Times of Economic Uncertainty Call for Review of Credit Risk Mitigation Strategies

What are credit professionals but risk takers? Every day, credit departments all around the world are making different decisions, all of which will alter their company's business. Like a marriage vow, credit professionals know they are going into their final decision for better or worse, and no matter the outcome, they will accept the challenges that lie ahead.

Credit decisions don't always end with doom and gloom; however, a solid risk management plan will certainly come in handy during troubling times. The Five Cs of Credit—Character, Capacity, Capital, Collateral and Conditions—are a great start, but companies specializing in business credit and risk management, such as Fiserv, will tell you there is so much more to learn. Take for example Fiserv's Financial Risk Management solutions that not only focus on credit risk but also market and interest-rate risks.

"A better understanding of your risk position will equip you to plan more effective, and ultimately more successful, performance management strategies that benefit your entire organization," Fiserv's website states. Among the numerous benefits from their solution is an "integrated ALM, market risk, credit risk, liquidity risk, Basel II/III and IAS 39 to help correlate and model risk factors through the economic cycle."

"Every balance sheet is exposed to risk," Fiserv states. "Since financial services professionals do not have psychic powers, you must evaluate multiple balance sheet structures under alternative interest rate scenarios. Why? Financial institutions need to understand how much risk exposure is embedded in their balance sheet."

In an interview with PYMNTS, Gianluca Pizzituti, CEO and co-founder of invoice financing platform Velotrade, said that when working with a customer, there is generally:

- "Credit risk, or risk that a business will fail to repay financing
- Performance risk, which takes into account the threat of a vendor failing to deliver goods as reflected on a purchase order; and
- Transaction risk, which addresses the threat of false documentation of shipping fraud."

Prior to the pandemic at construction company Systems, LLC, credit manager Kendra Gerdes said, they actively offered their understanding and experience to all areas—especially to sales and upper management—about how they could help mitigate risk in any way possible. There are skills in the credit area that are transferable to other areas in terms of risk assessment and mitigation, she noted, and these are times of opportunity for credit professionals to become more actively involved in other areas of the company and provide bottom-line value.

"When the economy is in a state of flux, credit is asked to stretch," Gerdes said. "How can we maximize sales, mitigate risk and maintain the goodwill of the customer, while keeping an eye on the bottom line? These items come in conflict with each other as risk tolerance becomes harder to expand in lieu of more challenging sales demands and more risk puts pressure on the bottom line, with potential slow-pay or even no-pay situations."

The credit manager said they do their best, use their best judgement, offer their opinion on situations, and then do everything within their ability to ensure whatever decision that is made is the correct one. Systems, LLC, has found that these are the times when success isn't defined only by KPI's, but also by the intangibles that credit brings to a company with improving relationships, creatively working with customers to secure a sale and, most importantly, the payment as well as the follow-up questions to get to the substance of a challenge, she said. This includes openly communicating with smaller customers about using notices of furnishings.

Preferred Pump & Equipment, LP, a wholesale distribution company of water well equipment and supplies, has flourished during the pandemic, said accounts payable manager Lorri Howard, yet credit, performance and transaction risks are ever present and managed continuously to mitigate bad debt loss. The amount of risk to a business has more to do with business' credit administration practices, Howard said, rather than with how a debtor/customer will perform. As a wholesaler that operates in commercial credit, Preferred Pump & Equipment, LP, has the flexibility to implement practices to keep its bad debt and past due stable whether in a pandemic or in a recession. Her advice to other departments looking to improve their risk mitigation strategies during times like these centered around creating a network with a salesman or the front-line interaction workers.

"There are a lot of risk indicators that salesmen see that accounting and credit will not see until a risky situation has festered a bit," she said. "That early warning helps the credit department partner with the customer during hardships so that the credit extended can be more secured, but also appropriate (affordable) for the change in circumstance. Salespeople will also know of ownership changes which are so often not disclosed to creditors. That early warning allows credit to obtain necessary the documentation and any securities in place can be updated."

—Andrew Michaels, editorial associate