Managing High-Risk Accounts

Generally speaking, at least three kinds of customers will challenge credit professionals to step up and go beyond the numbers:

- Marginal accounts with high levels of exposure
- Start-up businesses
- Small- and medium-sized companies going through a business expansion and/or experiencing cyclical short-term cash flow deficiencies

Marginal Accounts

Marginal accounts fall into the high maintenance and special handling group because of the nature of risk and necessary follow-up.

Credit reviews take on a completely different spin with marginal accounts, especially when financial data are absent or inconclusive. When business conditions demand that a supplier reach out to these accounts, otherwise categorized as high-risk accounts, credit professionals must stand ready to use all the risk management tools at their disposal.

Implementation of these tools are a must to facilitate the flow of products to customers by supporting open account sales, while protecting a company's accounts receivable through sound credit decisions. Managing marginal accounts is challenging, and every decision carries a high degree of risk.

This process basically entails picking out the best prospects from among the bottom of the barrel. The farther a company strays from the mainstream of managing credit, the greater the risk and possible profit. Although challenging, marginal accounts represent a potential source of profitable sales if the right fundamentals are analyzed, the proper credit arrangements are structured and the proper credit tools are utilized.

With marginal accounts, financial information could be faulty or nonexistent. If it is available, the numbers alone may not support very high exposures on open account terms. Tapping other sources of information including nonfinancial fundamentals, developing knowledge about how and where the account fits into the industry within which it operates, and understanding how economic forces influence its financial behavior will help a credit professional manage such challenging accounts and provide the basis for unsecured sales.

It is very rewarding to manage such a stimulating customer base and support sales that otherwise could not be completed. Managing high-risk accounts is similar to managing a high-yield junk portfolio. It is not an easy task, but it is not impossible either. Without doubt, managing high-risk and high-exposure accounts is one of the most challenging and satisfactory responsibilities performed by credit professionals.

New Businesses

New businesses obviously do not have a long track record, and not much more information other than a business plan, potential market opportunities and occasionally seasoned management.

The credit risk evaluation that a credit professional is able to perform will not be extensive on the financial side and probably will be limited in scope to assessing the owner’s character and then accepting or challenging the assumptions of the business plan. Lack of historical financial data, however, should not stop a credit group from considering sales on open account basis to a start-up company.

If nonfinancial fundamentals point to a favorable condition, the probabilities of success can be considered high. The seller may have excess capacity (which is a normal condition for a start-up business), but if the margins are robust, the decision to support open account sales under these conditions is justified.

Some fundamental factors that drive a start-up business toward success may include solid margins, experienced and successful management, a tested product to address a market void, good product mix, excellent product quality controls, state-of-the-art equipment to meet market needs, equity and outside financing in place. Under these circumstances, the decision to extend open account terms is a calculated risk.

Small- and Medium-Sized Companies

Finally, there are many small- and medium-sized companies with strong market niches, plans to expand business and needs for financial assistance or financial bridging to overcome a cash shortfall, which will allow them to get back into profitable operations.

Credit can use these circumstances as opportunities to team up with sales/marketing to develop a plan that creates the right environment for profitable sales. Vision, strong analytical and negotiating skills and a lot of work from a credit group are required for these sales to materialize and meet a seller's business and marketing objectives.

Source: *Credit: Beyond the Numbers*, 2011.