FECMA Magazine for European Credit Managers 1/2015

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Process oriented Credit Management

FECMA Congress
20. & 21. May 2015
Brussels, Belgium

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DIRECTORY AND FOREWORD

All of us involved in this great business of risk assessment, granting credit, accounts collection and all the multitude of supporting disciplines involved have strived for many years to achieve the kind of recognition worthy of such a noble and worthwhile activity. We always called it a profession, often when for some unfathomable reason many others did not. It always seemed to me that anyone managing the most valuable current asset on the company balance sheet has to be seen as an important, not to say vital, professional – accountants have long been recognised as professionals but to be frank, counting the beans is nowhere near as important as nurturing their growth.

It was way back in 1939 that the foundations of a credit management profession in the United Kingdom were laid down, initially as the Institute of Creditmen, but reborn in 1946, after a break for a bit of unpleasantness, as the Institute of Credit Management. ICM consistently promoted the profession, educating business, government and public alike and sustained the ambition and the vision of credit management as a profession in every sense of the word. On 5 November, 2014 at a meeting of the Privy Council, Her Majesty Queen Elizabeth II approved the Order granting the Institute of Credit Management a Royal Charter – ICM became the Chartered Institute of Credit Management. An age old formality followed in the manner of the Great Seal being affixed by the Crown Office at the House of Lords, and from 1 January 2015 the Chartered Institute of Credit Management (CICM) came into being. None of this would have been possible had it not been for the drive and determination of the CICM Chief Executive, Philip King FCICM, backed by a team at The Water Mill who were inspired by his commitment.

Now I hope that you will forgive me for hijacking this column in the name of CICM, but in truth, the honour bestowed on the UK Institute is good for the credit management profession right across Europe (and beyond). There can be no higher recognition of professional status than that of the Sovereign in Council, and it means that credit management on the UK now stands shoulder to shoulder with "traditional" professions such as accountancy, surveyors, architects and so on. Couple that with the fact that CICM is the largest credit management association in Europe (indeed the second largest in the world), and it is clear that the raising of standards goes far beyond UK shores. Credit managers in Germany or France, Denmark or Sweden or any country association who are members of FECMA can claim to be members of an internationally recognised profession of the highest order – seventy five years may sound like long journey but reaching the destination makes the journey worthwhile for us all.

Glen Bullivant FICM
President, FECMA

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CONGRATULATIONS! ICM BECOMES CICM

The Lord Lieutenant of Rutland, Lawrence Howard was in attendance to formally unveil the Royal Charter granted to the Chartered Institute of Credit Management (CICM) in March this year. Congratulations

Speaking at the ceremony, Lawrence Howard said this was the first time he had presented a Charter as Her Majesty The Queen's Representative: "To attain a Royal Charter in this day and age is a truly great privilege and the amount of work that must have been done by the chief executive, Philip King, and his staff is tremendous.

"I am particularly proud that this Chartered Institute is based here in Rutland; even though it is a tiny county we have a huge amount to offer, and now even more so."

CICM President Dr Stephen Baister FCICM, the Chief Registrar of Bankruptcy added: "I would like to give thanks to all the staff at the CICM Headquarters for the very hard work that they have put in to getting the Institute to the place it is, the product of which is today's ceremony."

The current CICM Chair, Bryony Pettifor FCICM (Grad) proposed the toast. The ceremony was attended by a large group of credit management professionals and senior members of the CICM past and present including Brenda Linger, Stuart Hopewell, Trevor Phillips, Glen Bullivant, Charlie Robertson, Laurie Beagle, Larry Coltman, Victoria Herd and David Thornley.

Professor Robert Turner FCICM – former CICM President and Her Majesty The Queen's Remembrancer – was also present alongside a large number of branch Chairs, local business people, councillors, CICM Corporate Partners and other key suppliers to the Chartered Institute. Other guests included executives from professional bodies such as the Chartered Institute of Payroll Professionals and The Foundation of Science & Technology. The Lord Lieutenant wished all CICM members future success, a theme that was echoed by Philip King: "The Chartered Institute and its members have a proud heritage and an exciting future ahead," he said.

ELIZABETH THE SECOND by the Grace of God of the United Kingdom of Great Britain and Northern Ireland and of Our other Realms and Territories Queen, Head of the Commonwealth, Defender of the Faith:

TO ALL TO WHOM THESE PRESENTS SHALL COME, GREETING!

About

The Chartered Institute of Credit Management (CICM) is Europe's largest credit management organisation, and the second largest globally. The Institute was granted its Royal Charter on 1 January 2015. The trusted leader in expertise for all credit matters, it represents the profession across trade, consumer and export credit, and all credit-related services. Formed over 75 years ago, it is the only such organisation accredited by Ofqual and it offers a comprehensive range of services and bespoke solutions for the credit professional as well as services and advice for the wider business community, including the acclaimed CICM/BIS Managing Cashflow Guides (www.cicm.com).

FECMA-AWARD 2015 WHO WILL RECEIVE IT?

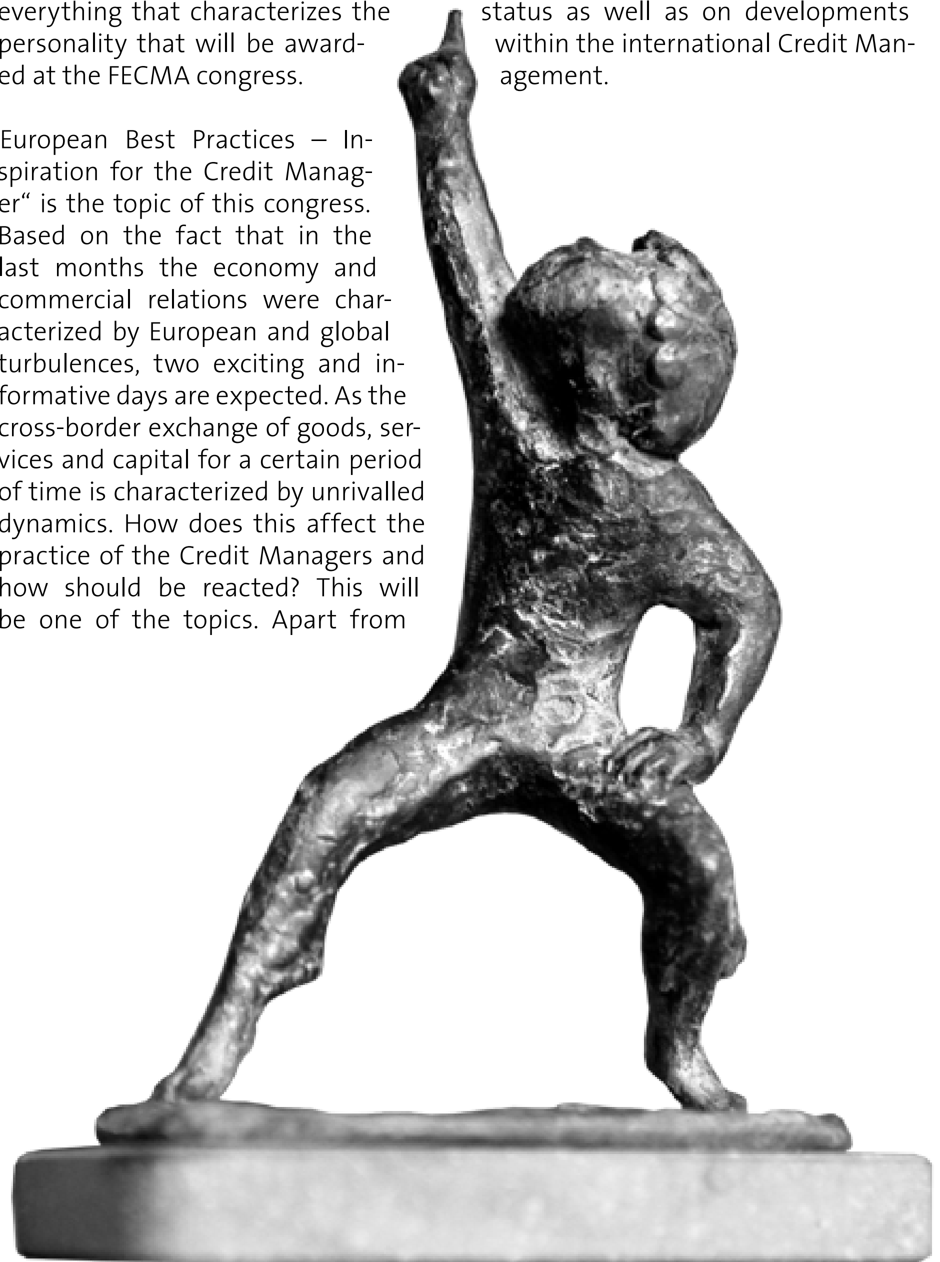
Determination - Stableness - Farsightedness - Eagerness - Motivation. Five positive characteristics - united in one small bronze sculpture. The artist Dieter von Levetzow, living in the Lower Rhine town Kranenburg - by the way a great-grand-nephew of Goethe´s last love Ulrike von Levetzow - has created this sculpture exclusively for the FECMA (Federation of European Credit Management Associations). "The decision was made last year", the chairman of the Bundesverband Credit Management e.V., Jan Schneider-Maessen emphasizes: "With this sculpture we want to honour a personality from the Credit Management for her lifework," Schneider-Maessen announces.

The awards ceremony will be hold for the second time. The person who will be awarded this price remains a secret. At least up to the FECMA congress that takes place on May 20. and 21. in Budapest. It is not a secret that the award is unique.

Dieter von Levetzow, who already at the age of 16 became student of the university of fine arts in Weimar, is a philanthropist. His figural sculptures that are not only visible in several Low Rhine cities, express vivid gestures and represent the orientation towards life..

His FECMA sculpture shows a young man with his index finger raised: "With this gesture I wanted to express that the figure looks towards the future", Dieter von Levetzow emphasizes. Levetzow shows a young man - the artists´ preferred subject. For the 89-year old juvenility symbolizes the relief from this world upwards - to higher ambitions: "With my sculptures, I attempt to express the positive." Once more he succeeded in doing so. Since this sculpture stands for everything that characterizes the personality that will be awarded at the FECMA congress.

"European Best Practices – Inspiration for the Credit Manager" is the topic of this congress. Based on the fact that in the last months the economy and commercial relations were characterized by European and global turbulences, two exciting and informative days are expected. As the cross-border exchange of goods, services and capital for a certain period of time is characterized by unrivalled dynamics. How does this affect the practice of the Credit Managers and how should be reacted? This will be one of the topics. Apart from speeches of renowned speakers the congress offers a platform for professional discussions on the current status as well as on developments within the international Credit Management.



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- commercial credit insurers

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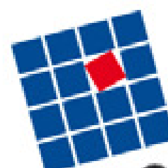

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MASTERING COMPLIANCE REQUIREMENTS

Automating processes for greater transparency, security and effectiveness

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Over the past two years, a third of all companies in Germany have fallen victim to economic crimes, but in the case of large companies this figure rises to half. To counter the rise in economic crime, various compliance regulations have come into being over recent years, namely FATCA, the Sarbanes Oxley Act, MaComp and MaRisk. This regulatory framework poses huge challenges for compliance officers at companies, particularly when the auditor is about to come knocking on the door. The crucial factor is to create clear organisational and process structures and to ensure that there is a proper audit trail when documenting and archiving decisions.

Compliance officers – who have a direct line to top management (e.g. the chief compliance officer who has his/her very own position on the board) – have a very important role to play within this context. They are responsible for ensuring that a "central department" is set up to coordinate the prevention of money laundering, terrorism financing and other criminal activities and that there is a company-wide compliance policy in place. As a result, they must enjoy the trust of all employees. However, the challenges faced by compliance officers go far beyond the compliance policy that is used to define and document the internal guidelines. In addition, there is the requirement for fully traceable decisions (for example, a compliance check on a potential customer):

- Who took the decision?
- When was a decision made?
- On what information was

the decision based? (For example: For what risks and against which lists has a potential customer been checked? What was the result of this check? Etc.) The responses to these questions must be documented and archived in full, even if decisions are subsequently revised. Naturally, the documentation and archiving processes must meet the latest data protection and data security criteria.

How to meet complex compliance requirements

The magic word here is "automation": not only do automated processes support decision making, but they also facilitate documentation and archiving.

Example of customer compliance: In accordance with the "know your customer" (KYC) principle, the first step is to clearly identify any potential new customer. The necessary information is retrieved automatically from external data providers and even automatic ID card verification is possible. Once KYC information has been stored in house, it can be reused and a validity period can be defined for the information obtained.
The next step is to cross-check the customer against predefined lists. These might include sanction, terror watch list, money laundering and PEP databases. In the event of multiple hits (i.e. ambiguous results), a decision maker is required to intervene manually.

On completion of these upstream process steps, all the relevant information concerning the customer is to hand. This is then used as the basis for deciding how the company should proceed next: Do the authorities have to be notified? Is the application to be rejected or accepted? If it is accepted, what conditions apply (e.g. monitoring)?

As part of the decision making process, the customer should be assigned

to a risk group. The categorisation system allows "similar" customers to be grouped together: For example, risk group 3 brings together all customers who are politically exposed persons (PEPs). Risk group 2 covers all those customers who were once classed as PEPs but who were no longer identified as PEPs during the latest check (e.g. because they have stood down from political office). Details of the decision and customer classification are saved together with all the data that led to this decision. Revised decisions do not "overwrite" this information but are archived alongside it.

In addition to the application process itself, regular monitoring also plays an important role. The risk classification assigned during the application process may result in different checking intervals for the individual risk groups. For example, risk group 1 has to be monitored once every two months while risk class 2 only has to be monitored once a year, and so on.

The scope and depth of the check can also be determined on the basis of the classification and triggered automatically: For example, the KYC identification process is always repeated for risk group 9, but in the case of risk group 5, the customer is merely checked against the sanction lists using the KYC information (which must be no more than five years old), etc. Within this context, it is useful to base the risk group on other data in addition to the compliance and risk-related information including, in particular, details of which products an existing customer reserves or purchases. In this way, the customer can be assessed from both the perspective of risk and value.

Compliance check: The 5 biggest stumbling blocks

1. There are many different regional, supraregional, national and international lists (particularly in the case of PEPs). Furthermore, there are numerous sanction and terror watch lists, each with a different focus (e.g. Al-Qaida lists, Interpol lists, U.S. Marshals list). For this reason, deciding which of these lists to use is a complex process and the outcome is determined not only by the particular sector concerned but also by the customer focus, location and choice of products.

2. For example, some PEP lists include details of relatives as well as the actual PEPs themselves. Consequently, the decision as to which particular person constitutes a PEP for the company is not a trivial matter and must be carefully debated and recorded in the compliance policy.

3. The crucial factor is not just to choose the right list but also to select the "right" parameters for the query: If the values are too fine, they are less likely to produce hits, thereby resulting in possible "false negatives", which is when the system returns the result "no hit" for a potential customer and fails to identify them even though they actually do appear on one of the lists. The problem is exacerbated by ambiguous data queries or assignments. For example, there might be numerous aliases (in some cases up to 20 names for the same person) or it may not be clear how the name should be spelled, particularly where different alphabets/writing systems are involved (Roman alphabet versus Arabic or Cyrillic alphabet). If you attempt to overcome this problem by using coarse values, there may be a higher likelihood of hits, but at the same time there is a greater risk of "false positives". This is when the query generates one or more hits but they could relate to a different person altogether.

4. The definition of the risk groups has to be carefully considered: with a small number of risk groups, there is no scope for in-depth "special treatment" while a large number of risk groups makes the monitoring process highly complex.

5. The fact that EU directives have to be translated into national laws, coupled with how even these (e.g. the German Money Laundering Act) are often formulated generically in terms of the stipulated measures and procedures, means it is difficult to define a "secure and reliable" process. In this regard, it is useful to cooperate closely with the auditor.

Conclusion: Process automation pays off

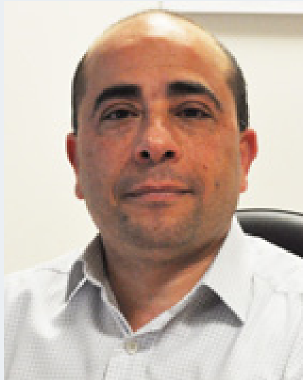
Automating the compliance check results in complete process reliability – making it impossible to bypass the process that has been rigidly defined according to the compliance guidelines. In addition, it does not allow any "leeway" when evaluating and interpreting the information on which a decision is based. The decision is made purely on the basis of predefined rules and criteria and so the process is always deterministic.

What's more, process automation ensures that all decisions are traceable. Consequently, it is always perfectly transparent how and why a decision was reached: the process is fully documented – including all the background information leading up to the decision as well as the decision criteria and process steps involved.

If companies pay attention to these points – traceability, transparency and clear decision criteria based on a company-wide compliance policy – they will be able to master the complexities of the compliance requirements and prevent economic crimes.

HOW CAN WE IMPROVE THE CREDIT CONTROL FUNCTION?

The following short article looks into some suggestions that I would like to recommend as I believe that if implemented they can improve the Credit Control function.



Joseph Dimech
GO
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1. The Company Credit Policy should take into consideration Customer Segmentation i.e. the various types of debtors' categories, as there will be various benefits and advantages for the same organisation.

2. The Credit Manager should allocate staff, specific amount of time and resources for each and every type of segment, the extent of time and resources would depend on the amount of revenue generated from each segment. I would personally recommend the inclusion of the pareto analysis (80/20 rule i.e. 80% of revenue is normally generated from 20% of our Customers) in the dunning process as this will enhance the efficiency of the whole collection process.

3. Staff within the Credit Control Function should be motivated to specialise in a particular debtor segment whilst retaining a certain element of flexibility. This will provide a room for career development. However in order to achieve this, further education and on the job training for the Credit Control Staff is required.

4. Operational concerns relating to Credit Assessment, Collection methodology and Legal matters should be appropriately addressed. Assistance by the firm's Legal Consultants would be required. Specific training to the Credit Control Staff concerning the local legal aspects is definitely required as it would be extremely difficult for the Credit Control staff to take the most appropriate Legal Action in the circumstances if staff is not properly trained.

Consequently the above recommendations should lead to:

- Reduction in the Cost of Credit
- Better collection processes
- Stronger Liquidity position for the Company
- Reduction in the Provision for bad and doubtful debts
- Reduction in the number of pending Legal Cases
- Reduction in the number of lost Court Cases
- More Profits for the Organisation

The above-mentioned recommendations should be seen as the result of a continuous process whilst operating in a changing environment. Credit Management will always be affected by various forces and both management and staff should always be prepared for these changes and for the implications that such changes may have on the business.

But as long as there are signs of goodwill from all forces within the industry, any drawbacks will be clearly outweighed by the benefits so the Credit Industry would keep on developing in a better industry than we know it today.

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FOCUSING ON CREDIT MANAGEMENT – THE KEY TO KEEPING CASH FLOWING

With the European Central Bank's recent increase in the Eurozone growth forecast to 1.5%, this is probably a much-needed slice of optimism for businesses operating in the region's main markets, which have struggled to gain any real upward

Even though this news should help business confidence, particularly as export growth is expected to improve, supported by the improvements in the US and UK economies, concerns still exist about Europe's vulnerability and its ability to cope with any new financial shocks, which could undermine current progress.

However, credit conditions may at last be improving, apparent from the easing of loan supply conditions for businesses and households by European banks, which should help to stimulate demand and contribute to a more robust recovery.
Central bank policymakers have also

set extremely low interest rates to reduce the real cost of borrowing and increases banks' capacity to lend. But, as credit conditions are just beginning to ease, they remain extremely tight.

An annual study conducted by Atradius into the payment behaviour of businesses in Western Europe found in December 2014 that the volume of business conducted on credit is a little over 42%. Of this percentage almost 38% of invoices were overdue by the time they were paid and 1.7% were uncollectable.

Although this is a small proportion of the Western European overall invoice value, it still runs into tens if not hundreds of millions of Euros. In Belgium, France, Italy, Great Britain, Spain and Turkey, the uncollectable figure ranged between 2.1% and 2.6%.

The Days Sales Outstanding (DSO) figure also made for sobering reading with 32.6% of companies surveys stating that the DSO was between 61 and 90 days with a further 12.7% declaring that their figure was more than 90 days. For Greece, Ireland and Turkey, this latter figure exceeded 20% of businesses with a DSO exceeding 90 days.

Although the credit conditions and interest rates, in general, are still encouraging liquidity and growth, it's clear that good credit management is probably now more important than ever, as in times of growth businesses can overstretch themselves to take advantage of a new business opportunity and rapidly find themselves with cash flow issues.

This is not only bad news for the company itself, but also for its suppliers who are likely to experience unexpected payment delays and even non-payment due to insolvency. As a result, well-structured and diligent credit management procedures are essential, yet it's evident from some of the payment behaviour research that a significant proportion of businesses are not as thorough as perhaps they ought to be.

To help provide a more structured approach to credit management, there is a range of initiative that can be implemented to help businesses manage the credit cycle more effectively and help reduce the number of surprises that inevitably occur form time to time.

The credit management cycle is a clearly defined process that not only helps maintain cash flow but also makes a significant contribution to the financial health and strength of any business. Credit management involves a set of inter-related disciplines that begin well before an invoice is raised.

In broad terms, these are usually defined as:

- Credit vetting
- Setting of terms and conditions
- Invoicing
- Collections
- Accounts reconciliation
- Reporting

To provide additional insight on three vital elements of this process, 'credit vetting', 'terms & conditions' and 'collections' are explored more fully below with some key points for consideration.

Credit Vetting

The potential for payment default or even the possibility of a bad debt due to insolvency is an ever-present risk when trading on credit, so the value and importance of obtaining accurate and up to date information on potential customers is vital.

By using credit vetting to assess the creditworthiness of customers, an indication of their ability to pay when purchasing items on trade credit terms can be obtained. The value of this information lies in its ability to help the supplier company decide how much credit to allow their customers, as well guiding on the allowable length of the credit period under terms of business.

While credit insurers such as Atradius

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and specialised credit vetting agencies can provide this information, individual businesses can also undertake their own research, using publicly available data, which can help build a picture of a customer's credit profile by highlighting items such as:

- Company name and registration details
- Registered office – important to note this address may not be the trading address
- Principal activities
- Directors & Shareholder details
- Legal civil judgements or any criminal cases pending
- Internet news and information – e.g. Google alerts and stock exchange feeds
- Company accounts

Obtaining the information is one thing, but interpreting it correctly is absolutely vital to build an accurate picture. In short, investing in credit information can often prevent bad debts later. Some areas to look out for that may reveal potential issues include:

- Unusual delays in payments
- Requests for longer credit periods
- Unusual ordering patterns
- Sudden switching of principal suppliers
- Poor accounts
- Lack of investment – visible by visits to buyers' premises
- High staff turnover
- Recent change of ownership
- Recent change of address
- Recent increase of capital

Terms and Conditions (T&C's)

Businesses that do not provide clear terms and conditions of trade, or have only confusing small print on the backs of their invoices, are inviting payment problems.

The main features of any terms and conditions should be that they are clear, comprehensive and enforceable. In short, such terms provide a sound basis on which businesses can be protected in the event of a dispute. However, they are only enforceable if they are stipulated at the time the contract is agreed with the customer and not introduced 'post-contract'. In credit management terms, T&C's are a vital part of the process as they detail the key principles on which individual companies do business, including their payment terms, but their importance can often be overlooked.

Collections

There is a natural tendency for businesses to be reluctant to part with their cash, particularly in times of financial uncertainty. Delaying a payment provides the questionable benefit of improving liquidity at the expense of one's creditors - even though the bills will have to be paid at some point.

Essentially, there are only two key strategies for collecting a debt - the amicable approach or the legal route. The complexity of the legal process varies from country to country, as specific regulatory requirements and procedures have to be followed in each.

As there is no guarantee of success, the legal approach is generally regarded as a last resort by professional debt collection agencies and many of the businesses that explore this option.
In any eventuality, it is always best to seek advice from a professional commercial debt collection agency, such as Atradius Collections, before embarking on any legal path.
By obtaining advice and guidance, it will not only be able to explore ways to avoid the legal collection option, but also, as a result of its worldwide experience of dealing with both legal and amicable collections, it will also be able to indicate the likely success rate.

Additional protection against non-payment

Trading risks are always present, particularly when trading internationally irrespective of business size. Credit insurance is simply a way for businesses to protect against the risk of not being paid when trading on credit terms.
Once the goods have been despatched and a customer has accepted delivery, they are obliged to pay by the due date. However, if payment isn't made, as a result of a customer becoming insolvent, political intervention or other reason, then the credit insurance policy covers the business against this potential financial loss.

As a result, credit insurance is regarded as an essential part of the credit management process by countless businesses of all sizes across Europe and globally, as it provides a range of benefits, including:-.

- Protection from the risk of customer non-payment
- Reduced risk of bad debts
- Improved cash flow
- Improved credit management processes
- Up to 90% of contract value is covered and paid as a result of a claim
- Credit insurance policies usually include a professional collections service
- Flexible, tailored cover to suit your precise business needs and risk profile
- Improved access to finance as banks regard credit insurance as a positive indicator

Businesses that spend the time and effort on front-end processes, such as credit vetting and T&Cs, should experience fewer issues with non-payment and enhance their collections successes when the invoices are due.

Also, It is worth bearing in mind that if within a credit insurance policy, most of the elements within the credit management process are already included, which can provide highly effective support to internal credit management procedures systems or be operated completely as a fully outsourced solution.

EuroCollectNet

is an association of European lawyers who offer a comprehensive service for the effective collection of debts throughout Europe and worldwide.

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PAN-European FECMA Credit Management Congress

Program | 20th May 2015

13:00 – 13:30	**Registration**
13:30 – 13:45	**Welcome and Opening by FECMA** Glen Bullivant, FECMA, UK
	Welcome by Instituut voor Kredietmanagement Prof. ir. Ludo Theunissen, IvKM, Belgium
13:45 – 14:30	**10 Global Economic Game Changers for the Future** Dr. John Lorié, Atradius, The Netherlands
14:30 – 15:15	**DNA of the international Credit Director: Why it is Key for Success** Paul Jones, The Walt Disney Company, UK – tbc
15:15 – 15:45	**Networking Coffee Break** Facilitated Speed Networking
15:45 – 16:30	**Effectively managing the Credit Intelligence Process** Sander Desmet, Bureau van Dijk, Belgium
16:30 – 18:00	**Credit Management Strategies: a European PerspectivePanel discussion** **Moderator:** Philip King, Chief Executive, Chartered Institute of Credit Management, UK **Panelists:** Pascal Fonteneau, Nordson Corp., France Paul Jones, The Walt Disney Company, UK – tbc Alexandra Paton, Equinox Global, UK Dr. Thomas Voller, EuroCollectNet Lawyers, Germany Andreas Wenzel, Agfa Graphics, Belgium
18:00 – 19:30	**Hotel Check-In**
19:30 – 20:00	**Registration for Dinner**
20:00 – 23:00	**Dinner**
	Opening Speech & European Credit Management Award Jan Schneider-Maessen, BvCM, Germany

Program | 21th May 2015

08:30 – 09:00	**Registration**
09:00 – 09:15	**Welcome and Opening by FECMA** Glen Bullivant, FECMA, UK
09:15 – 10:00	**CM Best Practices in international Industrial Companies** Steven Ponnet, AGC Glass Europe, Belgium
10:00 – 10:45	**CM Best Practices in international Telco / Media Markets** Joseph Dimech, Go, Malta
10:45 – 11:15	**Networking Coffee Break**
11:15 – 12:00	**Our Journey to create a World Class O2C function** Phil Rice, Aggregate, UK
12:00 – 12:45	**International Credit Management** Andre van Ommen, JLG Industries, The Netherlands
12:45 – 14:00	**Lunch Break**
14:00 – 14:40	**Revolutionizing the Payment Process Worldwide** Joachim Goyvaerts, Paypal, Belgium & Luxembourg
14:40 – 15:20	**Big Data Scoring: Innovation in Digital Lending** Lennart Boerner, Kreditech, Germany
15:20 – 15:50	**Agility in Credit Management: Supporting Business Growth after Recession** Vittorio Martorano, AGiCRE, Italy
15:50 – 16:00	**Closing by FECMA** Glen Bullivant, FECMA, UK
16:00 – 16:30	**Closing Drinks**

Program and speakers can be subject to change

SAVE THE DATE!

20. & 21. May 2015

Brussels, Belgium

Pan-European FECMA Credit Management Congress

„European Best Practices – Inspiration for Credit Managers and Credit Professionals“

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- Global Economic Game Changes: What to expect from the Future in Europe?
- Credit Management Strategies: an European Perspective
- DNA of the European Credit Director: What are the Key Success Factors?
- Corporate Turnarounds: Success and Failure Factors

The Federation of European Credit Management Associations (FECMA) would be extremely pleased if you took interest in joining the Pan-European Congress.

For further information, please feel free to contact Pascale Jongejans at fecma@sbb.nl or dial +31 35 69 54 103.

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CORMETA IT-TRENDS 2015

Cloud, mobile, in-memory and greater social media ambience. What are the latest IT trends in 2015, and what do customers need and demand?

Holger Behrens
chairman
cormeta ag

At the cormeta ag software company from Ettlingen, Germany cloud, mobile and in-memory are the initial technologies essential to making its own industry solutions operable in a way that is faster and available everywhere. Specialising in mid-sized SAP channel partner companies, cormeta sees challenges as well as optimisation opportunities for a variety of application areas such as CRM, ERP, logistics and business analytics/intelligence. The trends have less to do with new technologies than with existing technologies for which software manufacturers are now beginning to develop the potentials. Holger Behrens Board Chairman cormeta ag explains, "Cloud applications have great benefits, especially for use when the user is underway. In this regard we are particularly focused on improving operability. To a large degree private communication is moving to social networks which are easy to use and feature sleek looking surfaces and apps. We want to offer companies this same 'at home feeling', which can in turn reflect positively on the reputation of the company as an employer".

More speed and efficiency

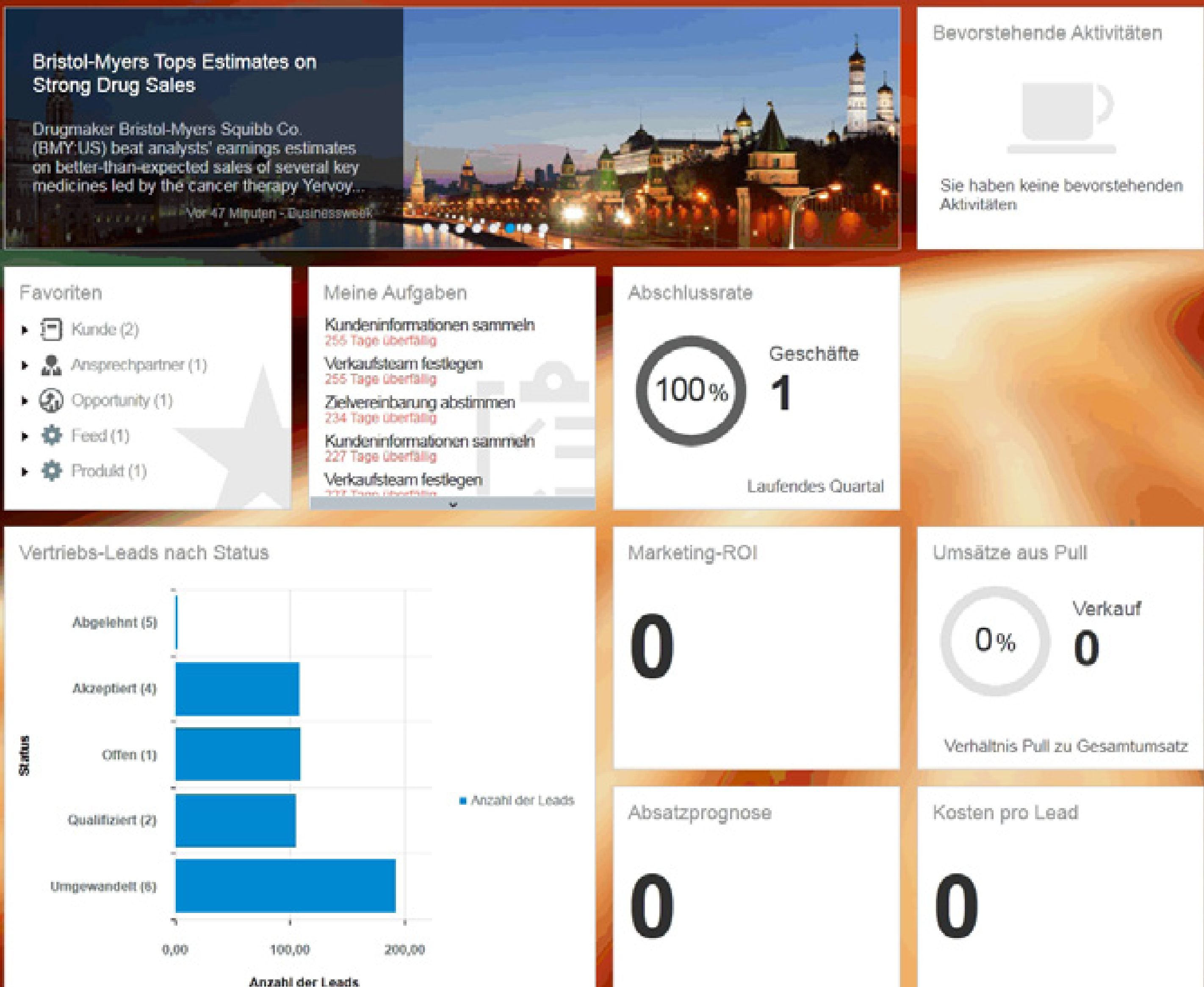
cormeta has already integrated cloud applications for customer and employee management into its own industry solutions. These enable companies to intensify the contact with customers on every channel, providing a clear overview from ERP right through to the PoS which can be accessed by mobile means at all times. These applications additionally optimise in-house and logistical processes, increase transparency and ensure that targets are achieved with greater speed and efficiency.

"We are also continuing to focus on SAP HANA", Behrens says in citing the company's other primary thrust. The associated computing power and the accompanying real-time capability possibilities can help businesses such as wholesalers speed up their ERP software, as well as systems linked to it like web shop applications. They can register product inquiries in real time and are capable of updating prices on online portals with their offers with-in only a matter of hours.

The existing technologies can of course be combined with one another. Behrens explains, "In clouds, we always want to have the latest data or data that has just been updated. A HANA system in the background makes this possible". "Predictive analysis", which is only possible in real time with in-memory computing, will also play a role in this regard.

Adds-on for more service

In addition to its SAP solutions the cormeta portfolio also includes a variety of add-ons for risk and credit. These include highly efficient tools for finance communication and credit management. The add-ons can be seamlessly integrated into SAP regardless of whether a cormeta solution such as FOODsprint or other ERP software serves as the basis or not. These tools enable companies to manage trade credit insurance policies (KVsprint), debt collection processes (CrefoSprint Inkasso), complaints/returns (DMsprint) and sales of receivables (ABSsprint). Managing credit



SAP Cloud for Customer: Cloud is one of the most important IT Trends 2015

insurance policies is important for ensuring full compliance with contractual details. Credit insurers are now offering special food policies that also apply to perishable goods. Additionally, cormeta also provides for the link-up to credit agencies (CGsprint). All of the add-ons can be compiled into a cockpit in an easy-to-understand fashion and centrally controlled in the RMsprint risk management software. Even with its high-tech focus on cloud or in-memory computing, cormeta ag has not lost sight of traditional optimisation possibilities. However, these possibilities can be pushed even further with the new technologies.

SAP Channel Partner cormeta

For close to 20 years, cormeta ag has been a qualified SAP Partner as well as industry expert focused on medium sized businesses. The established software and consulting company develops and implements powerful SAP Business All-in-One and SAP BusinessObjects Solutions especially for technical wholesale & retail, automotive parts and tyre trade, industrial manufacturing businesses, food & drinks industry, pharmaceutical industry and, the textile industry.

As strategy and technology specialists, the cormeta employees have comprehensive process and product know-how within the SAP portfolio and perform expert service and support for the SAP technology – for example for business analytics and business intelligence (BI/BW), product lifecycle management (PLM), mobile solutions based on SAP standards, in-memory-technologies (SAP HANA), extended warehouse management (EWM) and, cloud applications.

In addition, SAP and ERP users from any industry and of any size can benefit from the sophisticated cormeta Credit Management Tools. The state-of-the-art modules for financial communication and receivables management can be fully integrated into the SAP environment as add-ons: CGsprint, KVsprint, RMsprint, DMsprint, ABSsprint, CREFOsprint etc. can be seamlessly added to the operative business processes. They are supporting receivables qualification via financial screening of customers by credit report agencies, management of credit insurances and complaints, management of sold receivables (factoring), handling of debt collection routines as well as authoritative risk management.

cormeta ag employs a workforce of 98 at its headquarters in Ettlingen and at its subsidiaries in Berlin, Düsseldorf and Hamburg. During the fiscal year 2013/14 (ending 30.4.2014) cormeta ag achieved sales of 15.9 million euro. www.cormeta.de

PROCESS-ORIENTATED CREDIT MANAGEMENT…

… in global corporations for European markets

Prof. Dr. Matthias Schumann
Head of the Chair of Application Systems and E-Business at the University of Göttingen
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How do German companies organize their credit management for the European market? Which tasks are performed by credit managers, which design variants are there and to what extent can credit management processes be standardized for the whole of Europe?

In the design of such functions, German companies are often very process-orientated, especially when the use of these functions is spread across multiple departments. The following description is therefore based on strongly abstracted credit management processes. It will become clear that although the information used and the resulting decisions may vary between regions and countries the basic processes according to a standardized credit process framework are used throughout Europe.

The first important aspect to consider is the extent of the German credit management process. This usually begins with the initial checking of the address data for a new potential customer. It is not the case that credit management tasks begin only when the invoice has been sent and the unpaid positions have to be administered or debt collection procedures initiated.

Having established the qualification of the potential customer, in many industries the next question is that of customer financing through the agreement of a payment term and the credit limit associated with it. Depending on the risk entered into through this financing function, for a few industries the task that follows is to take into account this risk when setting the price for the goods or services provided to the customer. Parallel to this, depending on the areas of responsibility of the credit managers and the possibilities for the company to carry the risk resulting from supplier credit itself or to pass the risk on, checking and securing with the help of a credit insurance company may take place. Depending on the field of business of the company, the customer's order is then produced or is delivered immediately. This is followed by invoicing, monitoring of open positions, the handling of customer complaints, and possibly dunning procedures and debt collection activities.

The credit managers are involved in this process until, where necessary, checking and agreement by the credit insurance company has taken place, and then again at the latest when the monitoring of the open positions begins.

When one considers the first stage in the checking of a new customer more closely, it can be divided into the checking of the address, which generally involves performing a search in the data of an information agency through which an initial creditworthiness classification is also obtained and a comparison with the internal data for existing customers in order to avoid the unintentional creation of duplicate files for the same customer. Under certain circumstances, however, double files are created intentionally. In some industries, the data is then compared with lists such as blocking lists for individuals or embargo lists. After this, it is necessary to establish which volume of business is to be pursued with the customer in order to use this as a basis for obtaining further customer information if necessary, and then to use

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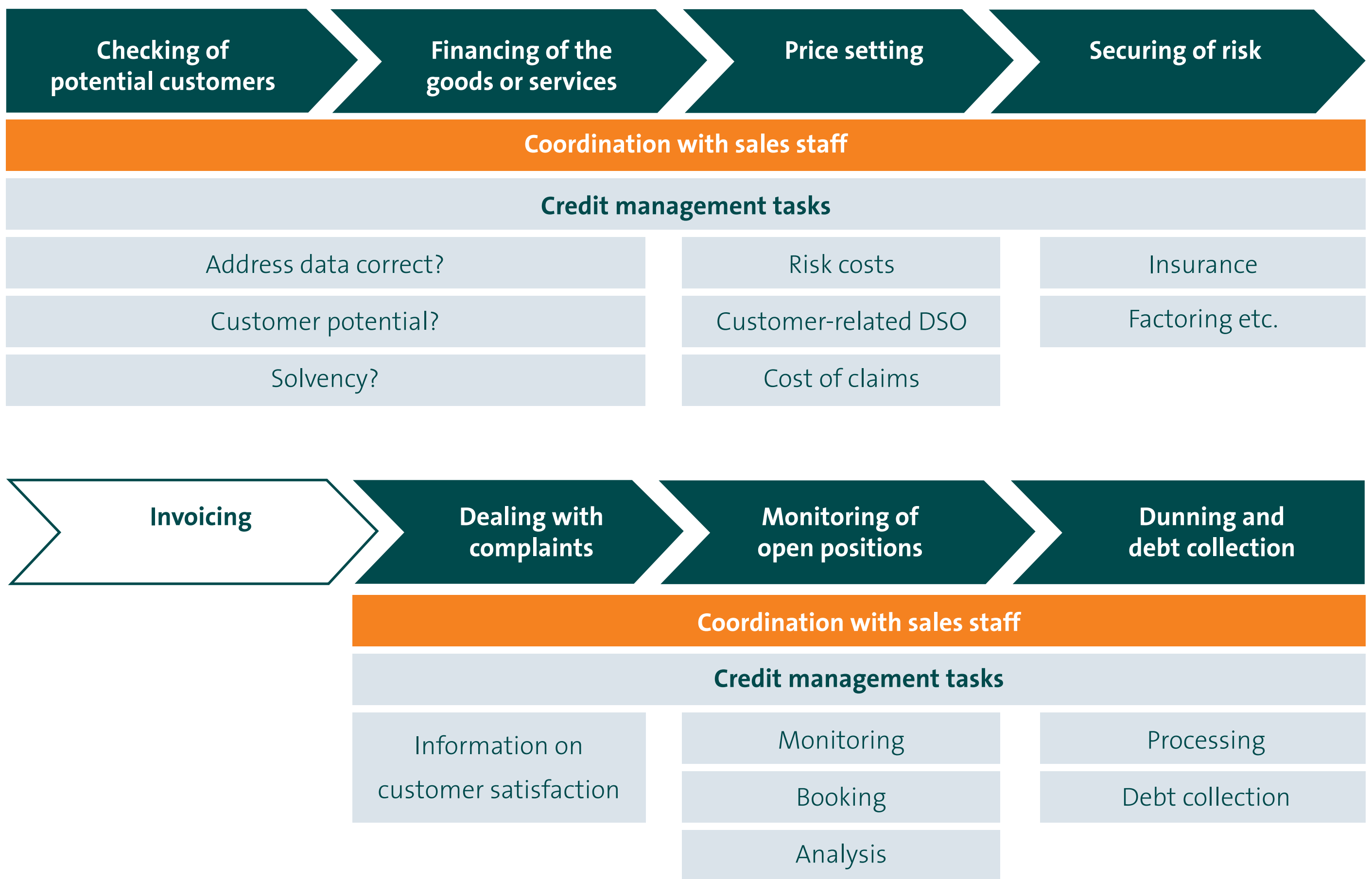

Fig. 1: Financial supply chain

the available information to decide on a credit limit and a payment term for the customer.

The initial checking of the customer does not necessarily have to be performed by the credit managers; it can also be carried out by sales staff. Nevertheless, the credit managers require complete access to the information in order to perform later stages in the process. Equally, the initial entry of master data for the customer can be performed by a department specializing in this task. These members of staff use the information collected to verify the master data before the creation of a data set for the customer.

In many cases these part-processes can be standardized, with the exception of some of the smaller details. It could be necessary to use different sources of information for different countries or for customers with different legal forms. The evaluation of the information must, of course, take place in a product-specific manner. Depending on the limits to be allocated, further checking of companies is carried out ranging from obtaining and evaluating further reports from information agencies to the evaluation of the annual reports published by the customer companies themselves. In some countries these annual reports are publicly available but in Germany, for example, only heavily abbreviated annual reports are available for companies of a certain size.

The payment terms also need to be adapted to suit local practices in the countries concerned. It may also be necessary to designate securities. For each country, the securities that will be accepted to cover risks must be defined.

Credit insurance contracts are a method for securing risks that is often used by German companies. For limits that exceed the discretionary credit limit set by the insurance company, the required credit limit is checked by the insurance company itself. Depending on the result, the business with the customer is then either agreed, turned down or an alternative method of financing is sought, which may even involve payment in advance for the goods or services.

Further along the financial supply chain, the work of credit managers continues with the monitoring of open positions. If payment takes

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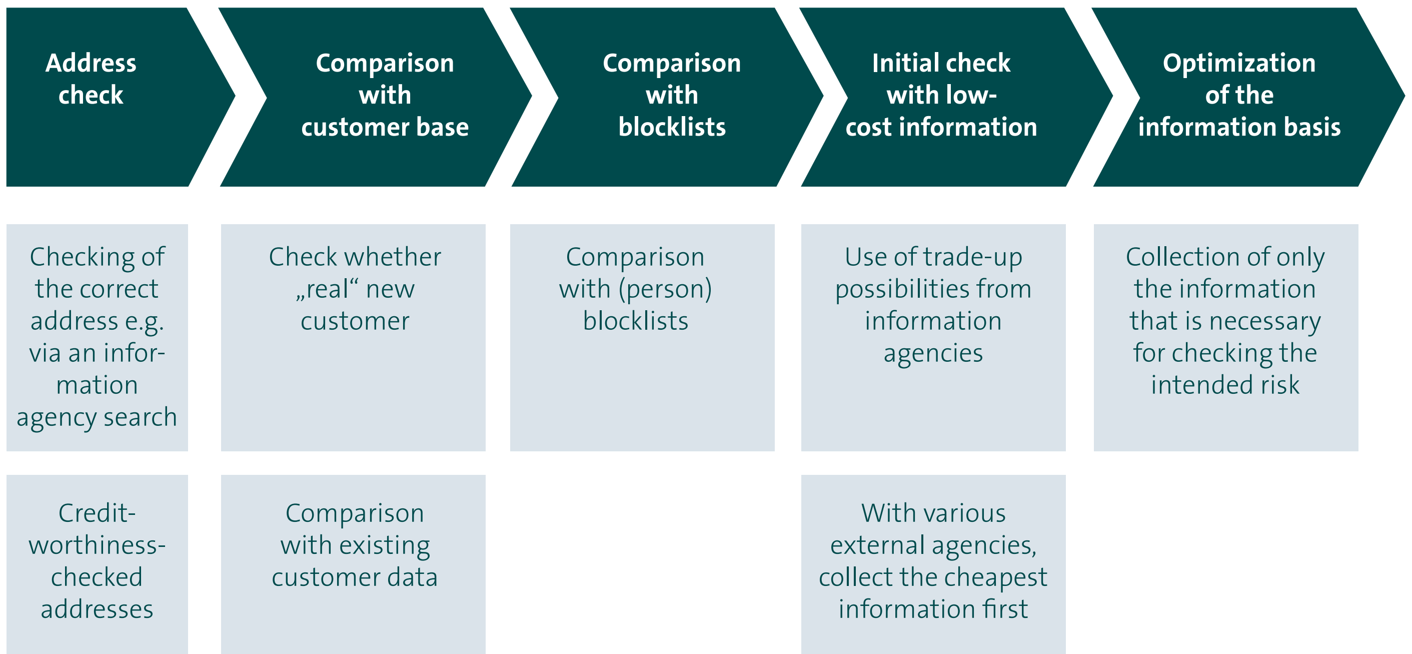

Fig. 2: Continuous monitoring of existing customers

place according to the agreed conditions, then the business transaction has proved to be unproblematic. If this is not the case, country-specific dunning procedures must be implemented (in writing, by telephone or through personal contact) so that if payment is still not made, debt collection procedures can be started. Depending on the country, this process is often already started as soon as the payment becomes overdue.

Here, it can also be seen that the basic processes are usually similar. Again there are differences in the detail, e.g. the way of dealing with specific types of security.

If a known customer places an order and a credit line already exists for this customer, then the process stages that are performed are also similar and do not depend on the country in question. The order is checked against the remaining part of the credit limit. If this is sufficient, the order is confirmed and is carried out. If the credit limit is not sufficient, part-processes are started that lead to postponement of the order, payment of outstanding invoices or the obtaining of securities. It may also be possible for the customer to increase his credit limit by providing further information.

Another process involving the existing customers is the continuous monitoring of the customer base. This can also be standardized independently of the country concerned. Internal payment records for the company's own customers are constantly analysed in order to recognize any deterioration in payment behaviour and to use this information to perform detailed checks of the situation of the customers.

Equally, external information, for example from monitoring performed by information agencies or changes in the limits agreed by credit insurance companies and their risk estimations, must be taken into account and appropriate measures carried out. This is a process that can only be performed continuously with the help of IT support. A country-dependent exchange of data with external payment record pools is also possible in order to compare internal information with data from the observations of other companies. Since these pools are not available everywhere, this needs to be set up for each specific country with its own specific evaluation process.

In a company group structure the basic processes presented here can either be carried out decentrally or heavily centralized in the form of a service centre. Critical questions must, however, be asked as to whether functions involving customer contact should continue to be organized decentrally. Independently of this, reporting functions for credit management must be set up for each country and/or for the entire company group.

In summary: the implemented credit policy is valid across all countries but the individual information sources and tools may vary. The parameters must also be adapted to the country in question. The basic processes of credit management, however, are valid for all countries and therefore comparisons can be made internationally.

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TRADE CREDIT RISK – FROM MONITORING TO MANAGEMENT

Trade Credit has always been considered an inexpensive source of financing, from the part of buyer, and a major tool for promoting sales, from the part of seller. However, that tool associates with several additional costs and risks that should be taken into account, so that they do not become a threat for the seller.

A direct cost of Trade Credit is the money paid for funds (either debt or equity) used to finance receivables until their due date. It is easily measurable and is usually involved in pricing function. However, when actual collection of receivables exceeds the agreed terms, credit cost can easily go out of control, thus creating loss, not to mention potential difficulty of the business to raise the additional funds required for financing them. Such predicaments, along with write-offs could easily become major threats to both profitability and cash-flow planning, which could eventually put in peril the viability of a business. Nevertheless, despite their importance, Credit Losses are usually too hard to be accurately forecasted. Thus, the need of Credit Risk Management arises.

Especially in the last years, facts as the worldwide economic recession, major corporate failures, accounting scandals, stock market and real estate bubbles, globalization of business and the liberalization of markets and capital flows have emerged the need for sound Trade Risk Management.

However, managing Credit Risk is a multi-dimensioned problem, involving a lot of factors, parameters and assumptions. As with any complicated problem, fully understanding and soundly defining it is the key to resolve it. So, in the following section we are setting the Credit Risk Management objectives and determining the factors of the problem.

Can we eliminate Credit Losses?

Since the main objective of Credit Risk Management is to control Credit Losses, the first thought would be: “Let’s eliminate Credit Losses”. This is easy; just do not grant any credit to your customers. But without granting trade credit, sales would drop along with profits. So, as a second thought: “OK, since we cannot sell exclusively on cash, let’s reduce credit to the riskiest customers”, a practice which in principle could decrease losses without dramatically affecting sales. Now the question is “How to identify the riskiest customers?”. The answer comes from external credit bureaus which offer scores of creditworthiness or/and from scores produced by internally developed empirical or statistical behavioral models. Those scores are not always the optimum solution for classifying the clientele, but they usually offer a fair way for doing it.

Having identified the riskier customers, it would be simple enough to reduce their credit so as to reduce credit losses. Is it really so simple? Still some significant questions remain to be answered:

- What is the optimum scores’ cut-off point for starting to reduce credit?
- What is the magnitude of a fair reduction for each customer?
- How the applied pricing policy could affect cut-off points and credit limits?
- How potential risk mitigation (insurance, guarantees and collaterals) could be taken into account?
- How the applied reduction of credit limits would affect net profits?
- What is a fair shielding of the business against risk concentrations (on a customer or a group or a sector level) and how it affects cut-off points?
- How the credit granting decisions to individual customers could be associated with the business’s financial targets (e.g. available working capital, required growth, risk appetite etc.)?

No matter how skilled and experienced a Credit Risk Manager is, empirically answering those questions and objectively reasoning the answers is very difficult, since the ability to combine so many factors and possibilities exceeds the limits of a typical human brain. Nevertheless, even today, many large corporates continue to rely solely on human judgment for answering the above questions, probably compromising their full potential for optimized and more objective credit decisions.

In the rest of this article we show how we support the valuable art of Credit Risk Manage-ment and the irreplaceable human intelligence already available in large corporations with advanced tools and techniques, drawn from our experience from the Banking and Advisory sector.

Think out of the box

In the last thirty years, substantial progress has been made concerning Credit Risk Management in the Banking Sector. Advanced tools have been developed for treating loan portfolios, which, since the nature of bank loans and trade credit is quite similar can teach us their rationale and provide us with the statistical theories we need in order to approach the specific problem. Some of those tools (e.g. credit scores or internal behavioral models) are already used by many corporations.

Mr. Elias Panagiotidis
Ark Analytics

The first lesson learned from the Banking Sector is that Credit Risk is quantifiable in terms of cost. And that makes good sense since Credit Risk is the only driver of Credit Losses, which is a negative element in the business's P&L statement.

The second lesson is that there are not perfect scoring models and thus we are unable to precisely discriminate the future defaulters from non-defaulters. What real-world scoring models along with statistics can do, however, is to lead us to a Probability of Default[1] (PD) for each customer. But, probabilities, by their nature, are not exploitable on an isolated observation (customer in our case) but on a population. In other words, if we want to utilize the power of probabilities, we have to relocate our focus from individual customers to populations of customers. For example, let's suppose that a credit scoring system has classified 1000 of our clientele's customers, with an exposure (credit) of €10,000 each, to a specific grade (e.g. B+) for which statistics (calibration) assigned a PD of 5%. This means we expect 50 out of those 1,000 to default. Can we exactly identify who will be the defaulters? The answer is no, but, still, we can estimate our Expected Loss (EL) from that part of our portfolio as 50 x €10,000 = €500,000.[2]

Focusing a little more on the above example we easily realize that the EL of €500,000 is the total cost of Credit Risk for the specific part of the portfolio. Therefore, by distributing that amount to the 1,000 customers proportionally to their exposure (evenly in our example) we achieve the target of quantifying Credit Risk in terms of cost. Under that perspective, the cost of Credit Risk for each of the above customers is €500. Of course, whether this cost is bearable or not depends on a bunch of other – fortunately known – factors as the volume of sales and the profit margin (those two determine the amount of nominal, or accounting profit), the funding cost (i.e. the cost of the funds used for trade credit) etc.

It should be noted that the aim of the above example was just to demonstrate the principles and the feasibility of expressing Credit Risk in terms of cost and not to be an actual solution for the problem. Therefore, it ignores several severe factors and, of course, does not answer most of the questions set in the previous section.

However, having a better understanding of the problem, we can now shed some light on all its aspects and, eventually, resolve it.

Highly diversified portfolios – An example

Let's return to the simplified example of the previous section. Some major implied assumptions were:
a) no recoveries after default,
b) credit exposure evenly distributed between customers and
c) highly diversified portfolio (i.e. the number of the customers is very high and the exposure of all and each of the customers is very small compared to the total portfolio exposure).

That is not usually the case, so below we are relaxing the assumptions and expand our calculations to the entire credit portfolio.

Let us consider a credit portfolio of n customers where each customer i has a current balance (exposure) of E_i and has been assigned a Probability of Default PD_i. Also, let LGD_i (Loss Given Default) be the money loss in case of default expressed as percentage over exposure. For the moment, let's accept that PDs and LGDs are derived from appropriate models[3]. Let's also assume that the portfolio is highly diversified. This approach relaxes the assumptions (a) and (b) of the simplified example but retain (c). In that case it is straight¬forward to prove that the portfolio's Expected Loss is:

$$EL = \sum_{i=1}^{n} E_i \cdot PD_i \cdot LGD_i$$

and the contribution of the customer i is $EL_i=E_i \cdot PD_i \cdot LGD_i$, which, according

to the rationale of the previous section, is the cost of risk for that customer.

Real world portfolios – Digging for a solution

Highly diversified Trade Credit Portfolios are rather rare. However, relaxing the relevant assumption is a little more complicated job, yet crucial for treating the probability of non-bearable credit losses and, thus, for ensuring a healthy capital structure and viability for our business.

Before we start digging for a solution, let's explore for a while the concept of concentra-tions in a credit portfolio. Let's consider a portfolio of 1,000 customers with a PD of 5%, an LGD of 100% and a total exposure of €10,000,000 (exactly as in our first example). This means that we still expect 50 of the customers to default. But now, let's assume that the exposure of one of those customers (let's name it A) is €2,008,000 and the exposure of all the others is €8,000 per customer. If we try to apply the formula of the previous topic we will get:

$$EL = \sum_{i=1}^{n} E_i \cdot PD_i \cdot LGD_i =$$

$$2{,}008{,}000 \cdot 0.05 \cdot 1 + 999 \cdot$$

$$(8{,}000 \cdot 0.05 \cdot 1) = 500{,}000$$

exactly as in our first example. However, this time, the result is a mean value. In fact, if the customer A is not among the defaulters, then the loss will be €400,000, while, in the opposite case the loss will be 2,400,000. Given that the probability of customer A to be a defaulter is 5% (this is the meaning of PD) the full answer to the question "What will be the loss on the specific portfolio" would be: "It will be €400,000 with a probability of 95% and €2,400,000 with a probability of 5%".

Once more, let's expand our understanding through one similar example. Let our portfolio have again 1,000 customers with a PD of 5%, an LGD of 100% and a total exposure of €10,000,000. But this time let customer A have an exposure of €1,508,000, customer B an exposure of €508,000 and all the others an exposure of €8,000 each. Following the above reasoning, the answer to the question "What will be the loss" would be:

• €400,000 with probability 95% x 95% = 90.25% (none of customers A and B is a defaulter),

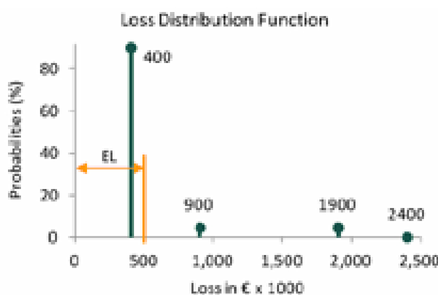
• €900,000 with probability 95% x 5% = 4.75% (customer A is not a defaulter while customer B is),

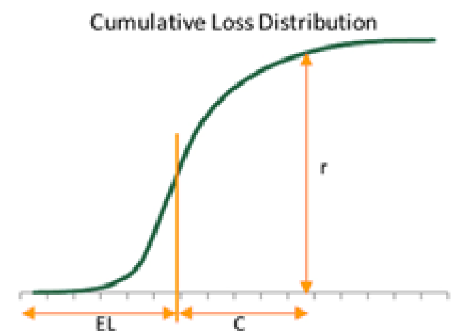
• €1,900,000 with probability 5% x 95% = 4.75% (customer A is a defaulter while customer B is not) and

• €2,400,000 with probability 5% x 5% = 0.25% (both customer A and B are between defaulters).

Note that the sum of the probabilities is 100%. As we see, by accepting a concentrated portfolio, the future loss becomes a distri¬bution instead of a single estimate. The mean of the distribution remains the Expected Loss calculated by the previous section's formula. The less concentrated the portfolio the less the standard deviation and the more the distribution converges to a single value, the EL.

But how we can interpret the infor¬mation captured by the distribution in terms of practical measures within our Risk Management process? One way would be to reserve an amount of €500,000 (the EL)[4] for credit losses, probably in the form of provisions. That would be enough to cover future losses with a confidence level of 90.25%. In the event that the losses exceed this amount, an additional capital cushion would absorb the excess amount (the unexpected losses). That cushion could be either equity (working capital surplus) or expected profits. If such a cushion is not available, our business is in danger of insolvency. In other words, the magnitude of the cushion, also determine the probability of our business's solvency. In our example a cushion of €400,000 (€900,000 – €500,000) would provide safety with a confidence level of 95% (90.25% + 4.75%), while a cushion of €1,400,000 (€1,900,000 - €500,000) would provide safety with a confidence level 99.75%. In the last case, the probability of insolvency of 0.25% for our business may be acceptable (it corresponds to an S&P rating of BBB) if the profit margin of the customer A is high enough to satisfy the Risk Appetite of our business. If not, we should reject the credit to the customer A or review their profit margin according to our business's Risk Appetite.





Given the Loss Distribution Function, as in the above example, the described logic can also operate in reverse; in other words we could get an answer to the question "What would be the required capital cushion for ensuring solvency with a confidence level of r?", or, in mathematical notation:

$$C = f^{-1}(r) - EL$$

where f the Cumulative Loss Distribution Function and C the required capital cushion.

In the previous section, we defined cost of risk as the contribution of a customer to the EL. This is fairly accurate for a highly diversified Credit Portfolio, but, as shown, concentrations generate for the seller additional capital requirements and capital is provided at a significant cost. Therefore, there is an additional cost for the portfolio's concentration risk, which is the cost of the capital cushion. And that cost should also be distributed per customer, this time proportionally to their contribution to the divergence of the loss distribution from the EL.

A simplified formula[5] for calculating the contribution of customer i in the capital cushion is the following:

$$Cp_i = PD_i \cdot LGD_i^{\,2} \cdot E_i^{\,2} \cdot \frac{C}{UL^2}\cdot$$

where UL_2 the variance of the portfolio's Loss Distribution (of n customers):

$$UL^2 = \sum_{j=1}^{n} PD_j \cdot LGD_j^{\,2} \cdot E_j^{\,2}$$

Summarizing, the total cost of risk for a customer in a real-world portfolio is:

$$RC_i = E_i \cdot PD_i \cdot LGD_i + Cp_i \cdot ROE$$

where ROE is the cost of the business's capital (usually approximated by Return on Equity).

The above examples were as simple as they need to just demonstrate the effects of concentrations. In real portfolios we usually encounter different exposures, PDs and LGDs per customer, so (a) the Loss Distribution becomes rather continuous and (b) the calculations for determining it become much more complicated. Moreover, concentrations do not derive only by individual customers, but also from groups of affiliated customers or from whole sectors with high correlated defaults.

Fortunately, for treating real-world portfolios we can borrow modern technologies from the Banking Sector to perform such calculations. More specifically, the Credit VaR models (e.g. Credit Suisse First Boston's CreditRisk+ in its modern variations) do an excellent job in resolving such problems, treating at the same time issues such as PD correlations and LGD uncertainties.

Reconsidering Credit Risk Management

In the previous sections we discussed some fundamental techniques for quantifying Credit Risk in terms of amounts. However, to include Credit Risk in our pricing calculations it must be transformed to percentages over sales (profit margin elements). This is quite simple. Let S_i be the projected sales in the next 12 months[6] for customer i, E_i their average exposure in the same period and WACC the Weighted Average Cost of Capital of the business. Then, the Cost of Credit (including the cost of post-dating cash flows) for that customer is:

$$CC_i = \frac{E_i \cdot WACC + RC_i}{S_i} = \frac{E_i}{S_i}\cdot\left(WACC + PD_i \cdot LGD_i \cdot \left(1 + LGD_i \cdot E_i \cdot \frac{C}{UL^2} \cdot ROE\right)\right)$$

Note that $E_i/(S_i = (DSO_i)/360)$ where DSO_i the mean Days Sales Outstanding for that customer.

Having a formula directly connecting Cost of Credit with Exposure (and DSO), Credit Risk Managers are now able to decide the optimum credit limit for retaining the targeted profitability and to follow all the normal procedures for pricing, treating Credit Risk as any other source of cost. Also, they can (a) generate scenarios by arbitrarily changing any of the parameters of the above formula and (b) apply them on individual customers or on the total portfolio for determining the optimum policies and for accurately measure their effects in business's profits and Credit Losses. Furthermore, Credit Risk Managers are able to determine the capital cushion that the business needs for facing unexpected losses (due to credit concentrations) for one or more arbitrarily set confidence levels (usually reflecting the Risk Appetite of the company or its Creditworthiness Rating). Moreover, the contribution of each customer in that cushion is known, thus the exact effects of fully rejecting a customer or of reducing their Credit Limit can be easily estimated.

Now is the time to reconsider our initial thoughts towards controlling Credit Losses. The idea "let's reduce credit to the riskiest customers" seems no more a decent solution. A better approach would be: "Let's determine our Credit Policy (Credit Limits, DSOs, pricing) according (a) to the customers' Credit Adjusted Profitability and (b) to the threat they introduce for our business's own creditworthiness"; both quantifiable. Remaining questions: None!

What's still missing

The aim of this article was to discuss the principles of a sound Trade Credit Risk Management approach, as simply and comprehensively as possible, avoiding discussions on advanced mathematics and complicated algorithms. The methodology described is relied on ARKANALYTIC's approach, but with some simplified techniques in place of the most complicated ones. The most interesting omissions were the following:

• Correlations of defaults between affiliates and between companies of the same sector (industry, country etc.) were ignored.

• For simplifying formulas the horizon of PDs is assumed annual. However, in some cases, a different horizon might be preferable, depending on the DSOs and the sales seasonality.

• The stochastic nature of PDs and LGDs was obfuscated.

The optimized figure is the **R**isk **W**eighted **M**argin (**RWM**):

Initial Profit — Funding Cost — Expected Loss — Concentration Cost

$$RWM = \frac{\frac{M \cdot S}{1+M} - E \cdot WACC - E \cdot PD \cdot LGD - C \cdot ROE}{\frac{S}{1+M}}$$

- M — Initial Profit Margin
- S — Sales Turnover
- E — Exposure (Suggested Limit)
- WACC — Weighted Average Cost of Capital of the business
- PD — Probability of Default
- LGD — Loss Given Default
- C — Contribution of the customer to the Required Capital Cushion
- ROE — Intended Return on Equity

1 For a definition of Default, see the "Comments on terms used".
2 This example does not take into account potential recoveries after default.
3 In a following section we will focus on those models.
4 In the specific, extreme example, an amount of €400,000 could be enough.
5 The formula should normally provide for PD correlations and LGD uncertainty, but it would add complexity exceeding the scope of this article.
6 The duration of the period is dictated by the horizon of PD measures and may differ by customer. In this article we assume a uniform annual horizon for all the customers to keep the formulas simple.
7 The Default definition is common and regulated for banks.

• The portfolio optimization algorithm that puts all together was left out. That algorithm is a sophisticated, parametric and forward looking iterative process, driven by a rich set of parameters that reflect both a given Credit Policy and a what-if scenario. It instantly applies those scenarios on the business's credit portfolio and returns suggestions for Credit Limits as well as their effects on the profitability and the requirements in provisions and capital cushion, on both customer and portfolio level.

Comments on terms used

In the article we extensively used the terms Probability of Default (PD) and Loss Given Default (LGD) as well known figures. Those measures derive from external Credit Rating Agencies or internal credit models. The credit models' development methodologies and the interrelated processes of validating and calibrating them are well documented and exceed the scope of this article. However, since the underlying experience is usually derived from the Banking Sector, some remarks are worth mentioning.

As Default we define the inability of a customer to meet their contractual obligations. Every cost that follows a Default Event is considered a loss and every payment a recovery. Default definition may differ per company and depends on the internal credit and workout procedures. Consequently, PDs should be assigned to the scales of external Credit Ratings or internal Behavioral Scores through an individualized calibration process, set up especially for the specific business. Even if some external Credit Rating Agencies have assigned PDs to their grades, those are usually calibrated for defaults on bank loans[7] and are not appropriate for use by corporates.

Interestingly enough, external ratings are long-term viability estimates. But, since the duration of trade credit granted by corporates is short-term, behavioral models, which by nature are short-term predictors, usually seem to perform better (exhibit better accuracy ratios). Nevertheless, external ratings (or, equivalently, internal assessments based on financial statements) are still a valuable component of Credit Risk Management because of their better early-warning ability. An optimal solution for getting the best of both worlds would be to develop a new model combining external and behavior assessments for producing more accurate PD estimates.

Finally, LGD models should take into account all the forms of credit mitigation used by the company (insurance, guarantees and acceptable types of collaterals) and should be subjects of annual validations and calibrations.

LAST WORDS

One of the greatest problems faced by any writer when compiling an article for future publication is not knowing what will have happened between sitting down at the keyboard and the finished product appearing in print. It is for this reason that we talk principally about what was, rather than what is or, of course, what will be. In these troubled times, events have a nasty habit of throwing a spanner in the works of any expected outcome, and all we have to fall back upon is what we thought when we began. 2015 is turning out to be a year of horror and mayhem in many places – Paris, Toronto, Copenhagen and more besides – and growing revulsion and anger is turning ordinary, quiet and peace loving people into something more.....I know not what. A General Election looms in Great Britain as I speak, but the outcome could well be known by the time this is published – no prediction from me. As I write, the so-called ceasefire in Ukraine fragments with blame laid on either side. Again, as I pen these words, talks about the Greek debt have reached the stage where the Eurozone finance ministers have approved the reform proposals put forward by the Greeks for a four month extension to debt repayment. This is based upon Greece implementing the reform of their public sector and measures to combat tax evasion. Getting the Greeks to pay tax at all would be a start!! Of course, the deal depended upon parliamentary procedures being implemented in several Eurozone states to give final approval, but ultimately the Greeks themselves must get their act together – this sorry saga has to come to an end sooner or later, whatever the consequences.

I was in London the other week for the CICM British Credit Awards 2015 – the credit profession's version of the BAFTAs or the Oscars. A glittering occasion, enjoyed by all and not spoiled by a small demonstration outside the venue by misguided people throwing paint and chanting stupid remarks. They had taken into their heads that the evening was a black tie, £4,000 per table obscene event for those who evict widows from their homes and force children into care. Someone once said that prejudices are the chains forged by ignorance to keep men apart – that small demonstration was a perfect illustration of both prejudice and ignorance. Later that week, my daughter and I visited the Churchill Cabinet War Rooms, deep underneath Whitehall – from there five years were spent fighting a battle against prejudice and ignorance. The streets around Whitehall, Downing Street, Westminster and The Embankment thronged with crowds from all over the world, enjoying freedom of thought, freedom of speech and freedom from tyranny. Freedom comes at a price, that price ranging from the ultimate sacrifice (picture the sea of ceramic poppies surrounding the Tower of London last year) to the more mundane – booking online a British Airways flight to Milan for later in February involved providing BA with a considerable amount of personal information so they knew who they were carrying and why. It is easy for us to take freedom for granted, but it takes vigilance to preserve – you can't unscramble an egg.

Since we last talked, the FECMA family has grown with a new member from Moscow – the Russian Institute of Credit Management, who made application at the Council meeting in the Czech Republic in November, and were unanimously accepted by all present. A very professional presentation and the potential for considerable growth in the face of a difficult economic situation – a good example of the need for credit professionals in a challenging environment. FECMA exists to promote professional credit management across Europe and to educate business and public alike as to the importance of receivables control and risk assessment to national, and therefore, international economic wellbeing. There are other national associations established, or already established, in countries in Europe not yet members of FECMA, but I am confident that 2015 will bring more into the FECMA family, with the Brussels conference in May yet another catalyst for action (as well as being a jolly good show!).

If I may quote the Monty Python team – and now for something completely different. Going back to my London visit, my perception of everybody being somehow surgically attached to their smartphones or tablets was reinforced by the number of pedestrians walking about oblivious to other pedestrians, black cabs and big red buses. Walking the pavements is an obstacle course – it may well be that they know where they are going, just as much as I know where I am going, but the small difference is that I am looking where I am going. I can understand that Pet Rescue or Candy Crush passes the time when riding the London Underground (it avoids all eye contact – hitherto an acquired London skill), but one should still keep an eye out for stops, and listen for any announcements. I noticed a young person on the Central Line, earpieces firmly attached, clearly engrossed in whatever was on the smart tablet. So much so, that she totally missed all audio and visual announcements that the train would terminate at Liverpool Street and also totally missed the fact that when at Liverpool Street, the whole train emptied, leaving her and her tablet to be tapped on the shoulder by an Underground employee. One thing for sure, she cannot possibly have been in the credit management profession – with or without smartphones or tablets, credit managers are always aware of what is going on around them, At least, they should be.

Glen Bullivant FCICM, President FECMA

CALENDAR OF EVENTS & NEWS ABOUT FECMA MEMBERS

CALENDAR BELGIUM www.ivkm.be

18th June	Credit managers' Day. Workshop for credit managers - in collaboration with Ghent University. The discussion topic for this year is 'Innovation in credit Management'.
3rd September	Seminar : Credit Management and sales : initiating a durable LAT relation Half day seminar in collaboration with the financial magazine : FD Magazine.

CALENDAR GERMANY www.credit-manager.de

16th April	Working Group Outfit, Langenfeld, Rheinland
24th April	Kick Off Certified Credit Controller, Ingolstadt
27th April	Working Group Insolvenzpraxis, Cologne
28th April	Working Group Working Capital, Leverkusen
5th May	Regional Event North, Wolfsburg
7th May	Coface Credit Management Award 2015, Mainz
11th June	Working Group B2C
18th June	Regional Event South-West
30th June	Regional Event, Nürnberg
10th September	SAP meets Credit Manager
23rd September	Regional Event Credit Management South
14th/15th October	BvCM Annual Congress, Würzburg
30th October	Kick Off Certified Credit Controller, Bochum
18th November	Working Group Insolvenzpraxis
19th November	Regional Event Credit Management South
24th November	Working Group International

CALENDAR HELSINKI www.luottomiehet.fi

16th April	Yearly get together, including sharing the diploma to new graduates from the Credit Degree program at Markkinointi-instituutti.
19th May	Yearly association meeting.
24th September	Yearly Credit Seminar.

NEWS MALTA www.macm.org.mt

14th May	MACM Workshop at the Corithia Palace Hotel, Attard – "Managing Credit Profitably – Granting Credit and Managing Credit Customers for a Profit".
17th July	The Annual General Meeting at The Brewery, Simonds Farsons Cisk Plc. A new Council to manage MACM for the next two years (2015 – 2017) will also be elected from and by the MACM Members. There will be Networking Refreshments after the Meeting.

FECMA WEBSITE

FECMA launched a new website which meets up to the standards of today.
Please take a look at www.fecm.eu and tells us what you think of it!

CALENDAR NETHERLANDS www.vvcm.nl

21st April	Workshop: pro-activie legal organisation of credit management on the German markets.
30th April	Workshop: Collections Management.
3rd June	The VVCM 5th Lustrum, which we will celebrate in Wageningen. With a full program of workshops, panel discussions, round tables etc. etc. Festive elements will be held as well, some well known Dutch experts in economy, finance and credit management will be welcomed.
10th June	Workshop: Management of Credits.
1st July	The famous VVCM Golf Challenge Cup event on the fantastic greens of „De Hoge Graaven“ in rustic areas near Ommen, where the former board member, and Honorary Member, Mr. Jan Smit, will be hosting this event for the 23rd time.

CALENDAR SWEDEN www.kreditforeningen.se

16th April	’After Work’ meeting, where any credit topic can be addressed and discussed.
28th May	Seminar where Intrum Justitia will give a presentation of the current credit situation in Europe.
24th + 25th September	Credit Conference.
Autumn	’Breakfast’ meetings’ and ’After Work’ meetings during the autumn.
November	Winter Dinner with speaker/presentation.

CALENDAR UK www.icm.org.uk

Masterclasses:	
22nd April	CICM Masterclass – Credit Risk & Compliance
29th April	CICM Masterclass – Success with Technology Solutions and Change Management
19th May	CICM Masterclass – Credit Risk and Compliance
8th June	CICM Masterclass – Success with Technology Solutions
8th July	CICM Masterclass – Credit Risk and Compliance
23rd September	CICM Masterclass – Credit Risk and Compliance
Also:	
16th July & 17th Sept	CICMQ Best Practice Conference for CICMQ
18th June	CICM Education Conference
12th June	CICM Fellows’ Lunch

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The "CreditManager Europe / CME" has one goal: to be the source of the best new ideas for professionals in Credit Management across Europe. Since 1986 the Federation of European Credit Management Associations (FECMA) has built permanent links between national Credit Management institutes and organisations and promoted co-operation, debate and discussion on all credit related topics. It has also allowed credit managers across Europe to talk to each other in a professional network, share advice and experience and develop closer understanding.

CME's articles cover a wide range of topics within Credit Management that are relevant to different industries, geographic locations and small, as well as large companies. While the topics may vary, all CME articles share certain characteristics. They are written for senior managers by experts in Credit Management. Proposals for articles demonstrating European best practices, innovative thinking and new approaches in Credit Management are those most likely to meet our readers' needs. They should also avoid any marketing for specific products and services. When evaluating an article, our editors often look for compelling new thinking and how a new idea can be applied to practice.

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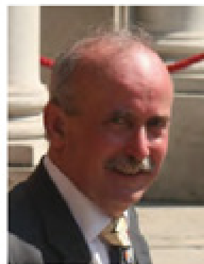

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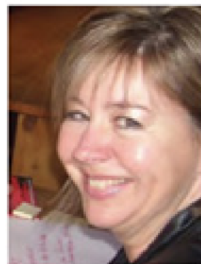

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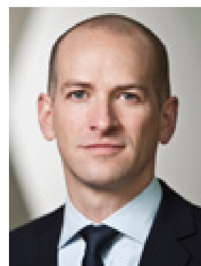

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