

# Insuring a Credit Decision



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Four o'clock in the afternoon and I'm releasing orders. Tomorrow morning, the deluge of orders will entrance our humming warehouse with a feverish pick and pack pace. It's hunger fed by each and every order released.

Time marches on with every approval keystroke. Orders are being held for various reasons, "over limit by \$2.50" the prompter screams out at me. The time: 4:35. Just as I'm thinking that we should really buffer in a small percentage in our programming so that I don't have to look at infinitesimal discrepancies. "Ah, here's one I haven't called in a while." I pick up the phone and call the debtor.

A zillion scenarios run through my mind as I wait for Mr. Debtor to take the call. The outstanding invoice was due last week, which strikes me as unusual since Mr. Debtor and I had agreed that he would pay on time due to the exceptional pricing and special terms we extended. Essentially, I would be in my full right to hold the shipment, but...

He has just placed a very nice order and Sales would have my head on a platter for throwing a wrench in the works yet again... and after all, one

week past due in the overall scheme of things is not a whole lot of time.

After having my ear blasted with distorted hold music, I guess no one bothered to tell them that they haven't properly adjusted the radio station; Mr. Debtor finally takes my call. The conversation goes something like this: "Hi Mr. Debtor, this is Michelle from ABC Supplierco (not the real name of the company), I'm calling for payment on invoice #123." A short pause ensues and Mr. Debtor shuffling through papers answers me "Yes, I have it here, don't worry you'll get paid" I sense something in his voice, so I respond; "That's great, thank you, but when can I expect the payment?" Another short pause ensues and I can almost feel the air thicken as I wait for his response. "Oh, sometime next week" he adds "I'll put it on the next cheque run". "I have an order on hold, has there been a problem?" I ask. Mr Debtor answers that there is no problem and he will call me to pick up my cheque if I want.

"Thank you sir that would be great, can I call you Tuesday?" With a positive response, I conclude my phone call and schedule a follow up in my agenda for Tuesday. After all, I wouldn't want him to mail the cheque by accident at this point.

Back at my computer terminal, I'm still not overly satisfied. While there was nothing overly unusual about this phone call, and the time lapse into next week seems acceptable, the general tone wasn't his habitual cheerful, aggressive self. He somewhat seemed defeated. It's nothing tactile but my gut feeling isn't great. I just can't pin point it. Time: 4:45, Not overly confident with Mr. Debtor's response, I skip to the next batch of orders to release and leave the order on hold thinking I will get back to it.

4:55: My phone rings. It's the salesman. He's just had a discussion with Mr Debtor who needs the goods the day after tomorrow for a rush order.

He impresses the huge importance of this order to Mr. Debtor... We have just enough time if I release the order today to pack it tomorrow and ship it by noon for next day delivery from Montreal to Toronto. Yep, Guess it's time to make a decision.

## What to do?

While the above scenario is fairly common, the credit decision is not always an easy one. In instances such as the one described above, credit insurance alleviates worries associated with making these sometimes-difficult decisions. In this case, I shipped the order. I knew I had an approved credit limit to rely on in the case of default or insolvency. The term insolvency normally encompasses bankruptcy, CCAA, receivership, etc.

**Tip: It is always prudent to check policy wording for a more complete description.**

## Maximum extension period

Credit insurers understand that most debtors on average will not pay on or before the due date, therefore they extend an extra time frame, called the maximum extension period, so that insured's may make alternate arrangements for payment while continuing a normal course of business. Once the maximum extension period expired, any new risk becomes the responsibility of the insured, although certain exceptions may be approved on a one-off basis.

**Tip: Always check policy wording, some credit insurance policies are loss occurring versus loss attaching. Always contact your insurer in advance and get any extensions in writing.**

## Statistics

Statistics Canada updated their web site on May 13, 2005 indicating 2004 Canadian bankruptcy information. ([www40.statcan.ca/101/cst01/econ11b.thm](http://www40.statcan.ca/101/cst01/econ11b.thm)) In 2004, there were a total of 8,128 business bankruptcies across all industries in Canada. Ontario topped the list with 2,558 bankruptcies and Quebec followed closely behind with 1,963. The higher number of bankruptcies across Canada occurred in construction (1,344) followed by retail trade (1,204).

There are no published statistics available on the StatsCan web site with respect to default of payment situations where the debtor has not filed, nor on informal proposals to creditors. And while some of the bankruptcies were certainly expected, it wouldn't be a stretch to speculate that large majorities were completely unexpected to suppliers. StatsCan doesn't treat these subtleties.

Many suppliers will base credit decisions on payment trend. While payment trend remains an important gauge of the debtor's performance, solvency cannot always be measured by payment trend alone.

## Not in my backyard

Another example and one case remaining fresh in my mind was that of a Canadian palette manufacturer. The supplier had known the proprietor since high school; in fact they were good friends. Never the less, we had a considerable limit given to our insured. Interestingly enough, the palette manufacturer had financed through a US bank. The financial institution itself went bankrupt and the Trustee called the loan, which precipitated the palette manufacturer's demise. Prior to the insolvency, payment trend had not been affected therefore restricting the supplier's (insured's) ability to react. It all seemed rather sudden and the Insured confided in me that they had never expected this from a friend.

With increasing globalization, more and more Canadian companies are exposed to external Conditions (4 C's of credit) beyond their control, and without the Collateral, may unduly inhibit their Capacity, and ultimately affect their Character... No matter how nice a guy Mr. Debtor can be.

## Credit insurance is a tool

The whole point of credit insurance is to mitigate the risk of unexpected and catastrophic losses. Many insureds will take a policy "To sleep at night". Moreover, the insurer has a vast databank of insureds in several industries and debtors that are often shared. We encourage discussion between the underwriter and the insured that may serve, in some cases, as an early warning to the insured. Moreover, if your insurer will not extend a credit limit, ask questions, there may be underlying problems. Used properly, credit insurance can be an important tool to many credit managers. •NCN



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