Atradius
Managing risk, enabling trade

Credit-to-Cash Briefing:

Comprehensive risk assessment of your receivables

Apart from the necessary credit rating of your individual customers, an assessment to which degree default risks arise from the overall structure of the accounts receivables is essential. Additional factors and eventually existing weak points within the business may also have a decisive influence on this risk potential.

The following checklist refers to the most relevant aspects you should pay attention to.

Receivables structure

A thorough analysis will bring greater transparency to the debtor structure, which in turn allows you to establish a risk profile.

According to customer groups	These can be differentiated, for instance according to: ▪ domestic/foreign (and possibly countries) ▪ trade sectors ▪ product categories. Allowing for e.g. dissimilar payment behaviour and insolvency situations in individual countries and sectors, this can lead to a quite differentiated appraisal of distinct areas.
According to size or spread	How much turnover is generated with which percentile of the customer base is an indication for either a wide scattering or a strong concentration. Whilst the former suggests a lower risk, the dependence on only few large customers may pose a threat to a company's earnings and liquidity in case of default or loss.

Potential exposures

Special attention should be paid to the exposures listed below that can have considerable financial consequences.

Separating debtors into groups with existing or non-existing security arrangements	A classification into existing guarantees or coverage, e.g.: ▪ bonds ▪ transfer of assets ▪ transfer of receivables ▪ lien ▪ retention of title ▪ comfort letters ▪ credit insurance can shed a light on how high the share of total losses can be, if effective security arrangements are lacking.
Possible repercussions due to the insolvency of major customers	In some cases the debtor base is dominated by only few major customers. This can have significant financial repercussions, if only one of them files for insolvency or fails to meet their payment obligations. Be sure to consider the impact on your business should this happen and take into account possible countermeasures to avoid a worst case scenario.

Past bad debts

On the one hand, the history of losses incurred through insolvencies makes it possible to draw conclusions about general default risks. On the other hand, it can indicate the quality of your company's receivables management.

Development over the past five years	The development of losses over individual years indicates tendencies, e.g. higher risks.
Differentiating individual insolvencies, e.g. according to sector, size, region	This can be helpful in assessing future potential risks inherent to individual segments.

Days of Sales outstanding (DSO)

The average time in terms of days between invoicing and payment indicates the efficiency of your receivables management. You should be well informed as to:

- how the ratio has changed within the past years/months
- how the ratio stands compared to your industry's average
- how many customers pay within the agreed credit period and how many fall in arrears.

Future risks

When assessing your debtors' creditworthiness, future developments and planning processes must be taken into consideration. Pertinent changes can influence the general risk assessment. The following aspects should be taken into account:

New products/target groups	A different customer base as well as new products or services can lead to a higher default or payment risk.
New regions	A thorough risk assessment is required especially with customers in new country markets
Expanded sales	In this case, it should be investigated if your debtor structure base has remained unchanged or e.g. certain businesses and products affected the rise in sales. This in turn might harbour higher risks.

Terms of payment

Make a critical assessment to find out if your payment terms meet your company's requirements or if they need to be adjusted. Often, too many individual clauses can result in too many variations. These might be reduced or their attractiveness could be enhanced, e.g. with the help of payment incentives like bonuses, discounts, period of payment.

Credit manager qualifications and skills

The risk of losses can be reduced by better qualified credit managers and related staff. It is thus worthwhile asking yourself, if your employees are adequately trained and motivated in the field of receivables management. This can be achieved through a broad range of methods, e.g.

- seminars
- exchange of experience during events
- membership in organisations specialising in receivables or credit management
- technical literature
- participating in internet forums.

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