



Credit risk management without the risk

Autumn/Winter 2007



# Back on the Agenda

The massive summer shakeout in equity markets worldwide may not have run its full course yet and a number of commentators are predicting further volatility.

For many companies, shifts in the stock markets don't appear to have an immediate impact on their business, but a report from Hewitt Associates points to an area of real concern.

According to Hewitt the seismic impact on equities in July eliminated half the accumulated surplus in pension schemes run by FTSE 100 companies since the market downturn in 2003.

This stat must be seen in the context that many companies have been reluctant to match pensions investments to liabilities since they believed returns on equities would reduce the amount they need to fund pension debts.

If pensions shortfalls are back under the corporate microscope and auditors and analysts take a robust view of companies' responsibilities we believe it's entirely possible that some companies will look at steps to mitigate pension fund liabilities.

In the past this has led to contentious corporate re-structuring – even to engineered administrations – which have not only disadvantaged pensioners, but also penalised – some would say unfairly – the companies' trade creditors.

Businesses trading with even the largest companies need to pay attention to their pensions position if considering granting sizeable credit lines.



# Behind Closed Doors

Bob Lilley

**The Insolvency Service has a new Chief Executive – Stephen Speed.**

At CIFS we believe one of his first tasks should be to examine a major concern over the conduct of administration procedures – in so-called "pre-pack" administration arrangements.

Pre-packs are cases where the work on a sale of a company or its assets is done before the appointment of administrators, with the sale – often to existing directors -following shortly after the appointment.

It's a fundamental principle of UK business life that all participants should operate on a level playing field. While we accept that the parties in recent pre-pack administrations have in no way acted illegally, it is clear that certain creditors have been disadvantaged.

Perhaps most worryingly is the seeming lack of transparency in pre-packs – giving rise to a widespread perception that the interests of smaller creditors are of little account.

The insolvency laws are there to ensure that *all* creditors are treated fairly. The danger is that they're increasingly seen to be operating solely in the interests of the "big battalions", and on occasion as part of a wider scheme to minimise pension fund liabilities at the expense of the creditor base.

The most common justification of a pre-pack is that speed is crucial to ensure an ailing company's continuation. But these schemes are often complex and time-intensive and the time taken to arrange them could equally be used to investigate a fuller and more thorough marketing of the business.

So what can you do as a creditor if you feel you've been "stitched up" in a pre-pack? Not much, save sue the administrators for failing in their duty under the Enterprise Act to act in the interests of creditors "as a whole".

That's likely to be costly and impracticable.

Which is why we believe Mr Speed should act now to curb what many see as excessive enthusiasm amongst banks, administrators and directors for pre-packs and insist upon full disclosure and justification of pre-pack decisions, as well as a more arms-length relationship between the parties.





# Trust Me - I'm an MBA

This summer's most disheartening business story must surely be that of Patrick Imbardelli, chief executive of Inter-Continental Hotels' Asia-Pacific region, who resigned, following a review of his academic qualifications "as previously represented to the company".

Imbardelli's humiliation raises questions about just who you can trust in a business context – for example, an Experian report on corporate fraud suggests UK companies are in the Dark Ages when it comes to making sure people are who they say they are.

At its simplest level whom can you rely on when it comes to granting trade credit? After all, you're effectively granting your customer a loan – and you wouldn't give a loan to a man in the street without knowing something about him.

Bank references are notoriously difficult to decode and are commonly felt to be less than insightful. Trade references, too, have their detractors as being too susceptible to cronyism or indeed falsification. Published accounts data is often long out of date.

Thankfully, the UK has a thriving credit information industry which provides a cost-effective source of information on prospective customers. Our own partner in this area – N2 Check – analyses data on companies and directors and details the likely risks involved.

It appears, however, that a staggering 75 per cent of UK companies have never used a credit reference agency, let alone insured their debts from customer collapse. In today's climate, it's difficult to justify such unnecessary risk.



# Smoking Gun?

Most of us will not have been unduly inconvenienced by the ban on smoking in public places introduced this summer. After all only 1 in 4 of the population is a smoker and most of them seem to be on the verge of contributing to the £100 million drugs industry dedicated to helping them stop.

As in most such moves there are winners and losers. Timber companies supplying brewers with decking and awnings for external areas to cater for smokers have enjoyed a mini-boom, for example.

But while anyone passing the summer crowds spilling out from city centre pubs may be forgiven for scepticism, it seems certain that the British climate will take its toll on smokers' visits to pubs and clubs in the winter months.

Consultants PwC believe that some 12 per cent of pubs across the UK will close over the next 4 years as a result of the ban. That's some 20 pubs, bars and nightclubs ceasing to trade every week until 2011.

Pause for thought if you deal with this sector – both in terms of limiting potential exposure to bad debts as well as in seeking replacement markets.



# Life Beyond six 0%

With interest rates at a six-year high and rate volatility set to continue, there's a compelling need for many businesses to focus on debt management to increase cash generation and reduce working capital requirements.

Sectors most impacted, according to business advisory firm, Deloitte, are manufacturing, publishing and food processing, while those least affected will be retail and travel. They point out that in a low interest rate environment many companies have not had to address this issue, but higher costs associated with successive rate hikes are forcing companies to re-think.

The impact of an economic slowdown, too, is likely to be felt in extended payment periods and companies will need to pay more attention to making their credit collection procedures as effective as possible.

Deloitte also emphasise that operational and sales teams should be involved in any drive for working capital improvement, which must be seen to have top management backing.



## Not Taking an Interest



Credit information specialist, Graydon, says that just 4 per cent of 500 credit professionals it surveyed have a policy of charging statutory interest on outstanding debts. More than half never do so.

Late payment legislation was introduced five years ago in a bid to stop companies funding their business at the expense of (often smaller) suppliers.

But, it seems, businesses are yet to be persuaded. Sixteen per cent of the companies in the Graydon survey gave fear of upsetting the client as the reason for not charging interest, with 25 per cent citing additional administration as a deterrent.

According to Graydon, however, if companies are to protect their cash flow in the face of lackadaisical – or in some cases, parasitical – customers, it's important their terms and conditions include the right to charge interest on late payments and that these terms are agreed at the outset by both parties.

Another information supplier points out that for 30 per cent of companies, being paid late means they delay payment to their own suppliers – not a very virtuous circle.



## Political Risk

CIFS is best known for its online business platform and its track record in providing comprehensive, flexible cover against the risk of customers going bust.

Less well appreciated, however, we're also expert in assessing and providing insurance for the political risks for companies trading overseas.

Protection against events like the withdrawal of import/export licenses, the inability to exchange currency and nationalisation can be readily supplied.

And our parent company, the Novae Group, has a dedicated Political Risk business unit which deals with significant export operations and advises on additional risk areas including non-payment of Letters of Credit and refusal to honour court judgements.

**Contact John Owen on 020 7903 7300 for further information.**



## Top of the League

Just how good are we in this country at paying our bills on time?

Perhaps worryingly, according to D&B, our late payment record – measured as the per cent of payments made 30 days or more beyond terms – has just exceeded the average for the major European economies for the first time in many quarters.

And the most reliable payers? They're to be found in Germany, where more than 80 per cent of payments arrive within 15 days of due date.

## Richard Brings Home The Bacon.....

..... or in this case a spanking new i-Pod, the prize in our last issue's Readers' Competition.

Lucky winner, pictured here with CIFS' Risk Underwriter, Maeve McCafferty, is Richard Shrosbee, a director of Harlow-based A1 Bacon, who will share his prize with his 8 year-old daughter, playing an eclectic musical mix ranging from ELO to hip-hop.

Richard's been with A1 for more than 15 years. It's a small, family-run business with 50 employees and a £17 million turnover, importing cured bacon from Holland, Germany and Denmark, then slicing, packaging and supplying it to the food service industry. It's a high-value business – a pallet of packaged bacon is worth around £2,000 – and is in the most competitive segment of the catering business.

The company has been a CIFS policyholder since 2003 and Richard acknowledges they've benefited from the user-friendly system. Equally, he's been impressed with CIFS' flexibility on limit setting. "With our previous insurer there was no room for expanding limits. CIFS are prepared to look at propositions and consider our trading history and payment record, for example, when setting limits."

Credit insurance has also enhanced A1's marketing by enabling them to expand profitable accounts to levels they may not have been comfortable with in the absence of protection against customer default.



# Retail at Risk

Analysis of D&B's database of UK businesses shows just how risky it is to trade with customers in the retail sector.

D&B's Risk Rating, which categorises companies on the likelihood of their going bust in the next 12 months, shows that an astonishing 50+ per cent of businesses selling domestic appliances, curtains and upholstery and furniture are at either high or above average risk of failure.

And new and used car dealers have 55 per cent of their number in the same situation.

Reassuringly, however, the majority of companies in the banking, insurance and estate agency sectors are in D&B's least risky sectors.



## A Stronger Case



Statistics issued by the Association of British Insurers show that claims on credit insurance policies have hit recent highs.

These figures, more than most, demonstrate that the need for trade credit insurance is particularly acute in the current economic climate. And as business failures approach record levels.

Given this context it's important for existing policyholders to work with their insurance brokers to make sure their policy provides cover that meets the needs of their business.

And for those companies whose balance sheet is not protected from the risk of suppliers failing to pay monies owed, well we'd suggest there's never been a better time to review that position.

## Payment Performance Matters

Apart from the obvious benefit to cash flow, there's another important reason why businesses should keep a close eye on how quickly they're paid by customers.

For deterioration in payment performance is a highly predictive danger sign of serious trouble ahead for a business – often pointing the way to future collapse.

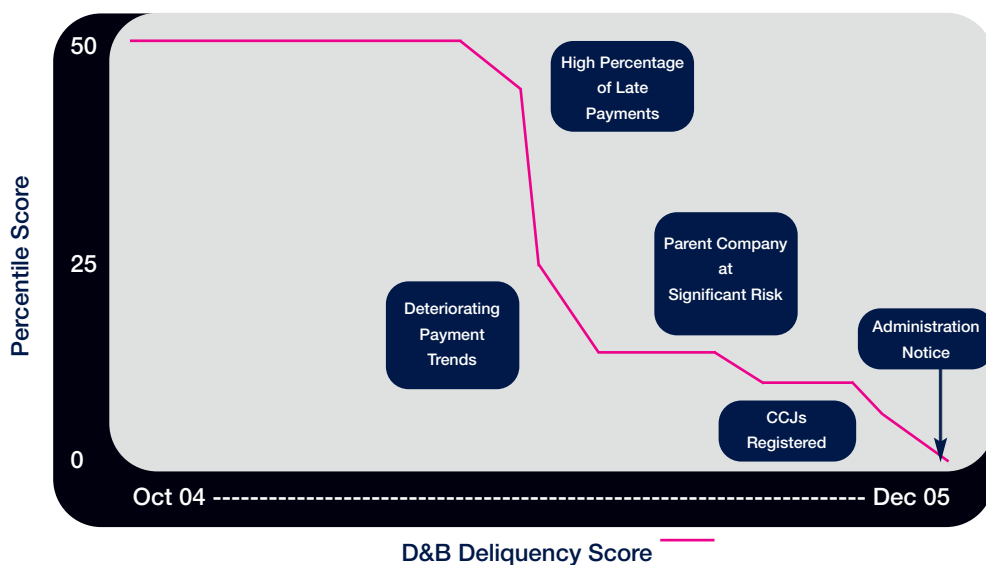
Take this graph of the demise of Unwins Wine Group, supplied to us by D&B, who use the volatility of payments and the percentage of

trade payments beyond terms as a key element of its predictive scores.

It shows that identifying the incidence of a high proportion of late payments would have alerted creditors to problems at Unwins a full year before administrators were called in, allowing them to evaluate creditworthiness and limit exposure,

Payment data can be obtained from business information suppliers and credit circles or can indeed be self sourced. Either way, it's clearly a metric that matters.

### The Demise of Unwins



## Streamlining

To help us respond to new business inquiries speedily and efficiently and give you a better service, we've set up a dedicated email address.

Please use [newbiz@creditindemnity.com](mailto:newbiz@creditindemnity.com) for all future new business submissions and inquiries.

## Stop press

Figures just released by D&B show that the rise in business failures continues apace.

Nearly 71,000 UK companies ceased trading during the first nine months of this year – that's 9.2 per cent more than at the same stage last year.