

## China: 6 firms out of 10 managed to reduce their payment terms in 2013

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### Executive summary

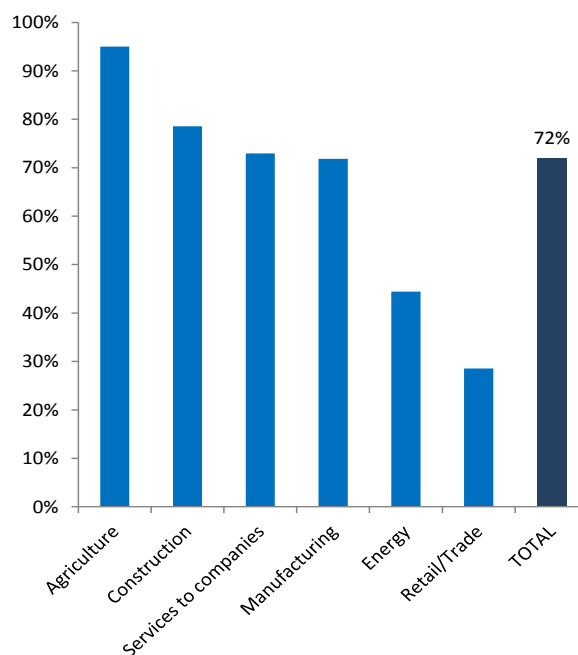
- According to Euler Hermes' Payment Behavior Survey in China, 7 firms out of 10 saw their turnover increase in 2013, benefiting from a robust domestic demand.
- Compared to international standards, Chinese company pay relatively fast: average days sales outstanding (DSO) did not exceed 2 months in most sectors and 6 firms out of 10 succeeded to reduce their DSO in 2013.
- However, firms in the energy and construction sectors stood out from the crowd with longer payment delays. DSO exceeded 2 months for more than half of the firms in these two sectors in 2013.
- For 9 firms surveyed out of 10, overdue payment stems mainly from financial difficulties of their customers.

### Favorable overall trend for companies coupled with stable economic growth

Almost 7 firms out of 10 saw their turnover rise in 2013 compared to 2012, while real GDP grew at a stable pace: +7.7% in 2013. This favorable trend is especially observed in companies in the agricultural and construction sectors, which benefited from a robust domestic demand (+8% in 2013).

However, firms in the energy and retail/trade sectors faced more difficulties (see Chart 1). Indeed, according to our survey, only 4 companies out of 10 in the energy sector, and 3 out of 10 in the retail/trade sector, saw their turnover increase in 2013. Several reasons explain this situation: weak foreign demand, deceleration in private investment and tighter credit controls showing the government's determination to steer growth towards a more sustainable and better-balanced model. Euler Hermes calls it the 3S-Cycle: "Solid, Sustainable but Slower".

Chart 1: Percentage of the firms that saw their activity rise in 2013



Source: Euler Hermes 2013 Survey

## Average days sales outstanding (DSO) did not exceed 2 months in 2013

The overall increase in activity of Chinese companies in 2013 does not prevent them from maintaining customer payment delays relatively short. In fact, days sales outstanding did not go over 2 months for almost 7 firms out of 10 in 2013 (see Chart 2). 58% even succeeded in reducing them compared to 2012. This favorable statement was confirmed by the fact that trade receivables did not represent more than 30% of the total balance sheet for 3 out of 4 Chinese firms, except in the construction sector where they weighed between 30% and 50% of their total balance sheet.

Moreover, it must be emphasized that even if terms of payment are usually relatively restrictive in China, they can be more flexible regarding foreign customers. Our survey shows that 75% of the firms offered in their contractual sales conditions less than 2 months in terms of payment domestically in 2013, compared to 62% for foreigner customers (see Chart 3).

## Companies in energy and construction sectors stood out from the crowd with longer DSO

The overall performance is favorable in terms of sectors since most of them showed DSO below 2 months. However, two exceptions must be highlighted.

Contrary to the other sectors, DSO exceeded 2 months in more than half of the firms in the energy and construction sectors (see Chart 2). Nonetheless, it should be noted that companies in these two sectors have "by nature" longer DSO. Moreover, many of them are state-owned companies, allowing them to accept longer payment delays.

Thus, according to our survey, almost 5 firms out of 10 in the construction sector and 7 firms out of 10 in the energy sector deplored payment delays from their customers that exceeded 10% of the total invoice value of their domestic sales in 2013. By comparison, only 4 firms out of 10 have faced payment delays in the retail/ trade sector.

## Overdue payment stems mainly from financial difficulties

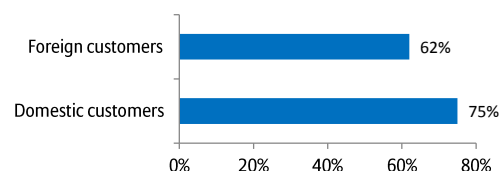
For 9 firms surveyed out of 10, overdue payment is mainly the result of financial difficulties and poor payment habits of their customers. These reasons could stem, in part, from the slowdown in credit growth (+14.1% y/y in December 2013,

Chart 2: Average DSO in 2013

	< 2 months	≥ 2 months
Retail/Trade	71%	29%
Manufacturing	70%	30%
Services to companies	69%	31%
Agriculture	67%	33%
Energy	44%	56%
Construction	41%	59%
TOTAL	67%	33%

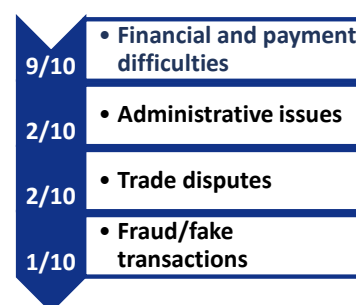
Source: Euler Hermes 2013 Survey

Chart 3: Terms of payment < 2 months at domestic/foreign level in 2013



Source: Euler Hermes 2013 Survey

Chart 4: Major causes for overdue payment



Note regarding figures: x/10 = x firms surveyed out of 10  
Source: Euler Hermes 2013 Survey

Chart 5: Percentage of firms that deplored overdue payment in 2013

Energy	72%
Construction	54%
Services to companies	42%
Trade	40%
Manufacturing	39%
Agriculture	17%
TOTAL	72%

Source: Euler Hermes 2013 Survey

see Chart 6) observed since Q4-2012. Three main reasons explain this trend: weakened markets, China's economic model transformation leading to more measured lending, and tougher action by the government to rein in increased non-standard financing – called *shadow banking*.

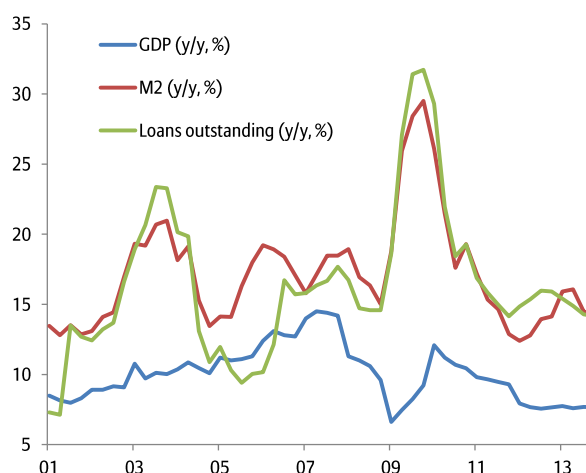
In fact, deceleration in credit growth both accentuated financial constraints of customers and increased financing problems of some Chinese companies. This is especially the case in sectors that greatly benefited from the skyrocketing credit expansion phase in 2009. SMEs, state owned sectors and the ones with overcapacities (notably solar energy, steel industry and real estate) are the most vulnerable to this slowdown in credit growth.

Thus, economic agents related to these sectors face more difficulties in maintaining terms of payment.

But while the risks regarding these "fragile" economic agents may be significant, most Chinese companies choose to self-insure to protect themselves from overdue payment and default, opting to manage the risks by checking and monitoring the creditworthiness of their buyers (7 out of 10 companies surveyed) or by requesting secure forms of payment (6 out of 10 companies surveyed).

Credit insurance is becoming increasingly popular as a risk mitigant tool, yet its use in the domestic arena remains low compared to in export trade.

Chart 6: GDP, money supply and credit outstanding



Sources: IHS Global Insight, Euler Hermes

#### BOX - Methodology

Our analysis is the result of a survey that was conducted in China during October 2013. 220 Chinese companies were interviewed about their managing towards payment delays.

Our panel is a representative sample of the Chinese business fabric by sectors. Interviewed companies have been distributed in the seven following sectors: agriculture, construction, energy, manufacturing, services to companies, and retail/trade.

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