CREDIT MANAGEMENT IN AUSTRALIA IN 2011

A report from Veda

"In the revenue-risk trade-off, credit professionals are taking a far broader approach to managing customers."

Moses Samaha, Head of Commercial Risk, Veda

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About Veda

Veda's business is about creating 'applied intelligence' solutions that offer greater insight into managing risk and return. We accumulate, transform, and connect data which enables us to make products and services that customers value and trust. For Veda, this entails a rigorous and continuous process of quality control, refinement and innovation.

Veda is built on the largest, most comprehensive and current data source in Australia and New Zealand. We hold more fit for purpose credit data than any other organisation including information on 16.5 million credit active people and 4.4 million businesses. Every day we report on the credit status of 60,000 people and businesses applying for credit across the Tasman. The breadth and depth of our data, and the knowledge it delivers will help you take a proactive and informed approach in making decisions.

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Each year Australian business writes off billions of dollars in bad debt, but there are ways to improve this. Understanding credit and fraud risk at point of application better is important, as is providing a smoother and more efficient customer experience. Segmenting better and actively managing existing customers and the collections process can improve customer satisfaction, reduce the incidence of bad debt write offs and ultimately improve your bottom line.

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Foreword from our Head of Commercial Risk

Moses Samaha

Welcome to this report on a survey of Australian credit managers that the Veda credit risk management team has conducted in 2009 and 2011 respectively. Veda provides services to a large proportion of Australia's credit professionals, and working closely with them has given us a detailed understanding of local credit management issues within a national and global context.

In 'Credit Management in Australia, 2011' we present an overview of how global and local economic factors are affecting the industry in general, and our customers in particular. We also explore how credit professionals are responding positively to adverse factors that have blunted consumer confidence and spending. Declining retail sales and increased savings continue to aggravate cash flow for business, creating a negative spiral, which is increasingly problematic. In light of this it is encouraging to see a change of behaviour and a greater degree of prudence being applied in decision-making.

Taken together, the 2009 and 2011 surveys provide valuable insights into credit risk management practices and can be summarised accordingly. First, demand for credit is increasing, and credit managers are under growing pressure from within their organisations to sign up business that is higher risk. Previously, such business would have been regarded with utmost caution. The trend is discernible and was widely reported by credit managers who feel uncomfortable about taking on 'bad' risk. Furthermore, they believe the need to secure business and maintain sales at the cost of balance sheet integrity is potentially injurious to the longer term interest of both credit providers and their customers. Notwithstanding, the selection criteria, or filters, are getting tighter. In other words, the bar is being set at a much higher level.

Another significant finding is that in the revenue-risk trade-off credit professionals are taking a far broader approach to managing customers. This is wholly positive, with many extending their role beyond the traditional 'tick the box approach', which they regard as outmoded at a time when a lateral approach is needed. Being an intelligent partner in a collaborative environment is seen as the way forward. For example, customers are being offered special payment plans, with greater attention being paid to understanding their needs. In turn, they are taking greater steps to understand the needs of their own customers.

Finally, in recent months credit activity has experienced healthy growth. The uptake in asset finance facilities is evident, and so is the use of online credit facilities, including debit cards. The next two quarters are going to be key. In the last 12 months the Reserve Bank of Australia has cut interest rates in a bid to stimulate the economy at a time when another severe global recession seems likely. With inflation holding steady, a further cut in interest rates would help to stoke consumer confidence, creating the potential for spending to recover the 10 per cent lost since before the GFC.

I hope you enjoy the insights into business practice that the findings of this survey offer.

Moses Samaha
Head of Commercial Risk

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A note from Terry Collins, CEO of AICM

In 2009, Veda produced a survey of Credit Management in Australia, and I'm delighted to see that they have now produced the next in the series, showing us the trends of the last two years. Veda's access to a broad range of industries and companies of all sizes ensure that their surveys give a strong reflection of what's happening in the market.

The two years since the last Veda survey have seen some significant changes in the way credit risk is handled overseas, and as the 2011 survey shows, Australia has not had the same constraints placed on credit as in the USA and Europe. It's also important to note that Veda's survey validates and confirms trends that the Australian Institute of Credit Management has observed during this period.

This survey was conducted in conjunction with the AICM's annual conference. A good proportion of the respondents are AICM members, many of them being credit managers of SMEs and large national enterprises across many industries. Consequently, we're confident that the results of this survey are representative of the broader trends affecting credit management in Australia.

I encourage you to read this survey and reflect upon how its findings correlate with your own impressions of how credit management has been changing in Australia over the past two years. Identifying best practice and finding the ways to achieve it is always the goal of our industry, and this survey provides a revealing snapshot of where the Australian credit management industry is headed.

The AICM supports Veda's continued efforts to identify and analyse industry trends, and we look forward to the next survey.

13 key findings

- Lack of confidence in government and media dramatisation of the global economic crisis have contributed to a drop in business confidence, with no major improvement expected in the next 12-18 months.
- 74% of respondents have experienced slower payments and cash flow difficulties.
- 47% have seen an upsurge in credit demand since 2009.
- Days Sales Outstanding has risen slightly since 2009, with 36% saying this has increased.
- 92% conducted regular reviews of accounts, with 30% of these being done quarterly.
- 91% felt that default information was Important to Very Important.
- 53% are facing increased pressure to approve a higher number of applications.
- 31% are experiencing pressure to open accounts when there is adverse information.
- 67% saw obtaining guarantees from directors as a priority, up from 37% in 2009.
- 72% have employed external collections companies to retrieve outstanding debts.
- 72% consider charges held by directors or related companies to be a greater risk to their business.
- 96% were aware that PPSR is coming.
- 55% were planning to register security interests on all their debtors.

Introduction

Context

In the wake of the Global Financial Crisis (GFC) of 2008-9, the world's media has consistently produced alarmist headlines such as 'European meltdown' and 'Crisis far from over'. The credit rating of the USA has been downgraded and economies of several Mediterranean countries are struggling under high and unstainable levels of debt. Moreover, with the Euro as a currency serving the needs and circumstances of all members of the European Community being brought into question, global share markets have become exceedingly volatile.

Despite the global alarm, Australian companies continue to perform well within Australia and beyond, having emerged relatively unscathed from the GFC. Australia's mining industry continues to boom, although the existence of a 'two-speed' economy is widely accepted as reflecting the imbalance between the resource sector and the rest of the economy.

The key word here is 'relatively', because although Australian businesses have managed to avoid the worst excesses of countries like Greece or Italy, many have been feeling the pinch.

Purpose of the survey

Veda last ran this survey in 2009 in the midst of the GFC. To follow up on the findings of that survey Veda commissioned the 2011 survey to ascertain how Australian businesses had been coping in the intervening two years.

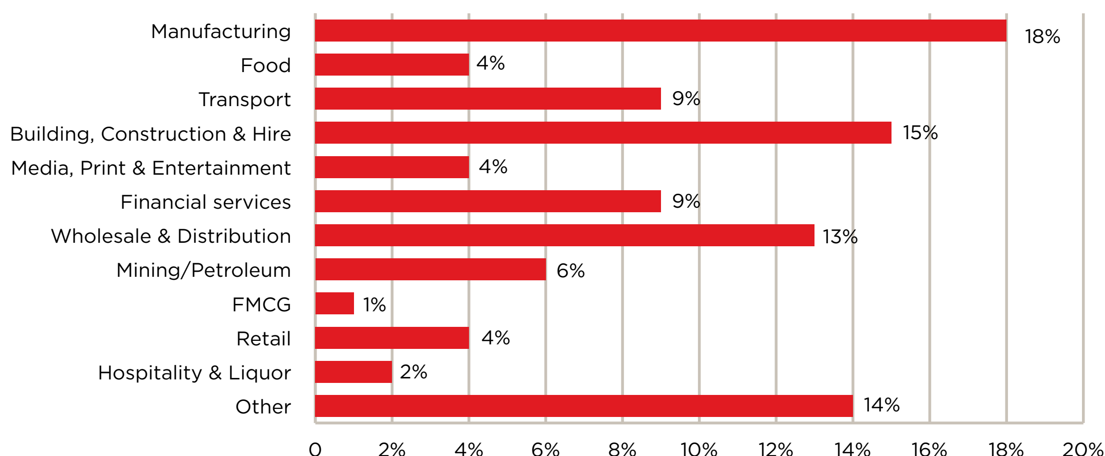
The survey interviewed key personnel who manage the part of the business that is responsible for cash flow: the credit managers. Its ultimate purpose was to capture the experiences of credit managers during 2010-2011, and gain a clearer picture of how volatility in the global economy is affecting Australian businesses.

Who we surveyed

Between 12 and 28 September 2011, we surveyed credit managers in 220 organisations across Australia, 80% of which operate at a national level.

Industry types

We presented the survey to online users and as a face-to-face interview of a representative cross-section of Australian industry. The largest proportion is from manufacturing (18%), building and construction (15%) and wholesale and distribution (13%).



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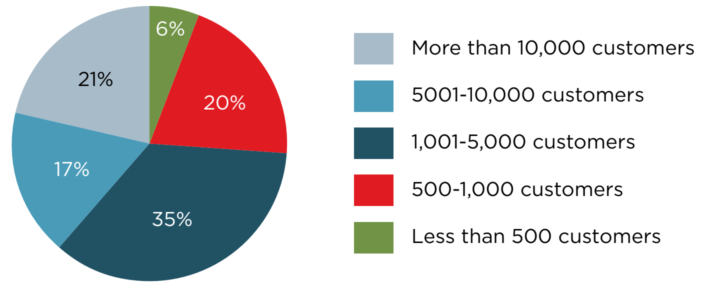
Company size

Of the credit managers we surveyed, 80% operate nationally and their companies range in size from small to extremely large, with 21% having more than 10,000 customers. This gives the survey a reasonably even spread of respondents.

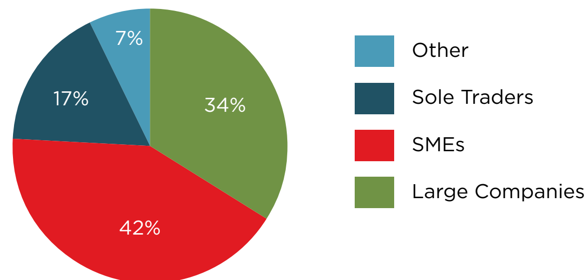


Credit terms

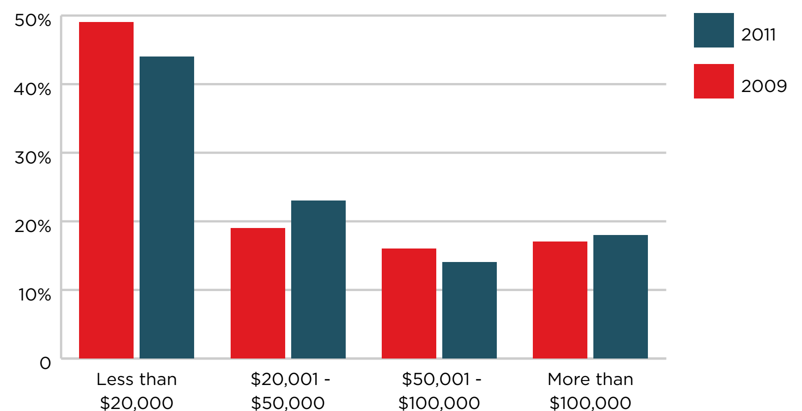
Payment terms of 30 days were most common among respondents, with very few offering terms longer than this. Some offered terms of 7, 14, 21 or 28 days depending on the client.

Customer types and account sizes

Small-to-medium enterprises (42%) and large companies (34%) made up the bulk of our respondents' customers, and 43% of the accounts were for amounts of less than $20,000.



This represented an increase from 2009, with a proportional fall in the number of accounts with values higher than $20,000.



What we asked

The survey requested a basic profile of the business, then addressed the following topics:

- their impressions of the economic situation and the outlook for the next two years
- an assessment of the level of demand for credit from customers
- the incidence of delayed payment, non-payment and the need for account reviews
- the extent to which debt collection was required
- the prevalence of companies going to external administration or bankruptcy
- the expected impact of the Personal Property Securities Register legislation.

The survey results indicated that, while many businesses are experiencing an increase in delayed payments and defaults, the overall picture is better than might have been expected.

Assessment of economic conditions

The second part of the survey looked at broader economic issues. With the credit ratings downgrade in the US, debt trouble in Europe, volatile world financial markets and the introduction of a carbon tax all affecting Australian businesses, the views for the immediate future of our economy were starkly different from 2009.

Impressions of current and future conditions

Nearly three-quarters of 2011 respondents (74%) felt that the economic outlook in the immediate future was negative, compared with just 33% in our 2009 survey. This represents a complete reversal of sentiment in just two years and revolves around a number of common themes examined below.

The role of government

Respondents expressed a distinct lack of confidence in the Federal government's ability to manage the economy. Dropping the First Home Owners Boost in December 2009 and restricting the First Home Owners Grant to $7,000 in January 2010[1], plus a lack of incentives for investment builders, has badly affected the building industry, with knock-on effects into suppliers of materials.

Media and international competition

Fuelled by media over-dramatisations of the global economic situation, respondents noted that lack of confidence was compounded by a number of other factors. These included consumer behaviour and competition with multi-nationals putting in cut-throat bids to gain market share at all costs.

Retail shoppers, concerned about real increases in the cost of living, as well as rising credit card debts[2], were increasingly turning to large retailers and online shopping, looking for the lowest possible price.

A two-speed economy

The 'two-speed' economy created by the boom of the mining and resources sector was a reality for many respondents. Businesses not connected with this sector were suffering and being forced to lay off full-time staff or assign them to part-time roles. Some respondents believed that this latter practice was masking the reality of unemployment levels in official figures.[3]

No change expected soon

Many didn't see much prospect for improvement within the next 12-18 months, and predicted an increase in the number of businesses being placed into administration in 2011.

Some positives

While there are clearly some significant issues facing businesses, some respondents noted that there were also positives to be found. With mining going strong and the overall Australian economy relatively stable, the retail sector could be expected to bounce back once consumers gained more confidence in the stability of the Asia-Pacific region.

Some consider the current adversity as an opportunity and are expanding their operations aggressively at the expense of the competition.

The effect on business

Again, 74% of respondents reported an impact on their business from the state of the global economy, with many noting that they are experiencing slower payments and associated difficulties managing cash flow.

Payments delayed

Customer cash flow issues were creating a knock-on effect, with partial payments from smaller customers becoming increasingly common. Medium-to-large businesses that were previously paying within 60 days were extending their payment intervals to 65—75 days. In response, many businesses were resorting to stricter credit terms such as pre-payment, and in some cases were losing significant accounts entirely.

Common causes

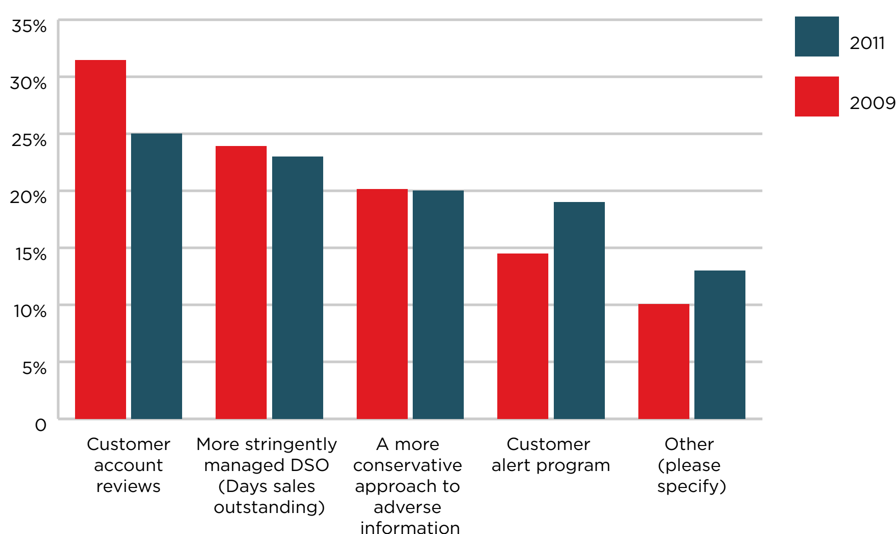
The causes of this drop in cash flow were attributed to low consumer confidence, uncertainty about the carbon tax and the decline in the building and construction industry. Declining sales, increasing competition and corporate restructures shedding jobs were all requiring many respondents to work harder to keep their existing business, let alone expand.

The exception was companies linked to the mining industry, who were experiencing a boom in sales. The next year in the mining and agricultural sectors was generally seen as likely to be positive due to high and sustained demand.

Adapting to the changing economy

In the light of payment delays and loss of critical accounts, many businesses were taking measures to protect themselves against increased risk of default. 89% of respondents said they had made changes of some kind and were closely monitoring their credit policies.

Since our 2009 survey, customer account reviews had fallen by approximately 6%, but the number of organisations placing customers on an alert programme had risen by 5%.



The increase of 'Other' methods reflected credit managers taking more active steps to identify and 'head off' payment issues. Some were reducing risk by identifying customers who had the potential to become a problem and managing their terms and limits with them. Others worked closely with customers to reduce outstandings, negotiate payment plans and help slow payers.

In general, respondents were introducing broader control measures and following up overdue debt sooner. When taking on new business, credit checks, upfront deposits and accounts with pre-payment terms were becoming more prevalent, while the credit limits of existing customers were monitored more closely.

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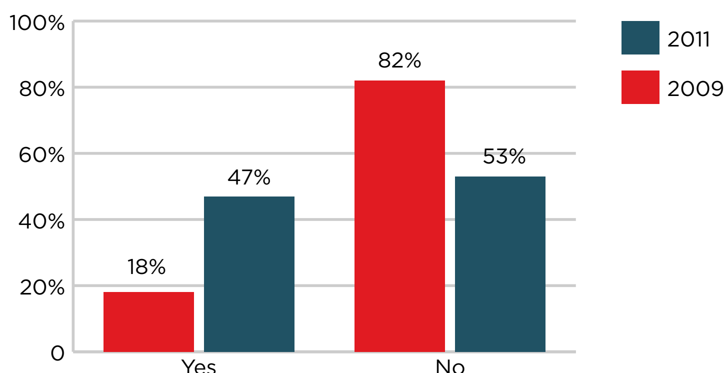
Managing payments

Demand for credit

The Veda Business Credit Demand Index released in September 2011[4] showed that business enquiries were up 17% on the previous quarter and 3.6% year-on-year. Despite this strong quarterly upsurge, credit demand still remains below pre-GFC levels and is 0.5% down on FY10. Within this context, we asked respondents about the pressure for credit and how they were handling this.

Up for some, down for others

Demand for credit was rising for 47% of respondents, who had seen an upsurge in credit demand in their business since 2009. This was a noticeable increase on 2009 when only 18% had seen an increased in demand for credit. Significantly though, others had experienced the opposite, noting that since the GFC many executives are risk-averse and focussed on paying down debt.



Many respondents viewed taking on credit risks for short-term benefit as a risky strategy and noted that market share was not always the main driver of the business. In taking on new customers, it was deemed important to review each application on its own merits, but the focus was moving away from acquisition for its own sake, and towards providing better service to existing customers to retain their business.

Reliance on credit controls

Despite 53% of customers facing increased pressure to approve a higher number of applications, there was reluctance to deviate from established credit policies. Most respondents had clearly-defined and well-established credit control procedures in place and were confident that they were able to identify bad risks.

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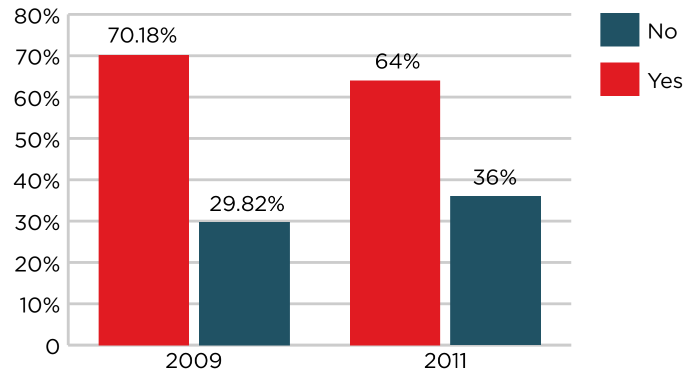
Adherence to payment terms

In answer to the question "Are customers paying later then they used to?" 64% of respondents answered 'Yes'. This result was down slightly on the 2009 survey, in which 70% said customers were paying late.



Customers holding onto their accounts

With nearly two-thirds of respondents experiencing delays in payment, there were some industries that were more likely than others to withhold payment. Small-to-medium enterprises, building and construction and the hospitality and liquor industries were identified as the main culprits, with major corporations still paying within usual terms.

Suppliers to large construction companies were often struggling to bring in their accounts, and in many cases were paying after 60 days. Some hotels and bottle shops had restricted their cash flow and were only paying when pushed.

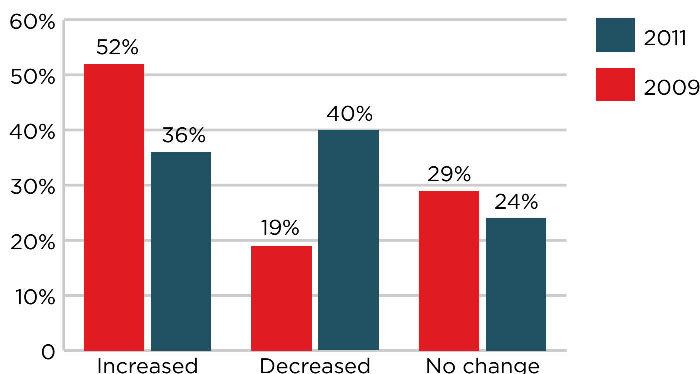
Days Sales Outstanding falling

The average number of Days Sales Outstanding (DSO) among respondents was 44.89, virtually unchanged from the 2009 average of 44.72.

The degree of change was split, with 40% of respondents saying their DSO had decreased over the last 6-12 months while 36% saying it had increased. This was an improvement on 2009, when 52% of respondents noted that their DSO had increased.

Among the 40% who experienced a fall, this drop was attributed to stricter terms, closer reviews and a concerted effort to reduce DSO. With an average DSO of 42.93 being the desired target, even these respondents were hoping for further improvement, and it was noted that the figure could be partly due to lower sales and extended terms.

"Not all companies are paying later. It is predominantly the smaller and mid-tier companies which have been affected. The major corporations are still paying within their usual terms."



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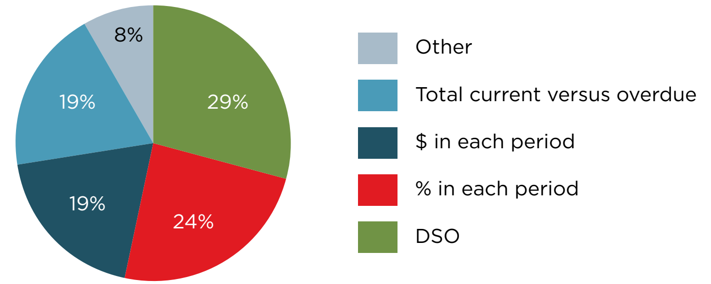
Key indicators of payment performance

Days Sales Outstanding was the main performance indicator for 29% of respondents, with Percentage in each period the next most significant at 24%. Dollars in each period and Total current versus total overdue were deemed of equal significance by 19% of respondents, but 8% of respondents used a range of other indicators.



Some of the other methods used include:

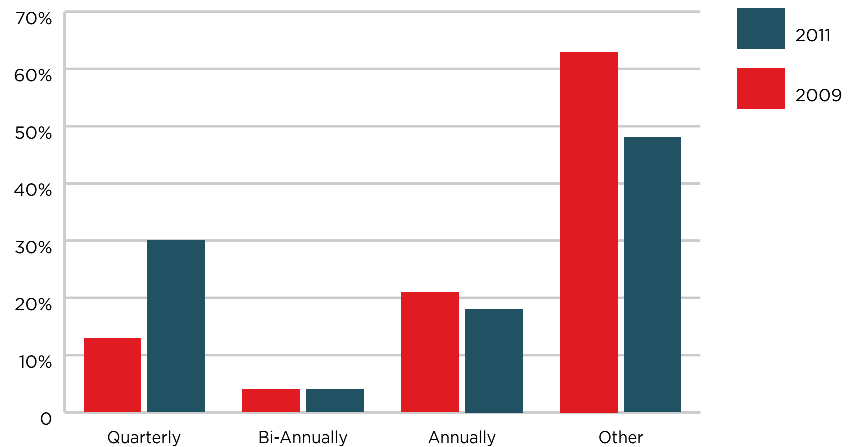
- number of accounts overdue 30 days + percentage of collectable debt
- number of customers who paid within terms, in 60+ days or 90+ days
- percentage measures of:
  - cash collected
  - bad and doubtful debt
  - bad debts to sales
  - customers complying with terms.

Account reviews

Our previous surveys have shown that businesses tend to focus on SME accounts. In this survey we sought to discover whether this was still the case or whether the focus was shifting to larger accounts.

Review frequency

92% of respondents conducted regular reviews of accounts, with 30% of these being done quarterly. This was a major increase from the 12% who were conducting quarterly reviews in 2009. Furthermore, 24% of respondents were opting for monthly or fortnightly reviews, or conducting them on a needs or exception basis, reflecting an increased need for closer oversight of particular accounts.



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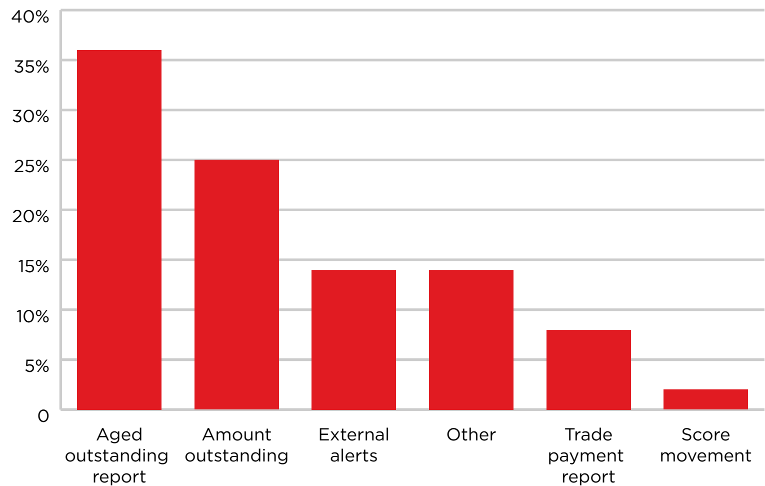
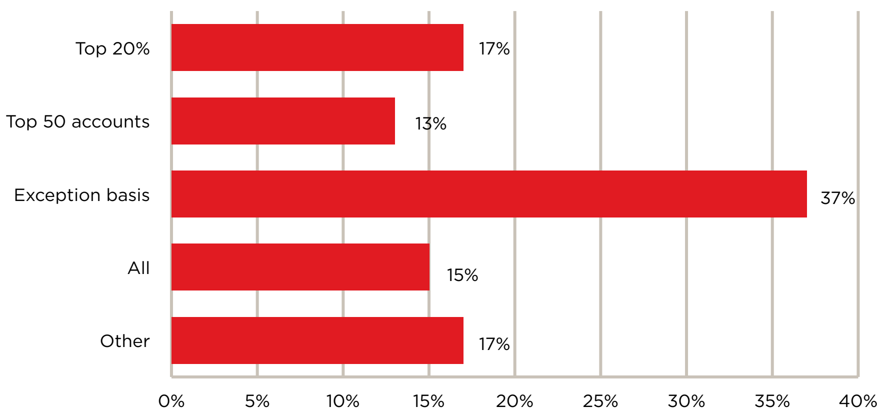
Triggers for reviews

The main trigger for an unscheduled account review was the Aged Outstanding report, which 36% of respondents nominated as the initiator. Next most important, at 25%, was the Amount Outstanding report.





Exception accounts were the main targets for review at 37%, with all the other account categories (including all accounts) averaging around 15%.

Actions taken

When the performance of an account continued to deteriorate, respondents took several courses of action, the most common being reducing credit limits and/ or terms, and limiting or withholding supply. Reviewing credit reports and feedback from trade bureaus was also a common approach.

Consultation is key

Many respondents noted that, whatever approach was taken, consultation with the sales team and personal contact with the customers was important, the vital thing being to work out a strategy with the customer to enable continued supply wherever possible. If a late payment became an issue, some respondents put the customer in question on a pre-pay arrangement or suspended the account.

"If payment performance deteriorates, we reduce credit and terms, and discuss our concerns with customers to establish the problems and work out a strategy to continue supply where possible."

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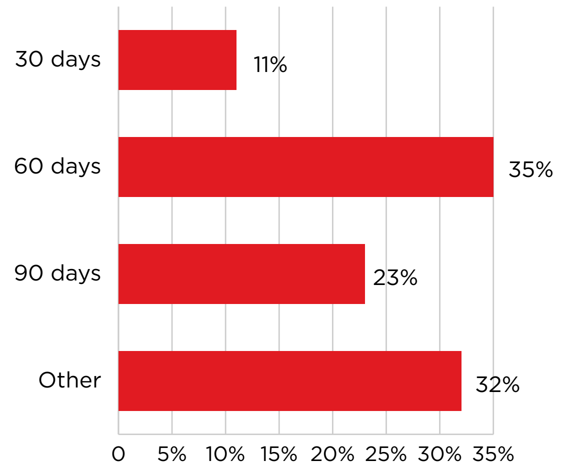
When to act

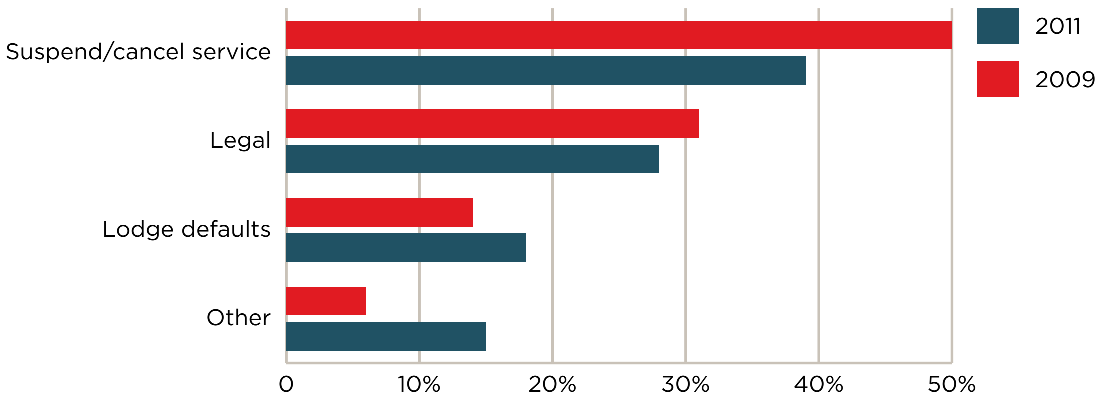
The 2009 survey revealed that 60 days was the most common point at which action was taken, with 33% nominating it as their first point of dealing with delinquency. This has not changed significantly in 2011, with 35% of respondents nominating 60 days, although, for 30-day accounts, many are now taking action at 45 days.

Of the 32% who nominated 'Other', many noted that they took action "on a case-by-case" basis, or "as required", rather than following a hard and fast rule. Others worked on the basis of a fixed number of days past the due date (from 1 to 14 being common), acted at the end of each month, or most simply "if payment terms are not adhered to".



What action to take

Suspending or cancelling the service has fallen by more than 10% since 2009, supporting the earlier finding of a greater focus on retaining customers (see **Demand for credit** on page 8). Legal action too had fallen slightly, while the adoption of other methods involving communication with the customer had risen by 10%.

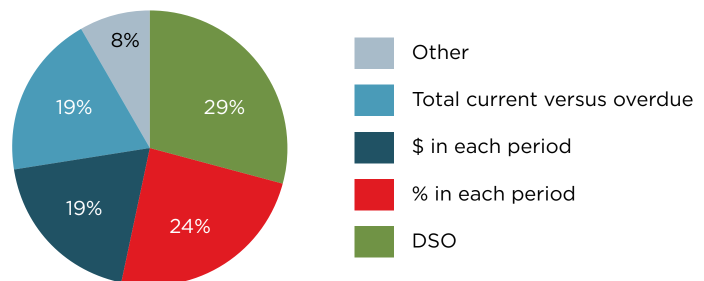


Initial steps of phoning the customer and sending letters of demand were typically followed up by suspending services, lodging defaults and using collection agencies, with legal action as a last step.

When making a decision, 91% of respondents felt that default information was Important to Very Important, some including all adverse information as well as relationships to previous failed companies.

As the pie chart on the right shows, the four main types of adverse information are deemed to be almost equally important.

All of these findings demonstrate that credit managers are broadening the treatment they are adopting when they need to take action.



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Pressure to open accounts

The survey found that while 69% of respondents are not experiencing pressure to open accounts when there is adverse information, this leaves 31% who **are** being pressured.

Among this group there was a good understanding that "chasing sales over quality accounts" had risks and that sales teams needed to understand that their salaries are paid from actual customer payments. Some managers had experienced pressure from senior management to agree to accounts that didn't fit the company's risk policy, but in these cases they had taken steps to mitigate the risk.

Writs and guarantees

Although 85% of respondents had seen an increase in the number of court writs for non-payment, it was noted that the Australian Taxation Office has recently become more stringent in its application of the law in relation to debt recovery[5], which may have influenced this result.

With this the focus on obtaining guarantees from directors has increased significantly, with 67% of respondents noting it as a priority, up from 37% in the 2009 survey.

When customers don't pay

Use of external collectors

In a recent press statement (Australian Financial Review, 10 August 2011) ASIC released figures on increased insolvencies, blaming, in part, the ATO for tightening debt recovery on the SME sector. Veda has also seen the number of small businesses registering insolvent continue to rise.

With insolvency becoming increasingly prevalent, 72% of respondents have employed external collections companies to retrieve outstanding debts. Of these 72%, 46% had increased their use of external collectors in the past year.

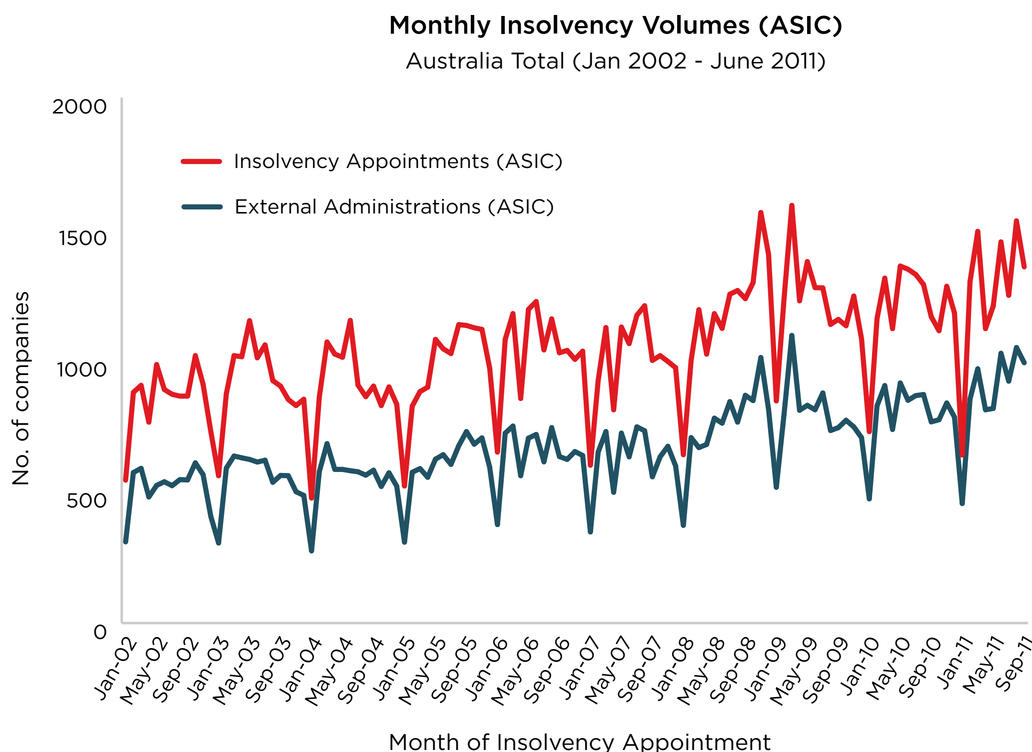
Among the 28% who had not used external collectors, the approach was to handle recovery work up to the point of legal action, preferring to implement repayment plans rather than take on the costs involved with collection agencies.

Many respondents have a strict credit policy in place and 68% were not planning on changing it, while others are fine-tuning their policy rather than making dramatic changes.

"When it comes to collections, we are being more flexible with customers, preferring to implement repayment plans rather than costs involved with collection agencies."

External administration and insolvency

ASIC figures show that the number of companies entering administration soared to 1,027 in June – the darkest month since early 2009. Administrations for the 2011 financial year reached 9,829, up 5.9% on 2010[6].



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External administration

In the 2009 survey, 74% of respondents had noticed an increase in external administrations. In 2011 this was down to 65%, so the business environment is slightly more stable than it was two years ago, although small-to-medium enterprises appear to be the ones most likely to struggle.

Phoenix companies

Veda has noticed an increase in the number of 'phoenix' companies post GFC. Veda's research shows the rate of new incorporations is higher for companies in external administration than those not, with 11% of 2010 incorporations having a linked prior adverse via a directorship.

Respondents were clearly very conscious of this risk, with 91% checking the credit history of company directors. One noted that "a company is only as good as its directors, if a director has personal adverse information, there is little hope for a commercial enterprise."

Charges

In previous analysis Veda has seen that companies with charges held by non-financial institutions i.e. Directors, Shareholders, or related companies, are more likely to enter into external administration than those that have charges held by financial institutions.

Respondents supported this finding, with 72% considering charges held by directors or related companies to be a greater risk to their business.

Preparing for PPSR legislation

The Personal Property Securities Register (PPSR) is a major change in the way organisations register your securities interests. All national personal property registers (excluding land) will be combined into one online register from early 2012.

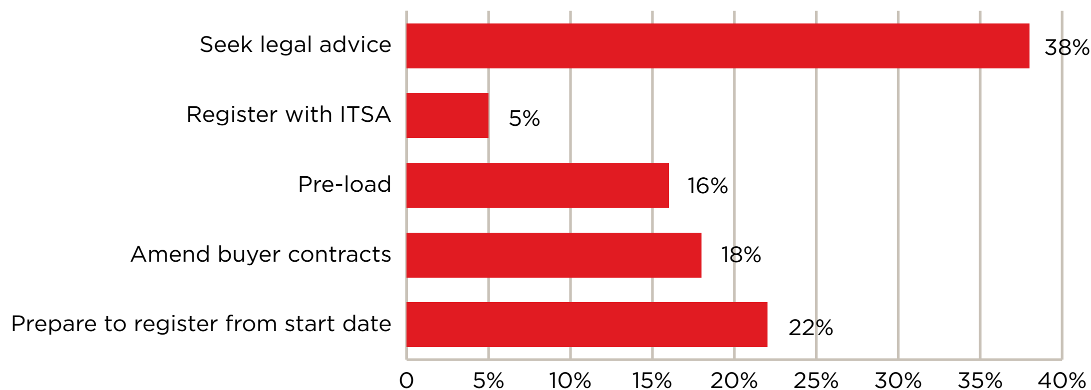
Level of preparedness

Nearly all (96%) respondents were aware that PPSR is coming, and many were preparing for its introduction in 2012. Of those who will be affected by the change to PPSR, 69% consider ASIC charges when they are verifying commercial entities.

Seeking legal advice about the impact of PPSR was the most common form of action being taken.

Many respondents were still considering what they will register, but 55% were planning to register security interests on all their debtors. Unsurprisingly, the decision of whether to register was based largely around issues of risk and exposure, with some respondents grouping their debtors into categories based on dollar value or credit limit.

"We will implement the PPSR process for all accounts over a certain credit limit."



The main issues

Respondents identified a broad range of potential issues associated with implementing PPSR. These fell into several categories.

Legal issues

Legal issues included:

- overall lack of knowledge about PPSR, and differing opinions among solicitors
- legal rights during the transition period
- frustration at continual changes from the Government.

Risk issues

General risks included:

- ensuring retention of title during the changeover period
- washing data to ensure integrity
- the possibility of lodging incorrect registrations.

Operational issues

Operational issues included:

- resistance from customers
- finding the time to get it all in place before the start date
- ensuring all the paperwork is done correctly.

The perceived benefits

Despite the perception that PPSR had some risks and entailed extra work for the business, at least during the transition, many respondents could see the potential benefits.

Among these, preserving Retention of Title and being on a level footing with the banks were common replies. Being able to minimise risk of loss, enjoy priority and eliminate preference payment claims gave a potential higher chance of recovery of all or part of the debt in the event of business failure.

Some were less favourable, believing that while PPSR might have some theoretical benefits, it would not make much practical difference. Among these respondents the attitude was that it was something they had to do to be able to keep doing business, so they were simply getting on with it.

The survey showed that 50% of respondents already had a programme of work in place to manage their debtors through the transition period. The other half were still trying to define the outcome they need to achieve and the steps to take to get there.

Conclusion

Despite a generally negative prevailing view of the prospects for the global economy over the next 12-18 months, most of our respondents are managing their credit risks in 2011 without too much difficulty.

Businesses exposed to the mining industry boom have fared best, while those associated with construction have been struggling more. While the incidence of customers delaying payment has been rising, and insolvencies are at their highest level since GFC, the rolling average of insolvencies has been relatively steady. Consequently, many respondents have not had to change their credit policies to adapt to the changes in the economy.

For many respondents the focus of their business has moved away from trying to secure market share, towards retaining existing customers and servicing them better. This is an understandable trend, as predictable risks are generally more manageable. When it comes to chasing outstanding accounts, again the focus has moved to improving communication with the customers and looking for ways to enable them to pay.

Companies with clearly-defined credit policies are sticking to their rules where possible and avoiding taking on potentially risky customers. Many are taking steps such as checking the backgrounds of the directors to ensure that they genuinely understand the nature and level of risk in offering accounts to new customers.

With the PPSR scheduled to be introduced in early 2012, credit managers are looking for advice on its impact on their business, and taking steps to ensure that they're ready. There is some resistance to PPSR within businesses and among customers, but on the whole the view is that it has the potential to simplify things and put companies on equal footing with the banks.

We conducted our last survey in 2009 in the midst of the global financial crisis. The results of the 2011 survey show that, since then, the business environment has stabilised slightly, and credit managers are using more, and better, tools to evaluate credit risk. Conducting more extensive background checks and offering terms that reduce risk are two common approaches that have increased since 2009.

Our respondents generally appear to be in control of their accounts, and have tried and tested methods for managing cash flow. While the outlook for the economy as a whole for the next year may not be as good as hoped, our respondents have the tools at their disposal to prosper.

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Like more information?

If you'd like more detailed information about the survey results, or would like to know how Veda can help navigate your company through these difficult economic times, please call **1300 921 621**, or contact your Veda Account Manager.

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Footnotes

1 Changes To First Home Owners Grant, Loan Market Finance News http://loanmarket.com/?p=2708

2 Australians credit card debt climbs to $49.3 billion - Reserve Bank http://www.news.com.au/money/money-matters/credit-card-balances-climb-to-50-billion-rba/story-e6frfmd9-1226056643781

3 Australia's unemployment rate at 5.2 per cent in October 2011, Australian Bureau of Statistics Press Release, 1 October 2011

4 Veda Consumer Credit Demand - April to June 2011, http://www.veda.com.au/news-and-media/article.dot?id=529337

5 Australian Financial Review, 10 August 2011.

6 Australian Financial Review, 10 August 2011.

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