A credit policy increases the company's financial security

The increase in bankruptcies and the large number of challenges at all stages of the value chain are putting pressure on cash flows and financial security.

By Kristine Seest

Clients demand longer credit times. Companies are focused on reducing inventories and strengthening their cash flows. And virtually all industries are affected by the uncertainty that has arisen in a market affected by increased energy prices, shortage of materials, rising commodities prices and longer delivery times. An analysis conducted by SME Denmark shows that the number of bankruptcies was at a record high in October – and higher than at any point during the financial crisis in 2008. This has created a new competitive situation and a different climate for negotiations and provided an opportunity to reassess existing credit conditions.

»It can have serious consequences for a company if just one customer or one supplier goes bankrupt. And unfortunately, many are doing that right now. This has led our clients to ask for specific risk advice on what they can do to strengthen their credit security and reduce their risk of loss,« says Executive Vice President Torben Højlund from WTW.

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When WTW assesses a company's credit risks, all terms of credit and guarantees in national and international B2B sales activities are reviewed.

Begin with the credit policy

Before delving into the rates and terms of the company's contracts, WTW recommends that the company's decision-makers take a critical look at the overall principles that form the basis of the company's sales agreements – even if the company has done business with the same customers and suppliers for several years.

»Even though the company has good business partners and returning customers, the huge price increases on energy, commodities and materials have affected them too and influenced their ability to pay and deliver. At the moment, we are seeing an exceptionally high risk of companies not being paid for their goods and services. Therefore, companies should review and make the necessary adjustments to their credit policies. And if you do not yet have a credit policy, I would strongly recommend that you prepare one as soon as possible,« says credit insurance specialist Jakob Toft Andersen from WTW.

The credit policy is important for the company's cash flow and its financial security – and also has an influence on whether employees feel that they can safely enter into agreements and make decisions in their jobs.

»It should not just be someone in sales, in procurement or a CFO who assesses the terms of an agreement. I have seen examples of how bad things go when an agreement reached by individuals does not live up to expectations. There can be large losses – so when accepting a risk, senior management must be involved, and the decisions must be clearly formulated in the credit policy,« says Jakob Toft Andersen.

Each link in the value chain is risk assessed when WTW assists companies in formulating the principles of their credit policies and assess the need to take out credit insurance or establish other forms of security.

Agreement or not?

Credit insurance typically covers 90 percent of the insured amount, outstanding amount, and mapping the credit risk profile will typically result in an upper and lower limit for when a business relationship should be covered by credit insurance and when – according to the company's credit policy – it should not be covered by credit insurance.

The limit can be set based on the size of the outstanding amount with a client, the size of a new order to be produced, or based on the security of a delivery where a supplier is prepaid. However, there may also be other criteria specific to the company that are relevant to take into account.

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»Not all clients and suppliers fall within the principles formulated in the credit policy, and what do you do then? The credit policy must be able to provide answers to this question. Should the customer who owes DKK 750,000, but cannot be covered by credit insurance, still be allowed to place an order? If so, what alternative security is needed for the company to do business with the customer? Should a guarantee or a clause be provided? And if that's not possible, should the company still do business with the customer and take the risk itself? Should the customer initially have had access to buy on credit without being able to be insured for credit? These are the kinds of issues that need to be addressed in a credit policy, so it is business principles and not individual decisions that apply,« says Jakob Toft Andersen.

Credit provides competitive edge

Many companies are currently under severe pressure from price increases and reduced purchasing power and have to find new ways to trade to improve their cash flows. Therefore, credit sums and credit times are now being taken up as a crucial point at the negotiating table. When that happens, it is an advantage to be well prepared and have determined beforehand the level of risk the company is willing to take.

As an independent risk advisor, WTW helps companies identify and manage their risks so that the company can take advantage of market opportunities without being exposed to excessive risk. These days, WTW is upgrading its resources within credit and guarantees so that more specialists are ready to advise WTW's clients when they need a review of their credit and guarantee terms.

SME Denmark organizes 18,000 small and medium-sized enterprises. Read their analysis of bankruptcies in Denmark.