NATIONAL ASSOCIATION OF CREDIT MANAGEMENT

BUSINESS credit®

APRIL 2009

THE PUBLICATION FOR CREDIT & FINANCE PROFESSIONALS $7.00

selected topic

Dan Meder

Considerations for Managing a Portfolio in a Market Downturn

For many companies, managing a customer portfolio used to involve a wait-and-see approach, with credit managers reacting to slow payments and other negative account activities only as they would occur. In fact, many of these managers simply would check customer credit ratings at the beginning of a business relationship and rely on aging reports alone to determine who was currently a slow payer. However, the economic winds of change are blowing strong, and while managing a set of customer accounts is a challenging endeavor in any financial climate, the complexities are unparalleled in times like these.

The nation's booming economy once encouraged companies to "ship and chase" with little regard for risk exposure or basic checks on creditworthiness. It goes without saying that those times have come to an end. If you are not proactively managing your portfolio, you run the risk of endangering your business and stifling potential growth. A passive, wait-and-see approach is no longer an option. To survive and thrive in this economy, you must be able to assess an entire portfolio of customers critically to identify the good, the bad and the potentially ugly and take the appropriate steps.

The nation's booming economy once encouraged companies to "ship and chase" with little regard for risk exposure or basic checks on creditworthiness.

Dan will provide more considerations in his session:

17055. Impact of the Mortgage Meltdown on Small Business

Proactive portfolio management allows credit managers to adopt an approach that not only prevents losses, but also identifies new opportunities for up-selling existing customers. However, to do this effectively, credit managers need a 360-degree view of each customer and enough actionable intelligence to make educated decisions. Having instant access to the right data can make all the difference.

The Right Tools With the Right Data

Common sense dictates that not all customer accounts are created equal and that some customers inherently represent better opportunities for profitable growth. To identify the best prospects, credit managers must have the ability to look beyond their own accounts receivable information to obtain a more comprehensive picture of each customer's current business condition.

In today's economy, every company needs a third-party portfolio management system. Relying only on aging reports can mask problems festering within a business, including judgments or collections activity that have yet to affect your portfolio. The right system will allow a credit team to assess a customer's payment history instantly and provide a platform for incorporating other sources of third-party data. A good portfolio-management system will enable staff to review information efficiently, examine customer data through the right filter and assess each customer's risk—and potential opportunity—on a case-by-case basis.

Note that a portfolio management system is only as good as the data it uses. The key benefit of an effective management system is the actionable intelligence that it can provide to users—the critical insight that allows credit managers to interpret data correctly and identify areas of opportunity and risk across an entire credit portfolio. When customers are late with a payment or seek a higher line of credit, a credit manager must be able to place that event in the right context and make the appropriate decision.

That's why, particularly in this perilous economy, access to external, third-party credit information about your customers is so crucial. The reason is simple: Customers do not exist in a vacuum. They conduct daily business transactions, have relationships with a number of different suppliers, and maintain personal financial histories that can affect their businesses directly. It can be easy to view a portfolio as simply a collection of product orders and payments, but every organization exists in the real world and makes decisions that can affect its viability. The complex economic landscape requires a wide-ranging view on each customer—in some cases, from both a commercial and personal credit perspective—to understand who you're doing business with and how they play a part in your portfolio.

Blended Scores and the Small-business Owner

There is a valid reason to review both personal and commercial credit information on existing and would-be customers. It's no secret that the U.S. financial landscape is powered by small business, with more than two-thirds of all U.S. businesses employing fewer than five employees. While small businesses represent a robust sector of the economy, they can be volatile and difficult to assess in regard to their creditworthiness. The difficulty is partly due to the fact that many small business owners often use both personal and commercial lines of credit to fund their businesses, leaving credit managers with the challenge of predicting where the first indications of small-business credit difficulties will surface.

A perfect illustration of this dilemma is the mortgage meltdown that's been growing exponentially since last year. In 2008, Experian® conducted a study that examined the impact of the meltdown on small businesses and found that, more than ever, small-business owners were relying on commercial lines of credit to fund their businesses as their access to personal lines of credit diminished. As small-business owners experienced home-loan trouble and foreclosure, access to personal lines of credit and financing declined, forcing a move to commercial lines of credit. The study demonstrates how the personal financial troubles of small-business owners can have a direct effect on business operations and, most important, the financing options at their disposal.

Experian studies have found that the best metric for judging the creditworthiness of a small business comes from a sophisticated melding of personal credit information of a business owner, along with credit information on his or her business itself. The idea behind blended data is simple: The more information you feed into a model, the more predictive it will be, and blended data gives creditors the best of both consumer and business information worlds. In other words, high-quality scores allow small-business creditors to do their job: lend goods or money to qualified, value-generating businesses.

Obtaining blended scores is a great method of securing critical insights on the overall business condition of your customers. To maintain an accurate financial snapshot of each customer, credit managers should conduct quarterly credit updates—utilizing a blended score—across their entire credit portfolio. Quarterly score updates help to provide a gauge on the business health of each customer and any overall trends taking place, ultimately providing credit managers with an accurate reference point against which all client activity can be compared.

> If you understand who your better customers are and have confidence in the condition of their businesses, you maintain a huge competitive advantage and possess a real opportunity for generating profitable revenue.

Monitoring External Event-Based Activity

To fill the gaps between quarterly updates, credit managers should also subscribe to a service that provides ongoing updates, or triggers, on items that have changed within each customer's commercial profile. Triggers are event-based notifications that alert a company when an account in its portfolio receives a derogatory claim, shows signs of distress or experiences other significant positive activity that may impact its creditworthiness. These triggers include newly filed bankruptcies; judgments or tax liens; Uniform Commercial Codes; trades reported by a collection agency; changes in high credit; increased credit inquiry activity; adjustments in credit utilization; and derogatory comments from data contributors, including charge-offs and repossessions, overdue balances and other information that might raise a red flag and require attention.

While the use of triggers is not new, it's a particularly important tool as the economy seesaws back and forth in the coming months. Triggers provide continual updates on potentially damaging or positive customer commercial activity, ultimately helping credit managers better understand each customer and the potential ramifications of external events on their business relationship.

Using the System

The use of triggers, coupled with periodic credit-scoring updates across an entire portfolio of customers, provides credit managers with the context they need to make decisions and spot opportunities to up-sell existing customers. If you understand who your better customers are and have confidence in the condition of their businesses, you maintain a huge competitive advantage and possess a real opportunity for generating profitable revenue.

To illustrate the point, let's look at a trigger event that could be interpreted in a positive light: an increase in high credit. A proactive credit manager could recognize the notification as an opportunity to up-sell an existing customer. After assessing the customer's blended score and profile, the customer may represent a low-risk opportunity for generating revenue. Obviously, another business has deemed this customer worthy of an increased credit limit, and, as such, that customer may represent a solid opportunity for you as well. On the flip side, an existing customer may have a strong payment history and offer no reason for concern. But if, for example, the business has recently gone into collections with other suppliers and may be unable to keep up with its bills, this could be the trigger that places the customer on an order-to-order basis or lowers the business's credit limit.

Having an accurate view of your customers' business condition may also present you with the opportunity to generate loyalty. For example, a late-paying customer may have limited cash flow and require more flexibility with his or her payment schedule. If the customer has a strong payment history, has a good blended score, and appears to be in good standing with other suppliers and vendors, this may represent a low-risk opportunity to establish a long-term business relationship.

It's easy to panic in these economic times. Without the proper intelligence and accurate assessment of your customers, you risk losing business at a time when having good customers is at a premium. As the saying goes, if all you have is a hammer, everything looks like a nail. By fully understanding each customer, you'll have the confidence and flexibility to manage your portfolio, accurately gauge risk, and identify potential opportunities within your existing customer base. ●

Dan Meder is vice president of Experian's Business Information Services. He may be reached at dan.meder@experian.com.