WHITE PAPER

Dealing with Credit Risk

This white paper will show you how to build good credit management practices into your business and what steps to take when all else fails and you need to collect a bad debt. You will also learn about a tool called Credit Insurance that can help you grow and protect your business.

Canada

EDC

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GOOD CREDIT MANAGEMENT PRACTICES

Putting strong credit management practices into place, which includes insuring your receivables against commercial risks such as your customer going bankrupt or not paying, can help protect your company and help it grow.

The five basic steps are to:

- verify your customer's credit worthiness
- establish clear credit limits
- review credit limits regularly
- structure a clear sales contract
- have to a process in place to collect a bad debt

STEP 1: VERIFY YOUR CUSTOMER CREDIT

Step one is to confirm whether your prospective customer is creditworthy. Ask them to provide:

- **Corporate information:** including their legal name, trade name(s), head office address and contact information for the person responsible for purchasing and payment.
- **Bank information:** including the legal name of your customer's primary bank, contact information for their account manager, borrowing capacity, their current outstanding balance and the high and low borrowing balance over the last 12 months. Their average account balance over the last 12 months is also useful. If the bank is the main source of your information, update every 12 months.
- **Commercial trade references:** including the names of at least three of their suppliers. Contact them and ask what credit limits they have established for your customer, the last time they sold to them and your customer's payment history.

You can also have a healthy discussion with your customer around your credit expectations to help you protect against slow payment or non-payment, such as how long your customer can wait before reporting a problem with a shipment, ways to mutually resolve disputes and your right to terminate credit terms on future sales. You will be able to quickly gauge your customer's attitudes and align expectations upfront before extending credit.

STEP 2: ESTABLISHING CREDIT LIMITS

Use one or more these tools to set a credit limit.

- **Commercial trade references:** Leverage the information used to establish the credit worthiness of your customer. Use the lower end of the credit ranges that your customer's suppliers have set to establish your credit limit and commit to updating every 12 months.
- **Bank information:** Use the information from your customer's bank to establish a credit limit and update every 12 months.
- **Financial statements:** if the company financial statements have been audited and are less than a year old, you can get a good idea of their liquidity, profitability and cash flow. Accounts payable turnover will suggest how quickly you can expect to get paid, as well as the company's ability to meet long-term obligations.
- **Credit agency reports:** These can provide reliable and comprehensive information about a company's financial record, such as payment experience, bank information, financial statements and historical information about the company and its principals. Update every 12 months.

Check out your buyer

With EDC's EXPORT Check you can quickly obtain vital information on many foreign companies. For a modest fee, an EDC Opinion Report will provide key credit and financial information about the firm and an opinion as to whether it is insurable.

STEP 3: REVIEW REGULARLY

Review and update your customer credit files regularly, especially when:

- The company asks for an increased credit limit.
- The company asks for an increase in payment terms.
- You have not sold on credit to the company within the past 12 months.
- Your past experience with the company has not been good.
- The company's structure or ownership has changed.
- The company's payment habits have changed.

STEP 4: WORDING YOUR SALES CONTRACT

Clearly spell out the terms you want in your sales contract. This is critical since a contract that incorporates a well-worded, comprehensive sales and credit agreement will make it easier if there is a problem and make it more likely you will receive payment on time.

WHAT TO DO WHEN ALL ELSE FAILS

Sooner or later, everyone runs into a problem with a late-paying customer or one that shows signs of not paying at all. Follow some of these common collection processes to increase your chances of getting paid.

- **Take action early:** The longer you wait before following up with a customer, the slimmer your chances of collecting.
- **Use the phone to back up collection letters:** Collection letters work better when combined with phone calls. It *is crucial to call repeatedly and follow up promptly* if a promised payment is not received.
- **Talk to someone in charge:** When you call, make sure you're speaking with someone who has the authority to issue payment without further delay.
- **Be understanding but firm:** You can empathize with your late-paying customers, but make it clear, without being abusive, that you expect to be paid as soon as possible. Always ask for a specific date for when you can expect to receive payment, remind them of your payment terms and say that you will call if you haven't received payment by promised date.
- **Offer discounts for prompt payment:** Many companies offer to discount their invoices if they receive payment within a short period of time, such as 10 days.
- **Don't ship until the customer's account is current:** Often the best leverage you can have is *the threat to stop future shipments until you are paid.*
- **Involve a collection agency:** Collection agencies are powerful tools for getting paid. However, this can strain your relationship with the customer, because it can affect their credit rating.
- **Tell your insurer:** Every policy is worded slightly differently but the bottom line is that you need to be familiar with the requirements under your policy when dealing with an overdue account. For example, EDC's Accounts Receivable Insurance policy requires that you to stop shipping when 10% of an account balance becomes 60 days overdue. As well you can have a recognized collection agency send a letter to the customer.

Keep records of all your efforts to collect including copies of letters and account statements, together with detailed notes on your phone calls.

CASE STUDY: CLEARWATER SEAFOOD

Learn how Clearwater used EDC's credit insurance to protect their profit margin.

SO WHAT IS CREDIT INSURANCE ANYWAYS?

Customers want to buy on open account so that they receive your goods or service before paying for it. This is risky since you are extending credit with no security. But *with* credit insurance, you can offer open account terms because much of your risk is covered.

It also means you don't need letters of credit, commonly used for international sales, which are complicated and can be expensive. The competitive advantage of credit insurance hasn't been lost on European companies, who routinely insure their receivables both to protect their bottom line and to increase sales.

If you would like to learn about EDC's credit insurance solution called Accounts Receivable Insurance, which can cover one customer, one contract or all of your receivables, you can:

- Get a **free quote**
- Submit an **inquiry form**

Ce document est également disponible en français.