Credit Dynamics

Making learning happen

Collections and Risk in Recession

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Introduction

- Gerry Barron
- 35 years in commercial debt collection
- Head largest debt collection law firms in UK
- Credit Management Tutor ICM, Consultant, Owner Debt Guru consultancy and training consultancy – Credit Dynamics
- Fellow, advisory board member ICM
- Strategic Change consultant
- Co Author – Credit Management Handbook

Routemap today

- Overview of the UK economy and the outlook for the future – what risks do we face?
- Euro crisis – overview
- Unstable paths forward
- Risk – main features
- Credit managers roles becoming more complex
- Negotiating our way in the near future - safely

Bank of England - forecast

- “the world economy is adjusting from an unstable disequilibrium to a new equilibrium… associated levels of borrowing proved unsustainable. In more Biblical terms, failure to tackle the imbalances during the seven years of plenty before 2007 threatens seven lean years thereafter for at least part of the World economy… will mean only a gradual recovery in many advanced economies”
- Mervyn King Former head Bank of England

Insolvency

- By the end of today
- 302 people will have declared insolvency
- 45 companies will have been liquidated
- Trends down year on year
- Latent pressure

2014 after the 7 years….

- Growth predicted from 0.9% to under 2%
- Inflation likely to continue increasing to 2.7% in 2014
- Business investment lowest since pre recession (down 15% last year alone)
- Eurozone Crisis ………….the calm will not last!!
- BRIC countries will reenergize – pushing up commodity prices – stimulating inflation
- House prices up 3-4% but will not reach pre 2007 values *in real terms* until 2021
- Government bonds yields may go up from 2% to 4 -5% - stimulating higher interest rates

What shape the recession?

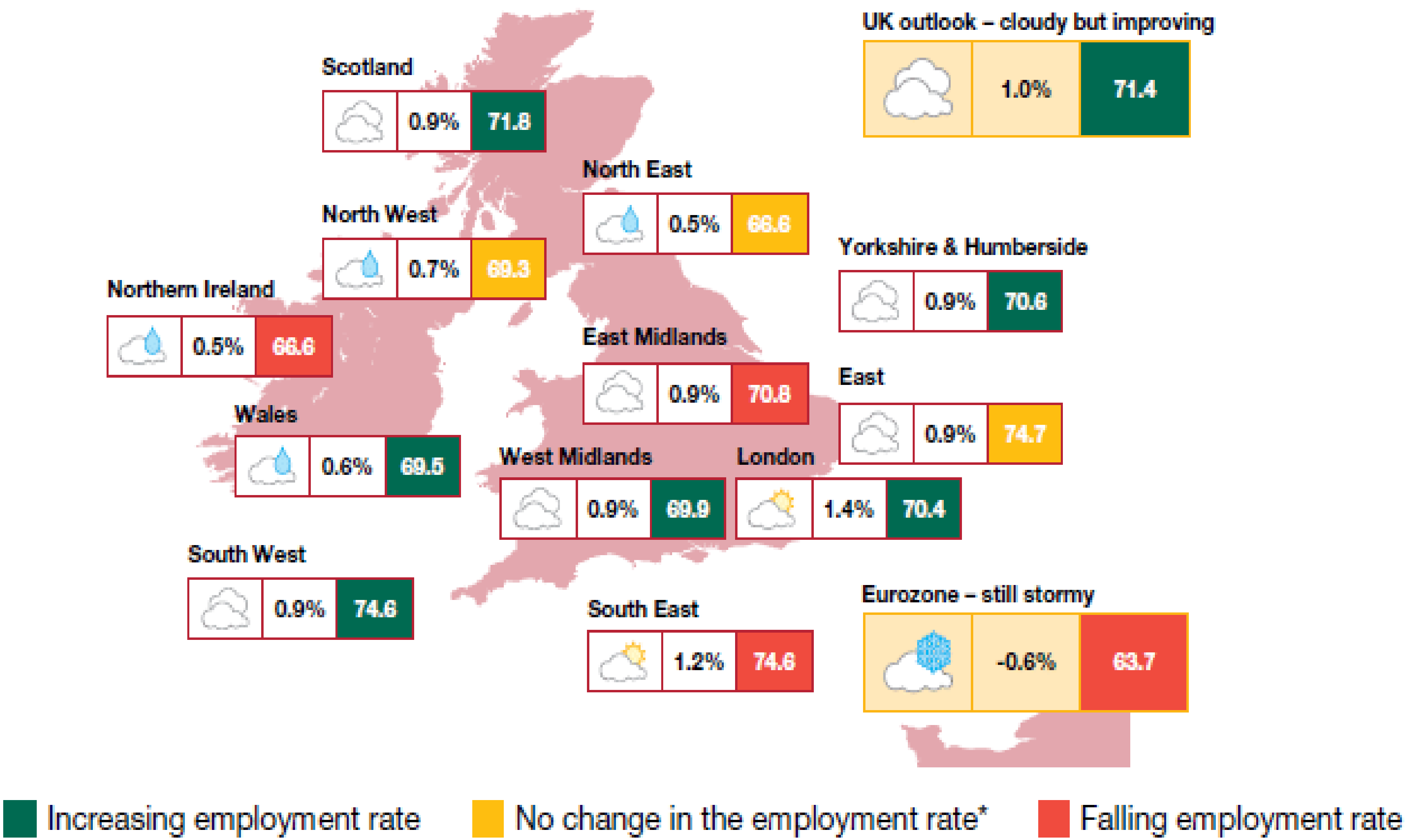
V	W	U
QUICK EXIT	DOUBLE DIP	**<u>LONG</u>** RIDE AT THE BOTTOM
		*Another 4 – 7 years?*

England outlook?

- Business confidence is starting to show some small signs of recovery
- Little or no growth over next 12 months at least
- Manufacturing confidence dropped and shown no sign of assisting the recovery, all being currently led by service sector
- Inflation targets not been met, on the increase
- Threat to low interest culture in the future

UK business climate map

Estimated average GDP growth in 2013 / Latest Employment rate (16-64)



Source: ONS, Eurostat, PwC analysis.
Note: Eurozone employment rate is from 2012 Q3.
*This means no change > 0.3%

Rise of the Zombies

- 146,000 “Zombie” companies in the UK
- “Zombie = near the point of insolvency, not failing or thriving.. Only just able to pay interest payments on debt” R3
- Simple change of circumstances – pushes them over the edge
- Financially “undead” are taking market share from viable companies and should be liquidated – with creditors taking the hit

Uncertainty creates Opportunities for Credit Managers

- We have another 4-7 years of dealing with the aftermath and its effects
- – it creates an excellent opportunity for the credit manager and the credit profession show their professionalism
- A new paradigm can be created
- Put credit risk management at the centre of business

Credit – The new Paradigm

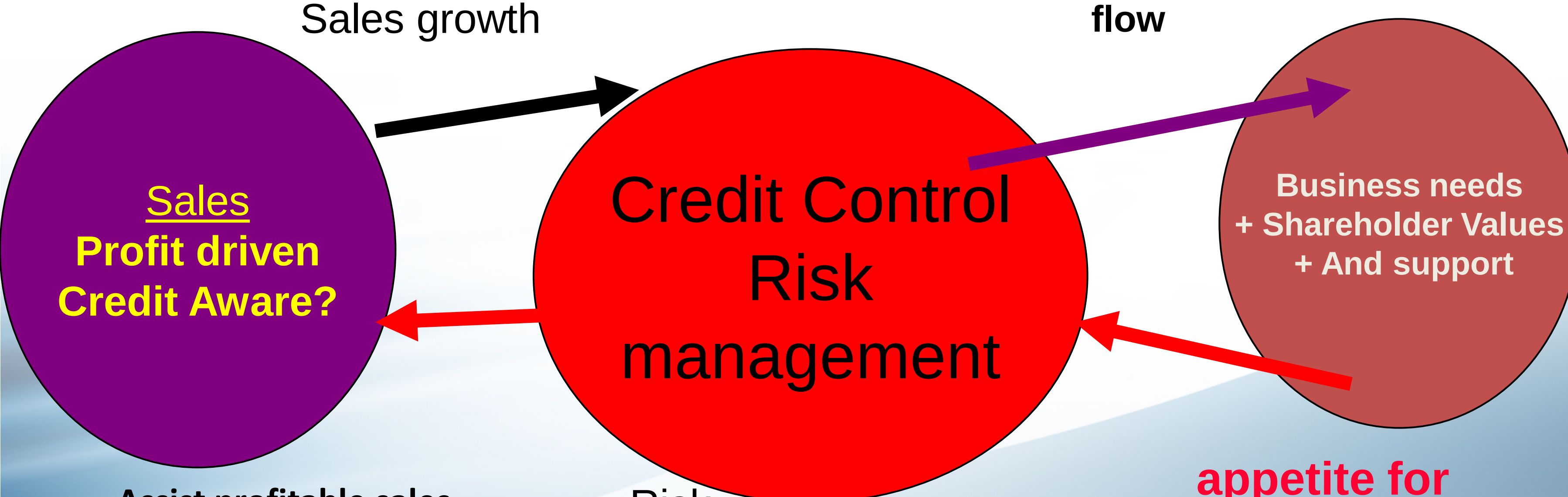
The hub and interface between the enthusiasm of sales and the discipline required in ensuring the survival of the business

Report and advise

maintain Cash flow

Profitable

Sales growth



Assist profitable sales

Sales effort

Risk management – pan divisional responsibility

appetite for risk driven by central strategy

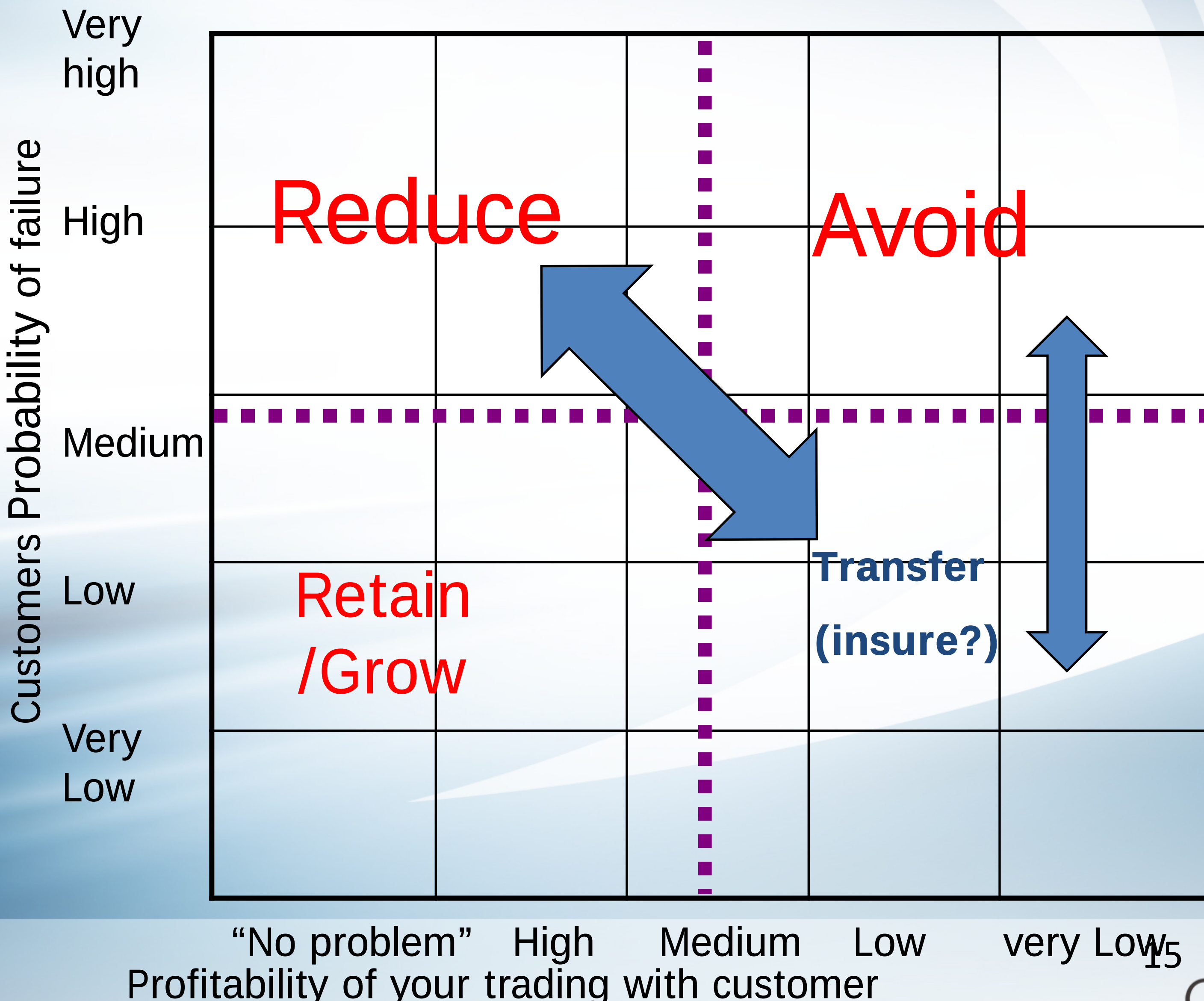
Managerial and strategic input

Classic Four ways of dealing with risk

- Avoid
- Reduce
- Transfer
- Retain
  - And two newer ones

- Exploit – very risky – (watch your back!)
- Ignore – fatal for credit professionals

Risk Matrix – segment for managing risk



The cross hairs are determined by (1) the appetite for risk and (2) the strategic direction of the business at the time

Knowledge transfer of **what credit risk is?**

Measure risk in terms of *effort*

- Easy to measure sales – no problem.
- How do we demonstrate to higher management that the largest asset in the business - the sales ledger is being managed effectively – by YOU?
- Do we know what our business - employers profitability is?
- DSO - is that all we have????
- – no – we should find correlative measures to support our argument of our own strategic contribution to the business

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What is the cost of poor risk management in credit?

- MODEL – an addition to DSO – <u>measure ourselves to sales effort</u>

- Based on an actual business here today
- Turnover £77m
- Profit 8.8% per annum
- Borrowings from bank – interest 6%

- See following examples

Example
risk for <u>late payment for 6 months</u> – impact on profitability

- goods sold for £5000
- Debt created is £5000
- Gross profit margin is 8.8%
- Gross profit is £440.00
- Banking cost is say 6% on the £5000, outstanding for 6 months = true cost of bank credit is £150.00 in cash, deducted from profit of £440.00, **<u>reduces profitability by 1/3rd</u>**

Sales - <u>not paid</u>

- Even with larger profit margins the cost of credit can swallow profits;
- by slow payments
- + bad debts
- + the loss of the working capital
- + higher admin costs
- Bad debt, and an increase in administration will wipe out the benefit of increase in profit and sales
- **For every £5000 not collected the business has to generate additional £56800 in sales to regenerate the original loss (example 100/8.8 = 11.36 times x £5000 lost)**

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Cost of credit on cash flow

- For every £100000 overdue for 60 days (Bank cost of say 6%) costs = £986.30 in interest – an extra cost to the business
- £986.30 needs another £11204.36 in sales to **recover the interest impact alone** (£986.30x11.36)
- + and loss of cash flow (8.8% profit)
- + cash flow impact - that has to be managed + Plus Administration costs

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What does it costs in sales when we **write off** a debt?

Write off	Extra sales needed	
100	1136	Effort
500	5680	Effort
1000	11360	Effort
10000	113,600	Effort

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Late payment – profit erosion

Profit Margin	Interest Rate	Months Overdue 1	2	3	4	5	6	7	8	9	10	11	12
4%	5%	3.6%	3.2%	2.8%	2.3%	1.9%	1.5%		0.7%	0.3%	-0.2%	-0.6%	-1.0%
	6%	3.5%	3.0%	2.5%	2.0%	1.5%	1.0%	0.5%	0.0%	-0.5%	-1.0%	-1.5%	-2.0%
	7%	3.4%	2.8%	2.3%	1.7%	1.1%	0.5%	-0.1%	-0.7%	-1.3%	-1.8%	-2.4%	-3.0%
	8%	3.3%	2.7%	2.0%	1.3%	0.7%	0.0%	-0.7%	-1.3%	-2.0%	-2.7%	-3.3%	-4.0%
	9%	3.3%	2.5%	1.8%	1.0%	0.3%	-0.5%	-1.3%	-2.0%	-2.8%	-3.5%	-4.3%	-5.0%
	10%	3.2%	2.3%	1.5%	0.7%	-0.2%	-1.0%	-1.8%	-2.7%	-3.5%	-4.3%	-5.2%	-6.0%
6%	5%	5.6%	5.2%	4.8%	4.3%	3.9%	3.5%	3.1%	2.7%	2.3%	1.8%	1.4%	1.0%
	6%	5.5%	5.0%	4.5%	4.0%	3.5%	3.0%	2.5%	2.0%	1.5%	1.0%	0.5%	0.0%
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7%	5%	6.6%	6.2%	5.8%	5.3%	4.9%	4.5%	4.1%	3.7%	3.3%	2.8%	2.4%	2.0%
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8%	5%	7.6%	7.2%	6.8%	6.3%	5.9%	5.5%	5.1%	4.7%	4.3%	3.8%	3.4%	3.0%
	6%	7.5%	7.0%	6.5%	6.0%	5.5%	5.0%	4.5%	4.0%	3.5%	3.0%	2.5%	2.0%
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	8%	7.3%	6.7%	6.0%	5.3%	4.7%	4.0%	3.3%	2.7%	2.0%	1.3%	0.7%	0.0%
	9%	7.3%	6.5%	5.8%	5.0%	4.3%	3.5%	2.8%	2.0%	1.3%	0.5%	-0.2%	-1.0%
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	6%	8.5%	8.0%	7.5%	7.0%	6.5%	6.0%	5.1%	5.0%	4.5%	4.0%	3.5%	3.0%
	7%	8.4%	7.8%	7.3%	6.7%	6.1%	5.5%	4.9%	4.3%	3.8%	3.2%	2.6%	2.0%
	8%	8.3%	7.7%	7.0%	6.3%	5.7%	5.0%	4.3%	3.7%	3.0%	2.3%	1.7%	1.0%
	9%	8.3%	7.5%	6.8%	6.0%	5.3%	4.5%	3.8%	3.0%	2.3%	1.5%	0.8%	0.0%
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	6%	9.5%	9.0%	8.5%	8.0%	7.5%	7.0%	6.5%	6.0%	5.5%	5.0%	4.5%	4.0%
	7%	9.4%	8.8%	8.3%	7.7%	7.1%	6.5%	5.9%	5.3%	4.8%	4.2%	3.6%	3.0%
	8%	9.3%	8.7%	8.0%	7.3%	6.7%	6.0%	5.3%	4.7%	4.0%	3.3%	2.7%	2.0%
	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Risk factors

- Customer risk – tools for management?
  - Any Zombies out there in your sales ledger?
  - What effort is made to understand your customers?
  - Pro - active customer management – get close to them
  - Use data – identify – segment - offset high risk

- Product Risk – is demand for your product or service increasing or decreasing – trend – what's the economy doing
- Competitive risk – what are others doing?

- Market risk – what factors affect your business? understand
- Economic risk? Both domestic, regional and global
- Internal appetite for risk management in your business

Uncertain journey ahead - checklist-

- Have a CURRENT RELEVANT AND FLEXIBLE credit policy – ensure your staff know it exists - and its contents
- Examine your terms and conditions – reinforce your terms with your customers
- Be aware of attempts to vary
- Review documentation suites – relevant?
- Act quickly to enforce your policy
- Reduce costs by in house collections boost – strengthen your departments skills and reduce external costs (example Veolia)
- Use late interest legislation where you are in a default collections situation (8%+base+penalties) (example)

Collections using demands

- Example
- Trained in house staff to avoid expensive litigation
- Now able to do own statutory demands- drafted and controlled in house
- Confident in knowledge of the law
- Collections up 40% and 27 days faster
- Using late payment legislation – generating £0000 profit per month
- Saving so far….. £77k over 9 months in external costs
- Generating a profit from what was a cost centre

“Your” positioning

- Information providers can and will help
- – put “at risk” businesses on alert for adverse events (Ledger 360) AND TELL MANAGEMENT OF YOUR CONCERNS NOW, NOT WHEN THEY FAIL
- Establish more frequent contact with peers in your industry
- Best Practice - Qicm – learn and support each other
- More management information streams – filed data at Companies House is historical it does not reflect reality of today
- Beef up your skills, your teams skills - train hard work easy!
- – set aside “risk staff” to continually monitor segments of ledger deemed at risk and
- **maintain elasticity in credit policies it will change for the better**
- **Put yourself at the centre of business risk decision planning – your professionalism is needed now**

Driving in Fog

- People speed up in fog – fact – there are no features –we become too confident
- Make sure you are seen by others
- Don't use high beam headlights – they dazzle you and others
- Follow the lines in the road – they will guide you
- Keep your distance – expand your operating opportunities
- If unsafe to continue
- Stop, locate to safety and turn your lights off
- **Dense fog usually doesn't last a long time**

- Don't overtrade with your "best customers" be aware that overtrading is a sign of insolvency
- Publicise your credit terms, reminders
- internally and externally.
- Celebrate your successes modestly .
- Stick to your credit policy and terms
- Don't collapse under pressure from Sales – keep your distance from troublesome risk
- Stop trading with undue risk - explain your analysis to sales and management – use your professionalism
- Bumpy ride but we can and will prevail as a profession

QUESTIONS

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