



How Much Credit Should You Grant Your Customers?

NACM

January 7, 2019

Pam Krank

President

The Credit Department Inc. (TCD)

Pkrank@tcd.com



Agenda

- Evaluate traditional ways to quantify trade credit lines offered
- Risk tolerance and credit policy
- Critical elements to access to consistently and accurately determine unsecured credit lines
- Create simple guidelines for consistent, accurate credit recommendations



Background

- 39 years Credit Management Experience
- Currently manages \$1 billion in daily trade credit
- Oversees credit lines on over 200,000 commercial businesses around the world
- Leads 25 credit analysts, collectors, deduction specialists, and portal analysts.



Credit Situation Today

- Global slowdown in growth; probability of global recession increasing
- Political instability around the world
- Companies are aggressively working to lengthen pay terms to preserve cash.
- Declining credit quality, increasing risk of short-term default probabilities
- Troubled company index shows 15.14% of public companies globally are at higher risk of defaulting*

Kamakura index 1-2-19



Credit Policy: Where it all Starts

Policy determines *Risk Tolerance*



Risk Tolerance determines *Credit Strategies*



Credit Strategies = *Credit line recommendations*





Credit line Recommendations

- Consistently set based on same elements
- Strategies dependent on size of line needed
- Business decision vs credit recommendation









Receivables Management Strategic Fit

Credit/Collection Strategy Options

Aggressive

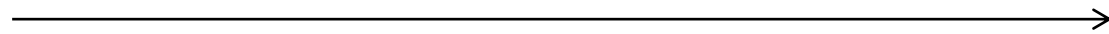


Collection strategy

 <ul style="list-style-type: none">• High risk customers• Small dollars• Short terms	 <ul style="list-style-type: none">• Commodities• Manufacturing• Low margin• Strong market share
 <ul style="list-style-type: none">• High margin• Low risk customers• Start-ups• Fragmented market	 <ul style="list-style-type: none">• Equipment• Secured• Large dollar

Credit risk tolerance (competitiveness, margins)

Lax



Strict



Traditional Strategy: Credit reports

- Same industry if possible
- Numbers of trade lines
- Unsecured Credit line amounts?
- Avg days to pay
- Agency rating/scores



Standard Analysis: Credit Reports

Challenges

- Only small percentage of vendors report
- Following lead of other companies not always wise
- Only interested in factual data; paying for much more
- **Not** leading indicators





Traditional Strategy: Reward Performance

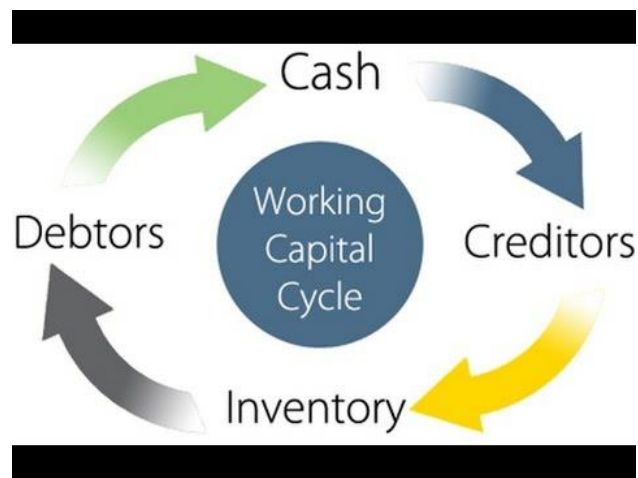
- They pay within terms, you increase
- Internal payments strong indicator
- Risks with ongoing increases





Traditional Strategy: Financial guidelines

- Net worth
- Percentage of Assets
- Working capital: Current assets less current liabilities





Credit Application: Critical Start to Determining Unsecured Lines

- ✓ Revenue/AR totals
- ✓ Years in business
- ✓ Numbers of employees
- ✓ Bank release





Most Critical Data: Bank Reference Requests

- **Ask these questions:**
 - How long as a customer?
 - Average deposit balance?
 - Overdrafts/NSF's? How many?
 - Credit/operating line?
 - Availability on credit line?
 - Expiration of credit line?
 - Balance on Term debt?





*Once we have the data,
how do we determine the line?*





Small Balances

- Define “small balance” for your business as the credit line recommendation
- Goal: yes/no decision



Data source: public records, DSO if existing customer



Medium-sized lines

- Line needs greater than default line up to \$250k
- Trade information helpful
- Specific line calculations possible

Data source: *public records, DSO if existing customer, trade credit reports if private, bank reference*

Larger Credit Lines

- Generally greater than \$250k
- Financials preferred/required
- Calculated lines based on financial analysis



Data source: Public records, Internal DSO, Bank reference, financials, trade information (optional) if private



Credit Lines Based on...

- Capacity of customer's *cash flow*, not assets
- Scorecard considerations: internal margins, importance to business, key supplier relationship
- Percentage of **available cash** range from 5-50 percent depending on considerations





Credit Line Exceptions:

- Business Decisions by Credit Committee
- Security options: UCC's, Mechanics' liens, Personal Guarantees, Letters of Credit.
- Monitor regularly based on risk of default
- Risk of slow pay vs risk of default





Credit line Follow-up

- ❖ Renewals based on risk of default
 - ✓ high risk = quarterly
 - ✓ low risk = yearly

- ❖ Monitoring based on newly received information:
 - ✓ Internal payment changes
 - ✓ Bank balance fluctuations
 - ✓ Public records changes



Determining credit lines: Conclusion

- Understand and define your “internal risk tolerance” in your policy
- Obtain the data you need to make the correct decision
- Differentiate the need for data based on size of request
- Verification of cash flow most critical to making accurate line decisions.





Questions?

Thank you!

Pam Krank

800 (651)-451-0164 x 203

pkrank@tcd.com