



FCIB
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Service, Development, Growth

Going Global Series



GOINGLOBAL

Financial Information to Assist International Credit Decisions

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Building Nations with Education, Innovation and Confidence in Each Other

"Commercial Credit is the creation of modern times and belongs in its highest perfection only to the most enlightened and best governed nations. Credit is the vital air of the system of modern commerce. It has done more, a thousand times more, to enrich nations than all the minds of the world."

Daniel Webster, 1834



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‘Going Global’ Checklist



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Your Checklist Should Include:

Credit Policy

Credit Investigation – Know your Customer

Financial Information for the International Credit Decision

Assessing International Risk

Credit Insurance

Commercial Letters of Credit

Resources - Agencies

Trade Credit Financing

Correspondent Banking Relationships

Compliance and Ethics





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Does your company require financial statement information from all International open account customers?

- Yes
- No



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Financial Information

Key Points

- Confidentiality of credit information is essential
- Credit investigations require ethical treatment
- Privacy laws vary around the world
- There are legal aspects to consider regarding the exchange of credit information
- Different accounting standards
- The effective management of credit is both an “art” and a “science”



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Standards for Financial Statements

- “Homemade”
- Prepared by an internal professional accountant
- Prepared by an independent auditor from the company’s books but without audit
- Compilation
- Review
- Audited but qualified: disclaimer
- Audited with unqualified opinion



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Where to get Financial Information

- **Internal sources**
 - The Credit File
 - File for every International customer
 - Credit application
 - Financial statements
 - Customer supplied information
 - Sales partners
 - Operational partners
 - Other business partners



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Where to get Financial Information

Credit Investigation – Direct vs Indirect

- Direct investigations are those where credit information is collected by the creditor either through direct contact with the customer or through direct contact with noncommercial sources of information such as individuals, banks or other trade references that may have useful information.
- Indirect credit investigations usually refer to acquiring information from a commercial credit reporting agency that are in the business of obtaining and providing credit information.



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Where to get Financial Information

Types of Direct Investigations

- Direct correspondence
- Order acknowledgement
- Personal interview
- Telephone contacts
- Sales representatives
- Terms of sale
- Bank information
- Trade information
- Public records
- Other sources such as newspaper, Internet, etc.



Where to get Financial Information

Types of Indirect Investigations

- Credit reporting agencies
- FCIB
- Organization for Economic Cooperation and Development (OECD)



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Comprehensive Financial Statement Analysis includes:

- Ratio analysis
- Cash flow (source and use)
- Capital expenditure programs
- External and internal conditions that have or could effect financial soundness of the customer
- Trend analysis (change for period to period)
- Accuracy and competency of financial statements (accountants letter and footnotes)



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Comprehensive Financial Statement Analysis includes:

- Stockholders:
 - Earnings per share and asset base
- Company management:
 - Cash available, expense levels, opportunities for financial growth, high profits (for lenders)
- Creditors:
 - Overall financial conditions: financial strength (balance sheet) and earnings power (profit and loss statement and cash flow)
- Bankers:
 - Assets to cover loans, operating profits, owner investment



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Financial Information - What to look for in results of operations (performance)

- **Net sales**
 - % change over time
- **Gross margin**
 - % change over time
 - % of sales
- **SG&A**
 - % change over time
 - % of sales
- **Operating margin**
 - % change over time
 - % of sales
- **EBITDA**
 - % change over time
 - % of sales
- **Pre-tax income**
 - % change over time
 - % of sales
- **Net income**
 - % change over time
 - % of sales
- **Tax expense**
 - Effective tax rate
- **Capital expenditures**
 - % change over time
 - % of working capital
- **Free cash flow**
 - % change over time

Financial Information - What to look for under liquidity

- **Current assets**
 - % change over time
 - % of short-term debt
- **Current liabilities**
 - % change over time
- **Working capital**
 - % change over time
 - % of sales
- **Cash**
 - % change over time
 - % of short-term debt
- **Cash ratio**
 - % change over time
- **Quick assets**
 - % change over time
 - % of short-term debt
- **Quick ratio**
 - % change over time
- **Current ratio**
 - % change over time

Financial Information - What to look for under leverage

- **Total debt**
 - % change
- **Stockholders equity**
 - % change
- **Tangible net worth**
 - % change
- **Total assets**
 - % change
- **Total debt to asset ratio**
 - % change
- **Net tangible assets**
 - % change
- **Short term debts**
 - % change
- **Short term debt % of total debt**
 - % change
- **Short term debt % of working capital**
 - % change
- **Total liabilities**
 - % change



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Customer Payment Behavior

- Good payment behavior is part of a good customer relationship
- Five C's of credit help determine customer payment behavior
 - Commitment and willingness (character) is just as important as capital and capacity
- What payment terms does the customer have/want?
- How are they paying you vs these terms?
- How are they paying others?
- Has their payment behavior changed?



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Solvency – Financial Risk and Leverage

- **CAMEL**
 - Capital Adequacy
 - Asset Quality
 - Management Quality
 - Earnings Potential
 - Liquidity





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Capital Adequacy

- Current earnings in the Country Risk context
 - Most information on such earnings is contained in the balance of payments
 - Usually published by the Central Bank
 - Not too different from a company's financial statement
 - Unfortunately, countries use differing accounting methods for compiling their payments balances
- The single most important and authoritative source of comparable data is the International Monetary Fund in Washington



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Asset Quality

- A country's natural, human and general economic resource
 - A close meshing of all three gives a nation true economic and financial strength
 - Some countries with a wealth of natural resources remain desperately poor because they lack the human resources to exploit their bounty to the benefit of all
 - Zambia
 - Others lack natural resources, but do quite well on the basis of their human and general economic resources
 - Switzerland
 - Japan



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Management Quality

- The government and the way in which it is running the nation's affairs
 - Ill-designed and badly implemented government policies can ruin the most affluent countries
 - Good policies can make a world of difference for nations that are resource-poor





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Management Quality

- Of particular interest in this context should be:
 - How those in power run their fiscal affairs
 - Spending and taxation
 - How well monetary and credit management are adapted to the country's real needs
 - Which way interest rates are trending and whether there is a big risk premium in local bond rates
 - How inflation is being managed
 - What kind of labor (especially wage) policy is being pursued
 - Whether local/international investors show confidence
 - This will depend largely on how social and political stability is perceived



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Earnings Potential

- How well a nation could do if it had the best possible government (read: management)
- Among internal criteria are such things as:
 - The “quality” of the population (health, longevity, literacy, skills)
 - The local wealth distribution (very large gaps tend to create socio-political tensions, while a sizeable and well-living middle class gives a country stability)
 - Whether there are protectionist tendencies in the populace, among the leaders, or both



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Liquidity

- A nation's foreign exchange cash flow prospects
 - Example: the risk of an export sale made on 180-day terms
- Up-to-date information is most difficult to obtain, and one must often rely on inside information, since the published data rarely show the most relevant indicators





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Liquidity

- But some idea of a nation's Liquidity can be gained also from regularly revealed indicators, such as:
 - Official international monetary reserves
 - Foreign exchange holdings in the local banking system
 - Pending IMF and World Bank facilities
 - Foreign debt payment schedules
 - Official borrowing facilities a nation may have abroad



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Different Accounting Standards

- GAAP and IFRS
 - Generally accepted accounting principles (GAAP)
 - Standards vary in different locations
 - Set by Financial Accounting Standards Board (FASB) in the U.S. Shifting toward International Financial Accounting Standards (IFRS)
 - Financial accounting, as opposed to managerial accounting, strictly follows GAAP
 - IFRS are published by the International Accounting Standards Board (IASB), an independent organization based in London
 - IFRS has been adopted by many countries around the world



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Do you feel financial statement information is important and needed to make the best decision for all open account customers?

- Yes
- No



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Early Warning Signs and Red Flags

- **Changing Payment Patterns**

- Has a previously reliable customer started missing due dates or begun falling further and further behind in paying invoices? If a company has asked for an increase in payment terms to 45 or 60 days from the standard 30 days, caution would be advised. Question request to reschedule payment agreements or schedule repayments over several payments rather than for the full amount of invoices.

- **Changing Buying or Selling Habits**

- If their previous buying was consistent, but has recently changed (more or less), this could suggest trouble. If regular customers are suddenly buying more, it may be an effort to increase inventories prior to a bankruptcy filing, knowing they may not be liable for the goods later on. They may also need the extra inventory to see them through the bankruptcy process, especially with the current tight credit market restricting the funds available for restructuring efforts.

- **Shrinking Cash Flow**

- Keep a close watch on your customers' cash balances over time if you have access to their financial statements. Find out how much they rely on equity, short term debt, or long term debt. Are they able to sustain operations through the generation of cash flow?



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Early Warning Signs and Red Flags

- **Higher Customer Demands**
 - If a customer you once rarely heard from is now returning more items, unjustifiably taking deductions, claiming damages to product, or has started making unreasonable demands on delivery, this could be sending you a warning. Customers in trouble may start demanding discounts that are not normally allowed.
- **Large Accruals**
 - Many distressed companies carry large accruals on their balance sheets. These figures need to be explored and justified. This information is usually available in the annual reports or recent SEC filings.
- **Withholding Financial Information**
 - Customers that previously shared financial information, but now suddenly claim it is against their policy to share financial data, could have something to hide. This should be considered a big red flag and could be an attempt to distract you from determining their problems.



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Early Warning Signs and Red Flags

- **High DSO**
 - Companies that have fallen behind on collecting their own receivables may find it difficult to pay their debts. What have sales and receivables done over time? If sales have remained consistent, yet receivables have increased, this would indicate a problem collecting receivables decreasing cash flow.
- **Changes in Management**
 - Changes in management could mean that there's a disagreement between executives and the company's board of directors or owner.
- **Persistent Rumors**
 - Credit experts recommend keeping your ears open for any negative news about your customers. In some cases this may be the only way to garner helpful information about privately held companies. Cooperation and communication between sales, operations and credit personnel greatly helps in this endeavor.
- **Tax Liens**
 - A tax lien against a company is a pretty sure indicator that it is going under.



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Your Detailed Checklist Now!

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Look for Future Educational Opportunities at FCIB:

Going Global Webinar Series – 2016

April

14th, Financial Information to Assist International Credit Decisions

28th, – Assessing International Risk

May

12th, Protecting Your International A/R Portfolio with Trade Credit Insurance

26th, *Commercial LCs*

June

Live Sessions at NACM Credit Congress Include:

25020 – International Credit Policy – Monday, June 13th

25030 – Credit Investigations and Getting to Know Your Customer – Monday, June 13th

25080 – Role of Financial Information in Global Credit Decision Making – Wednesday, June 15th



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Questions?

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