Five Risks You Can Target with Best Practices:
Become more efficient, more strategic and improve cash flow

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In today's business environment managing risk and improving cash flow are more challenging then ever:

- With bankruptcy rates rising, the risk of incurring substantial losses are greater than ever
- While economic pressures and business practices are causing companies to pay slower, there is a greater focus on increasing cash flow
- Credit departments are being asked to do more with less without assuming additional risk.

In response to these trends many credit professionals are unfortunately becoming more reactive as opposed to being proactive, which is strategically preferable. Every credit professional should be on the lookout for opportunities to implement proven best practices throughout the entire order-to-cash process. To help you on your journey, here are five common pitfalls that can be easily avoided by upgrading your practices.

1. Failing to Recognize Potential Frauds

Fraud costs business billions of dollars a year. Unfortunately, many credit professionals do not know what they should be watching for. However, if you understand which data elements correlate most often with fraud you can more easily focus your investigations and save time. Here are seven situations that deserve attention:

- ***An over-eager owner*** – How many times have you encountered a principal willing to provide everything you request?
- ***Questionable start date*** – The customer states they have been around 10 years and you have never heard of them.
- ***An ostentatious business name*** – Global Financial Equipment Sales sounds good until your sales rep informs you it is three guys working out of a storefront
- ***Unexpectedly robust financial statements*** – Current ratio or net worth well above the industry median and the company is a start-up.
- ***Atypical trade references*** – Are the companies in your industry? Are these valid companies?
- ***Trade references all from one industry*** – Telecom, business equipment, financial services, etc.
- ***Business principals involved in other failed or fraudulent enterprises*** – Have you checked the "Character" of the principals?

Moreover, D&B's Risk Management Solutions has found that fraud is even more likely when two or more of the above situations are observed:

2. Underestimating How Much Existing Customers Contribute to Bad Debt

Stop and ask yourself which customer segment generates the most bad debt: new customers or existing customers? Most credit professionals underestimate how much current customers contribute to bad debt. They don't realize that approximately 80 percent of bad debt is generated from accounts where you have had a business relationship for longer than 12 months. Your initial credit evaluation cannot be expected to predict defaults a couple of years hence.

Making matters worse, today's information moves and changes more quickly than ever. As an example for every 1000 customers your company sells, you can expect 200 will report significant changes each year. For you to keep pace changes need to be monitored if only to ensure a bad piece of customer data doesn't interfere with business operations. The accompanying table highlights the number of business changes that require updating in D&B's database each and every hour.

Hourly Demographic Changes
Realized in D&B's Business Database

Suits, Liens or Judgments	251
Telephone Numbers Changed or Disconnected	183
Changes in Business Address	43
Changes in Officers/Owners	36
New Businesses	33
Change in Business Name	8
Bankruptcy Filings	7

To maintain timeliness of this ever changing data D&B must make over 1 million changes per day. For the credit professional there are many ways to stay on top of this ever-changing pool of customer data. One recommendation is to utilize as many sources as possible to identify potential risks. Everyone in your company from the CEO to customer service should be encouraged to communicate both positive and negative customer information, whether drawn from trade journals or direct customer contacts. The more eyes and ears monitoring for changes, the more proactive you can be with your account base. Potential red flags to look for include:

- Numerous and significant suits, liens and/or judgments
- Announcements of imminent closure of operations
- Slowing payments to all vendors
- Licenses or business registrations revoked

Making customer visits with your sales associates is another excellent tool. This is also a great method to build bridges with sales, and an opportunity to teach sales what to look for when you are back in the office.

If your company utilizes reports from a business information provider, explore the monitoring solutions offered. These monitoring solutions can utilize real time data and incorporate predictive scores to determine who the riskiest accounts are. Similarly, industry trade groups can also contribute significant information.

Lastly a best demonstrated practice is to conduct regular reviews of your customers. At the very least an annual review should be completed; however, the credit exposure with a given account should be the driving force behind the how often this is completed.

3. Getting Caught Off-guard by Bankruptcies

Most credit professionals fail to recognize that customer bankruptcy can be predicted. Bankruptcy is a devastating experience not only for the owners and employees of the bankrupt company, but also for the credit professionals that extended open terms. Both bankruptcy and severely slow payments can be identified through the use of predictive scoring. Obviously a business failure or slow payments can happen for a wide variety of reasons, but what we really need to know is how to predict a majority of bankruptcy filings.

Statistically valid predictive scores can assist you to uncover the risk within your portfolio. Scoring is used extensively in the consumer market, and many credit professionals in the commercial segment should take advantage to more clearly identify their higher risk accounts. You first need to familiarize yourself with the characteristics of the available scores. Many credit professionals are familiar with D&B's Paydex Score, which is historical payment data used primarily to guess future payment patterns. But, did you know that a 17-point or greater drop in a customer's Paydex is highly predictive of the account ending up bankrupt within the next 18 months? Based upon this information future looking scores are now designed to predict both the potential for financial stress and severe payment delinquency. These statistically valid predictive scores incorporate multiple data sets and can be even more predictive when it comes to bankruptcy.

Utilizing predictive score will clearly identify your lower and high-risk accounts by segmenting your A/R portfolio and making it much easier to better concentrate limited resources. By rank ordering customers with a credit score, you will more easily identify and prioritize the accounts requiring more or less aggressive collection techniques, calibrate credit limits, align your most experienced associates with the highest risk accounts, change contract terms if needed or even exit a relationship where appropriate.

With the efficiency gains that will be realized, you can then spend more time with marginal accounts. If you had more time, you could actually read the notes to your marginal accounts' financial statements, which can contain critical information that statistical predictive indicators do not capture. By using scores and portfolio analysis techniques, credit professionals can assure a more consistent and systematic approach to receivables management.

4. Spending Too Much Time And Money on Credit Evaluations

Another common pitfall results from thinking we can save our company money by conducting manual, labor intensive credit application reviews in an effort to avoid bad debt losses. Add to this the fact that there are many data sources available, many of which are not consistently reliable or timely, plus the need for a quick decision and we have a recipe for bad decisions.

Manual credit decisions are not only costly when you calculate both the direct and indirect costs (it costs $75 and three days to completely process the typical credit application), but they are can also be very one-dimensional. Depending upon how much time is devoted to the credit investigation you may only see what the applicant wants you to see making it easier for fraudulent enterprises to put their foot in your door. Unfortunately the more time you spend building a comprehensive picture of the new customer the greater the cost. Thus you need multiple data sources that you have pre-verified as capable of supplying accurate information quickly.

Business information providers collect data from multiple sources, then verify and consolidate the data to provide a one-stop shop for obtaining a multidimensional view of the business in question. Many business information providers add scoring to make the information instantaneously actionable. The goal is to develop an evaluation matrix based on the information collected, so that lower risk customers flow easily through the system while blocking marginal and high-risk accounts. Then you can use your experience and expertise on the questionable accounts.

5. Failing to Take Full Advantage of Technology

A well-documented best practice involves leveraging automation, often coupled with scoring, to improve cash flow through faster response times and more consistent decisions. Automation also allows you to better partition your portfolio making it easier to see risk patterns as well as manage your franchise using 21st century criteria. Again, the common theme is to proactively identify those accounts that need your attention and use automation to handle repetitive tasks.

Unfortunately, many credit professionals do not take full advantage of technology. Credit professionals need to create greater system efficiencies to compensate for corporate cost cutting goals. That requires embracing technology in one form or another.

Sidestepping common pitfalls provides a framework for becoming more efficient and increasing cash flow. Once you recognize an opportunity, you then need to assemble the required resources to effectuate a solution. Until you take steps at becoming more efficient, you will in fact be whittling away at your limited resources. So ask yourself, what is one thing I can implement today to reduce risk, increase cash flow and free my time?