

Managing Cash In A Crisis By Optimising Credit Ratings

BY DENIS BAKER AND EMMA CAISTER

Most turnaround and restructuring professionals live by the 'cash is king' mantra. A core discipline is to generate, conserve and ration this most precious of commodities in the troubled businesses they work with. A key strategy in this process is persuading nervous suppliers and service providers to continue to trade on terms that do not put an unworkable strain on scarce cash resources. All too many rescues are torpedoed by withdrawal of supplier support.

Desperation on the debtor side and fear on the creditor side has in the past meant that maintaining manageable credit terms or indeed any credit at all with suppliers was a matter of wheedling, begging and all manner of subtle and unsubtle persuasion. There were always some suppliers who could be blackmailed into joining the lifeboat crew because their downside was so great, but this was hardly a scientific way of determining risk.

Now, however, credit managers have access to a bewildering choice of credit information, which will determine their decisions about credit limits or the recommendations they make to assist in judgements taken by the wider management team at the supplier. The management teams of struggling companies and their professional advisers need to make sure that they understand how that information is assembled and what facts, figures and ratios are fundamental to the assessment of credit risk in the modern risk management world.

At one unsophisticated extreme, there is a service which relies on nothing more than the net worth of a company as a guide to creditworthiness. Then there are early warning systems, designed to pick up adverse events, such as the late filing of accounts, financial court orders and bankruptcy filings, extremely useful in identifying the need for a credit manager to take urgent action to mitigate a potential loss.

At the other end of the spectrum, there are providers who use complex analytics applied to several key aspects of a company's financial profile, such as asset management, funding source dependence and profitability, not just as individual factors but in combination and set in the context of the country and the sector in which the business operates, as well as its relative size. A system like this also looks at trend data over several years, avoiding the 'moment in time' mentality which can be so misleading in a dynamic, rapidly evolving situation.

One of the great problems with most credit information is that it relies on out of date financial information, usually accounts filed at a public register of some type or advertised through such channels as newspapers. In the UK, for example, public domain information may be as much as 21 months

out of date, which might be particularly unfortunate for a company going through a restructuring which has already put it firmly onto an improving trend. But the most sophisticated system on the market in the UK offers modelling capabilities to stress test risk profiles and look at all manner of 'what if' scenarios.

The availability of this sort of facility is good news, but it does place an onus on struggling companies to provide current management information to creditors, credit information providers and credit insurers alike to facilitate this forecasting, otherwise creditors will make their own assumptions, often to the detriment of the debtor. Like cash conservation, improving management information is another key priority for restructuring professionals. Beyond keeping lenders informed, the next most beneficial third party use for the enhanced data is in convincing supplier credit managers that progress is being made and that their risk is not only no longer deteriorating but improving.

Many suppliers, especially the larger ones, have little discretion about the maximum risk they can take because their credit insurers oblige them to consider certain designated credit information and take account of the credit limits suggested by those information providers. But even then, the credit manager will take the ultimate decision about whether his company will trade with the debtor at all and if so, where he will set the credit limit within the parameters indicated by their credit insurers. The fact that a credit limit of say, £100,000 might be acceptable to the credit insurer, may not prevent the supplier deciding to take a more cautious view and setting a lower limit.

Credit management stopped being a guessing game some time ago and is now much more of a science than a dark art. Ultimately, restructuring professionals need to be robust about the credit risk they are asking their suppliers to take and use current data to negate shortcomings in the debtor's historic risk profile. Wherever possible, they also need to involve credit insurers and credit data suppliers in the debate. In these uncertain times of low growth, most suppliers would much rather take an informed decision to support and help rehabilitate a business, than walk away from a potential profit source and crystallise a bad debt in the process.

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