

International Trade Credit Management

Bare Essentials for Time Poor Executives



GRANTING CREDIT IS AN INVESTMENT DECISION

Granting trade credit should not simply be an incidental outcome of the sales process, a company must have a sound reason to grant credit.

A decision to grant credit should be the result of a strategic assessment intended to assure competitive advantage accrues to the firm.

REASONS TO GRANT CREDIT

- Product Enhancement
- Comparative Cost of Money
- Administrative Efficiency
- Building Trust
- Business Development

B2B CREDIT MANAGEMENT IS A SERIOUS GAME OF 'WHO CONTROLS THE CASH'

Means, motive and opportunity to pay are the three fundamental ideas a corporate credit manager needs to understand, in order to win the competition with customers for control of the cash.

DUE DILIGENCE

The first priority before accepting any new customer (foreign or domestic) must be to ascertain whether it is a genuine business. The full and correct name of the potential buyer, its registered and main trading address(es) and the names of the owners or active executives must be established.

Means, Motivation and Opportunity to Pay = M²O

- The **means** to pay when the invoice is due
- The **motivation** to pay when the invoice is due
- The **opportunity** to pay when the invoice is due

Absent M²O

If a potential customer does not have the **means and the motive and the opportunity** to pay on time, only authorize deliveries provided payment security is first obtained.

Types of payment or transfer risk security include; payment in advance, letters of credit (confirmed or not), bank guarantees, undisclosed risk sharing agreements or guarantees, Promissory Notes (avalised or not), Bankers' Acceptances, Parent Company Guarantees, and credit insurance. **Your administration must be excellent.**

Cash Flow Cycle Magic



No Need for a
Magic Potion

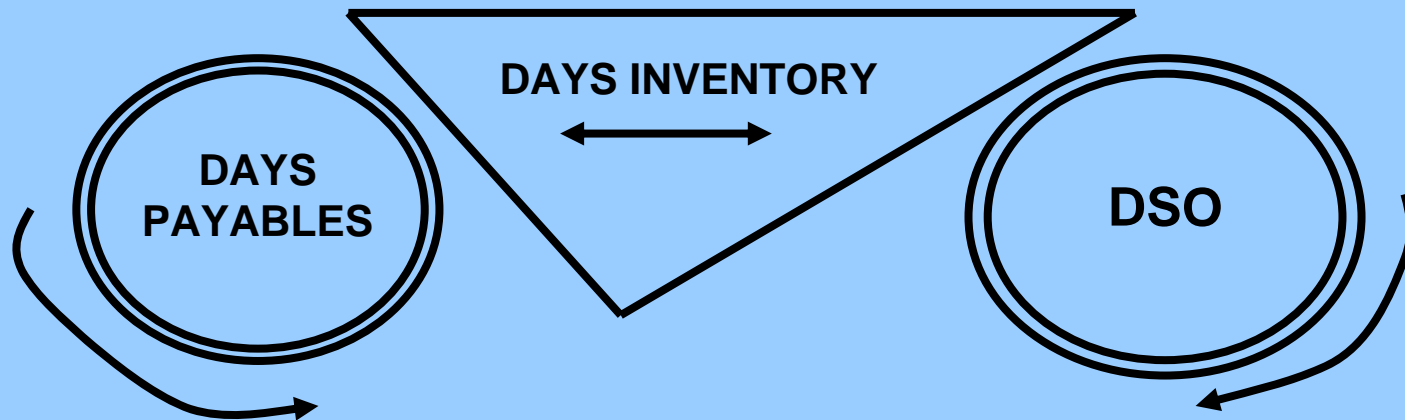
No Need to be a
Magician

The magical Cash Flow Cycle is described as magical because of the way it magically causes cash to disappear.



Left uncontrolled it will suck in cash and lock it beyond reach; particularly in times of rising prices or increasing sales volumes.

The **‘cash flow cycle’** is the time required to convert goods into cash; from the date the company pays the costs of acquisition of the goods to the date of receipt of the cash from related sales.



The Formula

Cash Flow Cycle

=

(Days Inventory + Days Sales Outstanding) – Days Payables

Days Inventory = Inventory / (Cost of Sales / 365)

Days Sales Outstanding = Trade Receivables / (Sales / 365)

Days Payables = Trade Accounts Payable / (Cost of Sales / 365)

An Example - Corus

Over the period 2002 through 2004, Corus Group Plc evidenced a cash flow cycle of between 64 and 66 days.

Hence in 2004 as its sales grew by £1.38 billion, the extra cash that became locked up in its Cash Flow Cycle grew by £250 million.

This represents some 18% of the sales growth.

In other words, for every £5 of additional sales Corus locked away almost £1 in additional working capital.





Corus 2005

COST OF SALES / DAY	\$24mio
PAYABLE DAYS	78
INVENTORY DAYS	82
RECEIVABLE DAYS [DSO]	54
CASH CYCLE DAYS	58
WORKING CAPITAL \$ MIO	1,392

Some 'What If?' Illustrations

COST OF SALES / DAY	PAYABLE DAYS	INVENTORY DAYS	RECEIVABLE DAYS [DSO]	CASH CYCLE DAYS	WORKING CAPITAL \$ MIO
\$24mio	78	82	54	58	1,392
	78	70	54	46	1,104 (288)
	78	82	40	44	1,056 (336)
	90	82	54	46	1,104 (288)
	90	70	40	20	480 (912)



Growth in sales is extremely cash hungry in every business; unless the components of the Cash Flow Cycle are carefully controlled.

SELLING RECEIVABLES

Receivable risk!
Receivable risk!
Fresh Receivable
risk here!
Bargain prices!
Anyone for
Receivable risk?



Traditional Methods

- ‘Non-recourse’ securitization,
- discounting,
- forfeiting, or
- factoring arrangements.



These can be costly to arrange, and may have a negative impact on the weighted average Probability of Default of the remaining portfolio.

RECEIVABLE QUALITY WILL IMPACT COST OF CAPITAL

Corus Group plc (S&P: BB- / Positive) reports the securitisation of certain of its trade debtors as follows:



GBP millions	2005	2004	2003
Gross amount securitised:	£272m	£406m	£338m
Less non-returnable proceeds:	£272m	£275m	£215m
Net securitised trade debtors:	0	£131m	£123m
Other trade debtors:	£1,410m	£1,070m	£847m
Trade debtors on balance sheet:	£1,410m	£1,201m	£970m

What is Required

A means to sell receivables ‘without recourse’ and without having to record the transaction as a loan, in compliance with IAS 39.

Moreover, without negatively affecting the overall risk profile of the remaining portfolio.

Ron Wells

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Ron Wells is the author of *Global Credit Management, an Executive Summary* published by John Wiley & Sons. This concise work demonstrates the vital importance of effective credit management, which too often is a passive and reactive discipline within a company. The Simplified Chinese version of *Global Credit Management* will be published in 2006.

Ron maintains a free access, credit resources web site at www.BarrettWells.co.uk.

Ron is a Certified Credit Executive, a Chartered Management Accountant, a qualified International Banker (ACIB) and a Chartered Corporate Secretary (FCIS). He participated in the NACM Graduate School for Credit and Financial Management in 1996/97, passed with distinction and was elected Best Student.

Prior to joining Chevron, Ron worked for various companies and commercial banks becoming a specialist in financial analysis, corporate credit management, trade operations management and trade finance-related marketing.