know your time is short – but we believe it will be a useful introduction to the basics which will help you make an informed decision.

HOW DO YOU PROTECT YOUR BUSINESS?

Unless it demands full payment upfront, no company is immune from the possibility of bad debt but there are ways to mitigate the risk of it happening and it’s impact.

Many of these methods will probably be familiar to you but it is worth evaluating them and asking whether they represent the best option for your business.

SELF-INSURANCE

Set up a specific fund to act as a financial cushion in the event of customer insolvency or another catastrophic loss

PRO's

- Reduces expenses
- Should increase focus on risk management

CONS

- Will there be enough funds in the event of a catastrophic loss?
- Ties up money that could be put to better use and is costly
- May hold a company back by reducing willingness to take on ‘risky’ business

BAD DEBT PROTECTION

Bolt on credit insurance to a factoring or invoice discounting facility

PRO's

- Peace of mind
- Easy to arrange if you already use a factoring service

CONS

- Cover is limited. It generally doesn’t include risks such as late payment, disputed debts, political risks, natural disaster or pre-shipment risks
- Typically, won’t provide ongoing customer monitoring or business intelligence on credit risk

CREDIT CHECKS AND BUSINESS REPORTS

Run credit checks or obtain business report on customers before offering credit or raising limit

PRO's

- Important element of any credit management process
- Chance to identify and avoid high-risk transactions

CONS

- Can the company be sure their provider has the latest financial information?
- No protection against the impact of an unforeseeable bad debt
- Information provider has no visibility on the trade with your customer

LETTERS OF CREDIT

Obtained by an export customer from their bank, this guarantees payment will be received on time and in full

PRO's

- Excellent bad debt protection as risk is transferred to a bank
- Proven tool for exporters

CONS

- Limited use for domestic trade
- Only covers a single transaction for specified customer
- Customers may be reluctant to arrange and pay fee
- Time consuming and sometimes complex to arrange

FACTORING

Sell accounts receivable to a factoring company who will take on the risk and be responsible for collection

PRO's

- Immediate access to 70-90% of the invoice value
- Certainty of payment supports cashflow management

CONS

- Erodes profit margin on each invoice, not forgetting the service charge
- Surrender control of customer relationship
- May deter investors

INTRODUCING TRADE CREDIT INSURANCE

Like the options outlined above, credit insurance is another way to mitigate credit risk. However, this alternative is worth exploring in more depth because it goes far beyond simple bad debt protection.

WHAT IS CREDIT INSURANCE?

Credit insurance is a type of business insurance which covers losses arising from non-payment for goods or services.
It means that should the worst happen - a customer's insolvency or protracted default - the policyholder can protect their bottom line and maintain their cashflow.

IS A CREDIT INSURANCE POLICY DIFFERENT FROM OTHER TYPES OF INSURANCE?

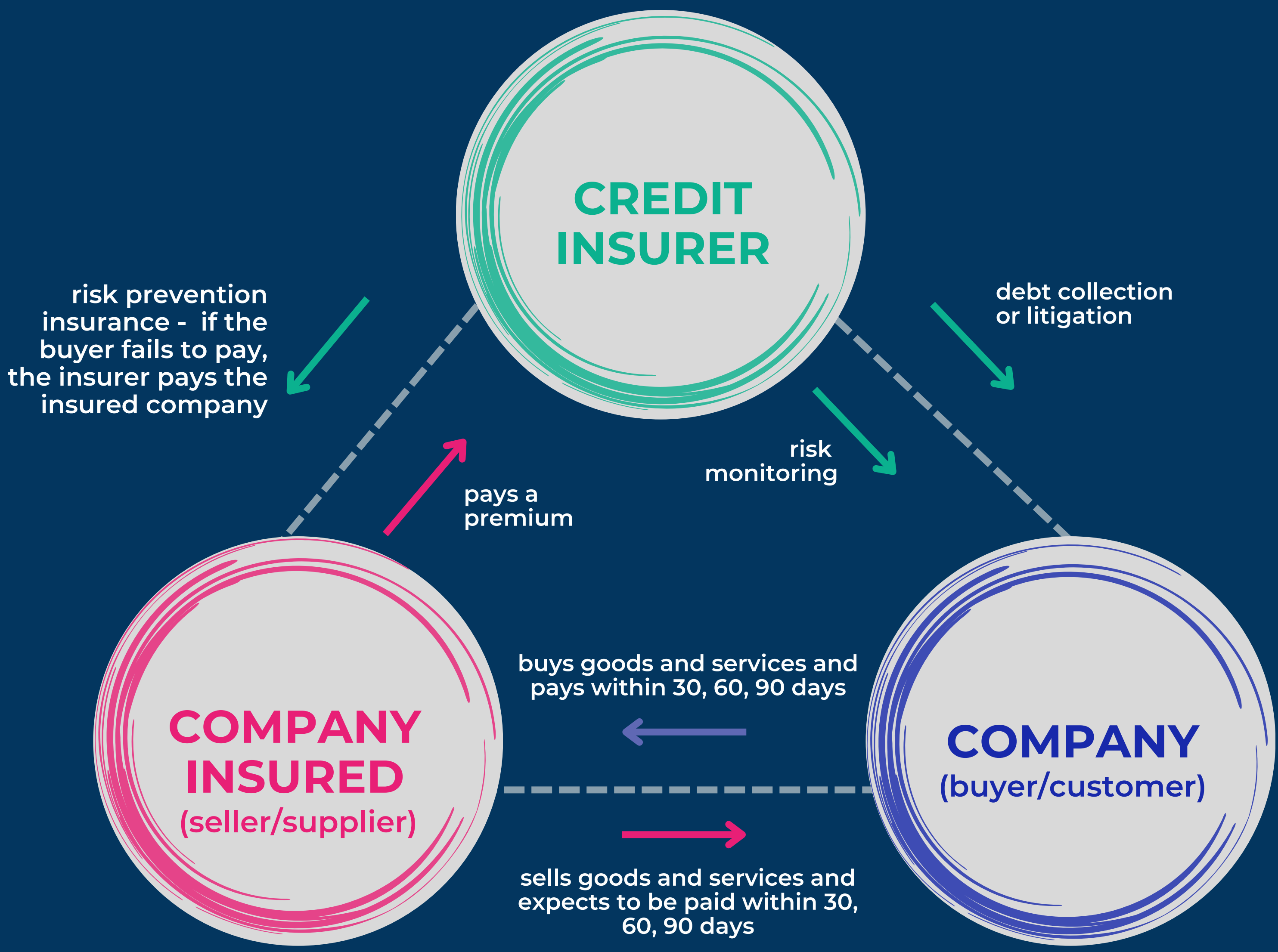
With most types of business insurance, such as employers' liability or buildings insurance policies, the provider has little contact with their policyholder between renewal times, unless they receive a claim.

By contrast, the best credit insurers actively support a company's trading throughout the year and provide an early warning system about changes in the risk status of customers so it can avoid foreseeable losses.
To be effective, credit insurance should be a partnership between both parties. The policyholder tells the insurer about customers' payment behaviour and notifies overdue payments. The insurer feeds this customer information into its database alongside data from other sources, such as financial statements and public records.

Meanwhile, the insurer gives the policyholder access to its wealth of business intelligence and expertise in credit risk. Working together, they can determine the level of credit risk, adjust the level of cover and agree credit limits, assess the financial health of customers and focus on the most profitable.

HOW DOES TRADE CREDIT INSURANCE WORK?

Credit insurance enables a company to protect its trade receivables against the risk of customer non-payment.



BENEFITS

1. Assists you to grow your business safely

TCI protects your business operations from unforeseen issues with cash flow, unpaid invoices and bad debts and can be a valuable tool to grow your business without worrying about payment defaults. It helps you to enhance credit lines with your existing customers and ensures that your business continues to operate smoothly despite non-payment by your debtors.

2. Improved business competitiveness

Can allow your company to offer more favourable credit terms and higher credit limits to your good buyers, while eliminating the need for costly letters of credit; which can make your business more competitive.

3. Offers better borrowing and financing options

Can enable your company to secure loans at better interest rates, as the receivable risk is secured by the policy. Banks and alternative lenders will usually require trade credit insurance to be in place, prior to providing invoice discounting, receivables finance or factoring services. Trade credit insurance also helps in protecting the interests of investors and stakeholders.

4. Ability to sell to new customers

Can assist you to identify and sell to new buyers / customers on credit basis, thus allowing the seller to grow the business.

5. Enter new geographies

Trading with international markets may open up your business to problems such as sourcing financial information on new foreign clients – made even more challenging by the lack of transparency in legal systems of foreign countries. Coface takes on this risk, and protects you against such risks in the future. We can assist you to identify and sell to new markets, through establishing the credit worthiness of the buyers. This allows you to grow your business without worrying about payment defaults.

6. Reduces concentration risk

Trade credit insurance mitigates risks for businesses whose bottom line is dependent on a select number of customers.

7. Helps in improving credit decisions, through obtaining detailed Information on Existing and New Buyers

To assess the creditworthiness of customers, credit insurers continuously monitor its customer's debtors. Coface is a leading credit insurance provider, with 70+ years of experience. It has an extensive database of 200 million companies worldwide. With international database, we can get detailed information on the customer including company history, financial statements and more.

8. Portfolio monitoring / warning signals on buyers

Insurers conduct continuous risk assessments on buyers. We are also able to establish how many other companies queried their financial status. If there are fewer queries into a customer's credit status over time, the insurer knows that the customer is becoming an increased risk and subsequently alerts and advises you to discontinue trade with the customer. Any alerts will give you an early warning signal about potential payment difficulties of the buyers and avoid future losses by stopping further sales. You can check the high-risk companies and alert your company to avoid any financial losses. Trade credit insurance, therefore, makes sure you can run your business with confidence. The information Coface collects might also help you to protect your business from potential fraud.

9. Protects the company's Balance sheets and P&L / Cash Flow

TCI protects your business against fluctuations in cash flow – specifically, those caused by bad debts and unpaid invoices. Unpaid invoices can lead to bankruptcy or insolvency, making it incredibly difficult for a company and its owners to bounce back in the future. With trade credit insurance, businesses have a safety net, thanks to the indemnification of unpaid debts. Therefore, even if a particular customer fails to pay continuously or becomes insolvent, a business will still be able to operate as if they'd been paid, while pursuing the debt through legal or other means. TCI also potentially reduces and quantifies the provisions for bad debts.

10. Collection services

Trade credit insurance provides access to cost effective collection services. Should a customer violate their payment terms, the insurer will first try to recover the funds on your behalf and failing that, pay out your business according to the policy agreement, after a set period. Even after this, though, the insurance provider will still attempt to recover payment from the defaulting customer.

EXPOSURE MANAGEMENT

What is Exposure Management?

Continuous monitoring and management of exposure by ensuring that insurers have updated information that justifies the undertaking of risk.

Why do we practice it?

- Businesses need real time information
- Change is occurring at a rapid pace
- Businesses want to manage cost implications
- Businesses want real time capacity available
- Businesses want to remain consistent and relevant

WHY TRADE CREDIT INSURANCE IS FREE

Company ABC

Turnover
R90 000 000

Premium Rate
to insure this amount is calculated at
0.32%

Initial Premium
R288 000

Deduct Company Tax

28%

	R 288 000
-	R 80 640
	R 207 360

Company ABC finances R90 million rand at the bank

Financial Operations
reduce the interest rate applied to
0.15%

Cost of Financing
less financial expenses
R 135 000

New Premium
R207 360 - R135 000
R 72 360

As the invoices are insured, the company could achieve less delays in payments from its clients.

Sales Outstanding
Reduce from 100 to 95
5 Days

Cost of Invoicing
R90 000 000 / 365 * 5 days
R 1 232 874

Bank charges
R1 232 874 @3.5% per year
R 43 146

Non-Payment Event & New Premium

	R 72 360
-	R 43 146
	R 29 214

With a non-payment event, you get refunded by your Trade Credit Insurance policy or alternatively should you not claim you would get refunded a performance bonus – it means that you could even gain something!

Which means, that at the end of the day,

the Trade Credit Insurance policy is for free!