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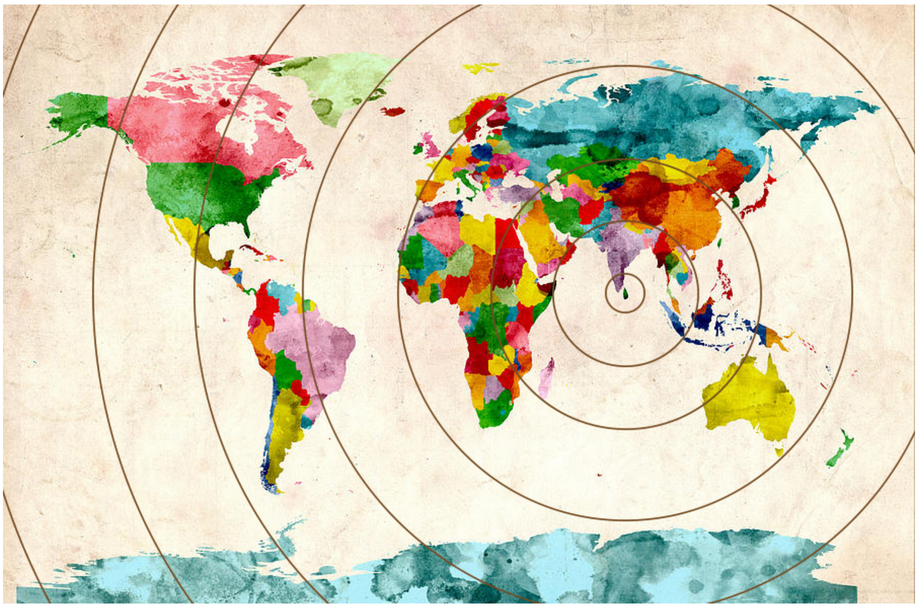
18
PERCENT
Decline in Sri Lanka's share of exports to GDP (2000-2014)

2-4
PERCENT
Sri Lankan exports covered by credit insurance

10-12
PERCENT
World average of exports covered by credit insurance



Map courtesy of *ideasworld*

Reviving Exports: The Relevance of Export Finance

This *Insight* analyses the importance of export finance as a tool to facilitate and promote exports in Sri Lanka. It identifies the bottlenecks that prevent effective use of export finance in the country and provides recommendations to improve availability, access and effective utilisation of export finance in the country.

Sri Lanka's exports have not kept pace with local and global developments. During 2000-2014, the share of exports to GDP has steadily declined from 33% to 15% and the share of world exports declined from 0.08% to 0.05%. For at least a year now the Sri Lankan government has been shifting its focus to recognise the importance of reviving exports. The UNP, which came out as the dominant party in the recent election, has made export growth a key component of its economic program. This *Insight* draws attention to and explains the applicability of an important instrument, known as 'export finance', in pursuing this new focus for the Sri Lankan economy.

WHAT MAKES EXPORT FINANCE NECESSARY?

In the competitive conditions of global trade, buyers are increasingly calling the shots on the payment terms and conditions of transactions. From the buyers' perspective, any payment made to an exporter in advance of receiving the goods is a payment made too soon. As the power of buyers increase, they are able to delay payments until goods are received, and sometimes even until they are sold. This means, in order to secure export orders, exporters are asked to take a significant cost and risk of deferring payment collection until goods are shipped and delivered.

Those who cannot adhere to these conditions tend to lose orders to their competitors.

The difficulty of adhering to buyer payment requirements is felt most acutely by Small and Medium sized Exporters (SMEs). This is because of the double crunch of low cash reserves in relation to the size of orders and lower credibility with banks for affordable working capital loans. Research finds this problem to be particularly acute in developing countries, more so than in countries with developed financial markets.

Export finance is an instrument that enables exporters (especially SMEs) to offer buyers these favourable terms while mitigating the associated risks and liquidity crunch. It works through a financial intermediary, such as a bank or specialised export credit agency, offering to advance the payment and take the risk on behalf of the exporter.

Sri Lanka is doing poorly in the availability, access and diversity of export finance instruments. Further, the few available instruments remain under-utilised. For example only 2-4% of Sri Lanka's exports are covered by credit insurance, while the world average coverage is around 10-12% of exports. All this suggests that both the availability and understanding of export finance as an instrument to facilitate exports is low in Sri Lanka.

EXPORT SETTLEMENT OPTIONS AND RISKS

Exhibit 1 provides some widely used export payment options and is arranged by the distribution of risk to the exporter and the buyer. Open account terms is the most favourable to buyers and least favourable to exporters.

In a world where buyers call the shots, the ability to trade on open accounts enhances exporters' chances of securing export orders. However, since the payment is deferred until goods are received, the whole burden of credit and payment risk is borne by the exporter. This is where export finance can help.

EXAMPLES OF HOW EXPORT FINANCE HELPS

Export finance can play an important role to enhance exporter's capacity to trade on open account terms by helping mitigate the associated problems and risks such as cash flow crunch and payment default. The following illustrations explain how export finance instruments can be deployed to assist the exporter.

Export competitiveness is no longer solely dependent on the price and quality of the product. Ability to offer competitive payment terms to buyers is also critical to secure export orders.

Export working capital financing: The delay between shipping the goods and receiving payment creates a short term cash flow crunch for exporters. This is especially acute for SMEs that lack sufficient internal liquidity. The result can be the inability to purchase raw materials and services required to fulfil other export orders and therefore the loss of revenue and business. Export working capital financing solves this problem by providing exporters with needed funds while waiting for payment from the foreign buyer. This helps to ease and stabilize the cash flow problems of exporters, and enable a smooth progression of the business.

Export credit insurance: By agreeing to accept payment later, exporters also incur risks. The two main risks are commercial and country risks. Commercial risk is the possibility of the buyer defaulting payment and country risk is the possibility of social, political or other issues (e.g. natural disasters) that arise in the buyer's country to prevent or delay the payment. The export finance instrument known as "export credit insurance" provides protection against such risks and resulting losses.

Export factoring: Factoring helps to virtually eliminate the risk of non-payment by foreign buyers. It allows the exporter to offer open accounts, improves liquidity position, and boosts competitiveness. This is done so by Factor offering to purchase the exporter's short-term foreign accounts receivable for cash at a discount from the face value, normally without recourse, and by assuming the risk on the ability of the foreign buyer to pay, and handling collections on the receivables.

SRI LANKA NEEDS MORE EXPORT FINANCE

In a highly competitive international market, export competitiveness is no longer solely dependent on the price and quality of the product. Ability to offer competitive payment terms to buyers is also critical to secure export orders. Exporters' ability to offer such payment terms depends on the types and cost of export finance facilities available in the country to help them mitigate the associated risks and resolve the short term cash flow problems. Sri Lanka fares poorly in assisting exporters in this regard.

Setting tall export targets is not enough. It should go hand in hand with effective policies and execution. This *Insight* shows that export financing is an important policy instrument that can facilitate and promote exports which has been neglected by politicians and policy makers in Sri Lanka.■

Exhibit 1: Risk in payment/settlement options

Lowest — Risk to buyer — Highest

Open account	Documentary collection	Documentary credit	Confirmed documentary credit	Payment in advance
• Remmitance of funds to exporter on delivery or on a future date	• Documents exchanged against payment or acceptance, cursory examination of documents, no verification	• Most secure and balanced option, detailed verificaiton, full compliance with L/C terms	• Documentary credit with added security for the exporter, payment undertaking by confirming bank	• Importer pays the exporter prior to shipment of goods

Highest — Risk to exporter — Lowest

Source: Improving the SME's access to trade finance in OIC countries, COMCEC coordination office (2013), pp.7-8

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