Baker Ing

Covid-19

How can Credit Management Mitigate Risk and Respond?

30th March 2020

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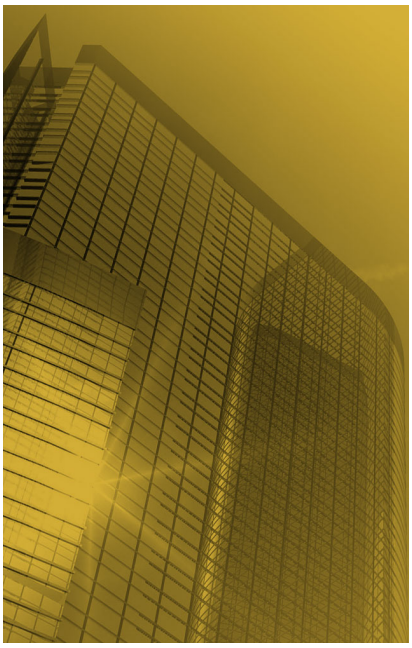
Covid-19



INTRODUCTION

We seek to understand how the Covid-19 pandemic is impacting, and is likely to impact, accounts receivable. We offer insights from senior credit professionals as to strategies and actions which may be employed to manage the situation for the best AR outcomes.

As a result of Covid-19's apparent high infection and mortality rates, governments around the world have adopted a strategy of social isolation (or 'lockdown') of their populations. This has meant the cessation of all but 'essential' business, which has in turn led to a global economic shock. We are seeing, and expect, severe impacts upon accounts receivable around the globe – creating a highly challenging environment on multiple fronts for AR professionals.

We highlight the current top priorities which must be addressed immediately and offer concise, practical advice to help manage this crisis on several fronts;

- Operations & policy
- People
- Payment behaviour
- Risk

This paper is a first look at AR in the context of the Covid-19 pandemic and will be followed by regular further updates, along with in-depth papers on the specific challenges facing AR, as they arise.

This is an overwhelming time for us all as we face new challenges, in both our personal and professional lives. We hope this paper allows our readers to gain some perspective on the problem at hand, plot a plan of action for taking control of the situation (insofar far as AR is concerned) and gain insight to stay ahead of the risks before us.

"Like most, if not all other credit professionals, I have been giving thought to 'business as usual'; when will that recommence? Will BAU pre-crisis look the same as BAU post-crisis? I don't think it will."

Johnathan Swan, Head of Credit Services, Hachette UK

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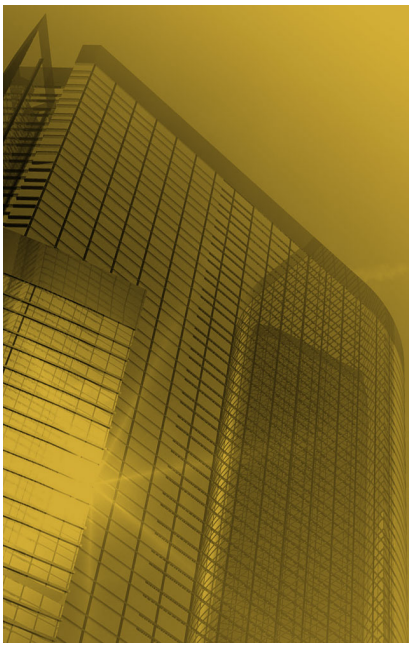


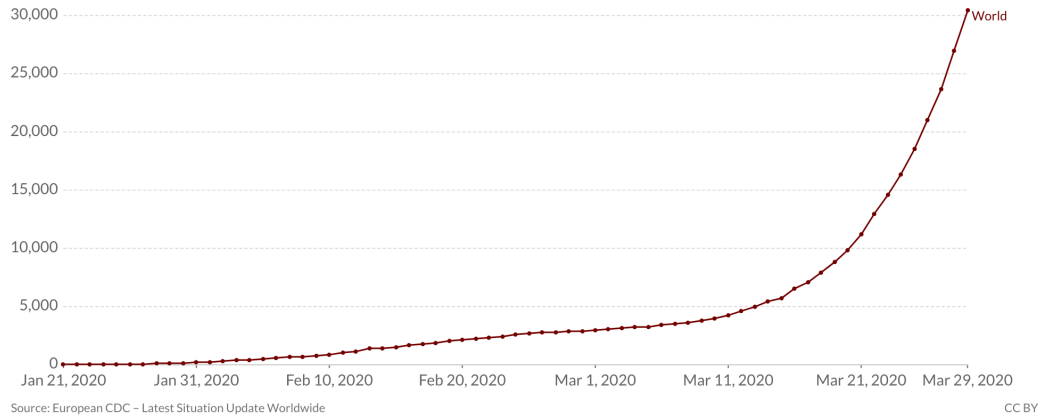
BACKGROUND

More detailed information on Covid-19 is available at the World Health Organisation's website. We include here a precis only for convenience, in order to provide some context for the scale of current problems being caused and the likely timeframe ahead.

> *"Coronaviruses are a large family of viruses which may cause illness in animals or humans. In humans, several coronaviruses are known to cause respiratory infections ranging from the common cold to more severe diseases such as Middle East Respiratory Syndrome (MERS) and Severe Acute Respiratory Syndrome (SARS). The most recently discovered coronavirus causes coronavirus disease COVID-19.."*
> World Health Organisation – 29th March 2020

Timeline

Although the first cases are thought to have been observed in China as far back as November/December 2019, the World Health Organisation records the first cases from January 21st 2020. Between that time and the time of writing on March 29th 2020, confirmed cases stand at 691,867 with 32,988 deaths (according to John Hopkins University of Medicine).



Total confirmed deaths due to Covid-19, as at March 29th 2020. (Chart licenced from Our World in Data)

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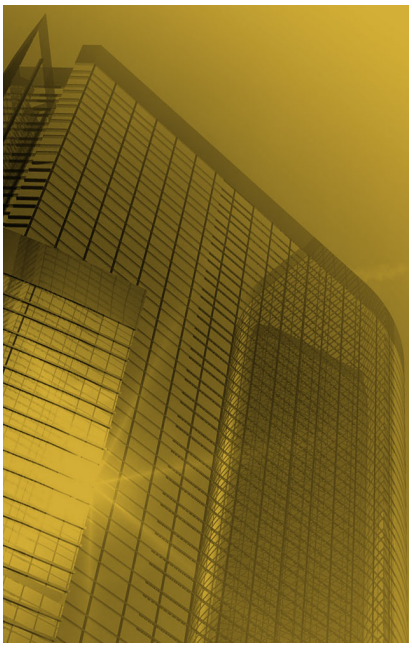
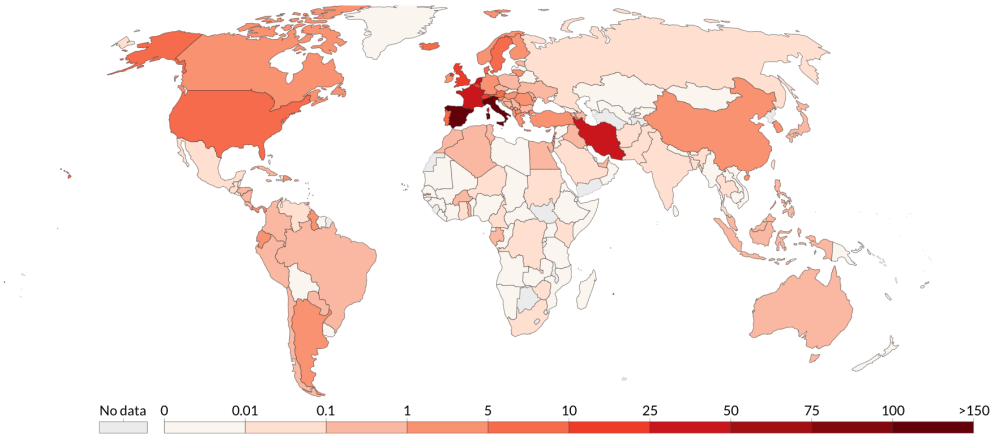


Global impact

The virus has now spread worldwide (either domestic transmission, or imported cases from people returning to the country from abroad).

Significant curtailments on individuals' freedom of movement and business opening have been imposed in numerous countries worldwide.

Severe restrictions on international passenger travel have also been implemented leading, in turn, to the closure of many flight routes by airlines.



Source: European CDC – Latest Situation Update Worldwide

Total confirmed deaths due to Covid-19 per million people, as at March 28th 2020. (Map licenced from Our World in Data)

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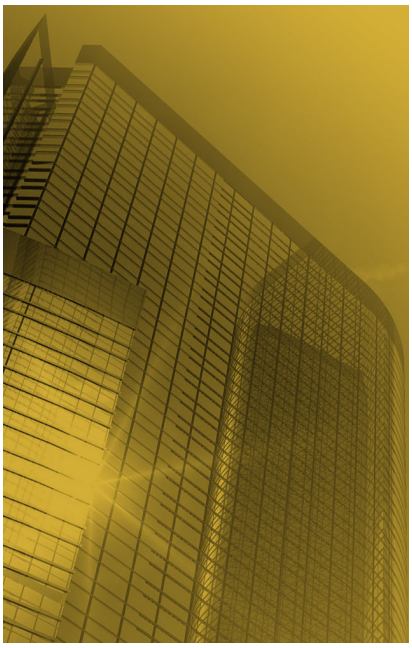
BUSINESS IMPACT



The greatest impact has been the imposition of nationwide 'lockdown' controls; discouraging and/or preventing workers from travelling to/from work. In general, it has meant employees must work from home where possible, travel to work only if they must and, if they cannot adhere to social distancing measures at work, must nonetheless stay at home. Further, as time has progressed, we have seen even stricter measures imposed, whereby all but 'essential' businesses are ordered to close completely.

As such, the first step for most businesses has been to focus on the safety of their employees by implementing work-from-home policies and technologies, or new on-site sanitation/safety procedures.

Given the huge disruption to all businesses – both from having to implement new policies and technologies, as well as having to cut-back on staff, or close completely – the next concern for anyone still able to operate is disruption to their supply chains. Assessing supply chain reliability, item prioritisation, sourcing new suppliers and mitigating logistics risks/barriers is a top priority.

The third prong of the immediate reaction is communications – to reassure that they are open and able to service orders, or to communicate unavoidable disruption. Furthermore, those business still able to deal with customers must communicate new ways of working which ensure customer and staff safety. Finally, there are other communications necessary in these difficult times, with the goal of maintaining confidence and relationships during down time, in order to ensure customers return when some semblance of business-as-usual returns.

Last, but not least (although there will be many other actions taking place, of course), is financial analysis. Businesses are rightfully doing all they can to understand how much pressure they can withstand, for how long, in differing scenarios. Contingency plans must be drawn up for all scenarios, given the extreme uncertainty.

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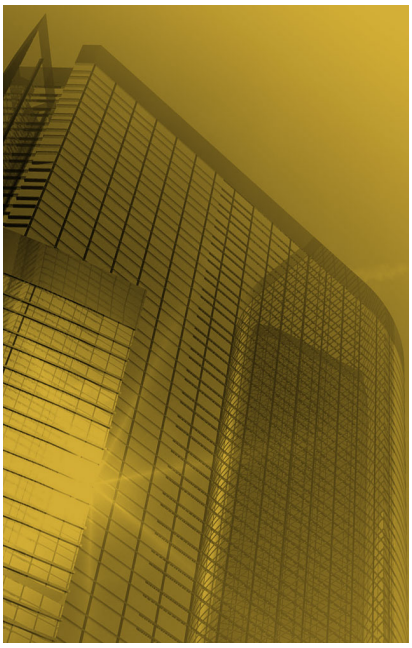

RECEIVABLES IMPACT

Credit professionals will be working in trading conditions that they will never have experienced in their career, at a scale that will be challenging to manage for all. Preparation, strategic planning and engaging with all key company stakeholders will be critical.

Practically every sector is likely to suffer significant economic shock and experience prolonged negative trading conditions. Receivables will be severely impacted, as it always is in these times; whether through direct bad debt and client liquidations, or necessary extended payment terms and a sharp increase in Days Beyond Term. The global supply chain will be severely disrupted for a time with cash flow implications for all business in said chains.

"Many consumers who have shunned on-line shopping are beginning to discover its benefits. If these people continue with a taste for this, then the already threatened High Street/Retail sector will be even more at risk of further (permanent) store closures."

Johnathan Swan, Head of Credit Services, Hachette UK

Receivables, credit and collections will require a change in strategy and management style, supported by Board level throughout all company Stakeholders.

"Switch your entire mindset from 'auto-pilot' (existing credit policy and process) to 'manual'."

René van Mil, Consultant, Credit Risk Collections

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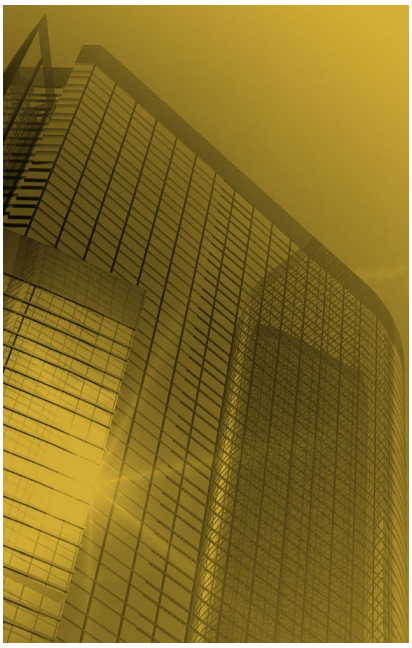

Operations & policy

Operations will come under strain as workloads increase exponentially, initially, then contract again as the crisis matures. New efficiencies may be required to meet these challenges.

Furthermore, given the business environment has so jarringly changed, it may be a challenge for some companies to adapt working practices and communications to a new paradigm – one in which people are less keen to engage with us. Credit policies will be challenged to breaking point and risk appetites reduced to nil. Furthermore, legalities may change, which impact upon existing policy.

"Being aware of legislation changes around disconnection and insolvency (Australia have extended the notice period for Statutory Demands from 21 day to 6 months)."

Andrea Baker FACP MCICM, Director Global Credit Management, Immarsat.

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Careful review of operational systems, processes and technology should be considered, as well as root-and-branch review of credit policies and insurance. Andrea Baker, Director Global Credit Management at Immarsat, recommends these 'quick wins';

- Implement a process for extended terms requests,
- Create a survey for sales people, and others, to fill in when they hear useful info.
- Enforce an emergency credit policy

René van Mil, Consultant at Credit Risk Collections also offers some tips;

- Assess the financial situation of the company, specifically, the cash position
- Determine if it is feasible/desirable to stop delivery in order to limit the growth of (accounts receivable) exposure
- Assess the profile of the customer portfolio, insofar as; the proportion of smaller customers vs larger ones, concentration of risk, and national/international exposure
- Confirm the customer acceptance procedure used
- Confirm what the terms & conditions of delivery were
- Determine if there is an Insurer in place to support customers
- Assess whether transfer and convertibility risk is expected in any countries

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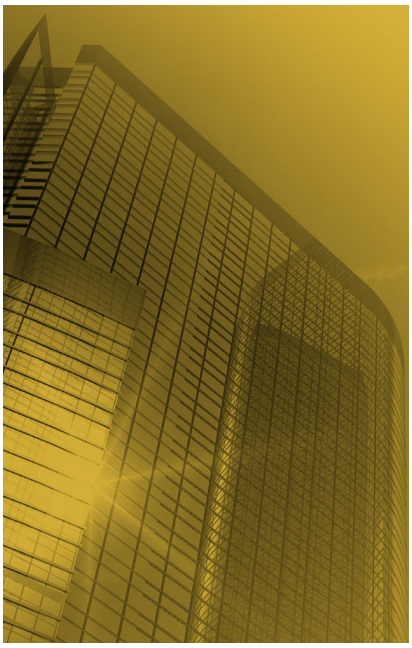

Credit professionals will need to re-categorise their client base according to how Covid-19 impacts them, certainly adding this as another variable within the credit scoring algorithm. Traditional credit scoring tools such as Credit Reference Bureaus, as a single means, will not suffice in providing accurate measures for predicting this 'new risk'.

"Review your account base and identify those customers that are financially weak. Increase your bad debt provision moving forward around this, amending when further information, good or bad, comes to light."

Chris Snelson, Senior Director – International Credit, VF Corporation

Many Bureaus' score cards are heavily dependent on filed financial fields which will not be impacted for 12-18 months. You should enquire with your chosen credit reference bureau, as to what extent other 'real time' variables impact a credit score and rating.

Examples of other data fields that impact credit scores are;

- Change in directorship
- Late filing
- Change in group structure
- Petitions to wind up
- International group structure strength (with some Bureaus)
- Payment performance data (this will be key and the size/relevance of contributing companies to the shared data universe will be important)

This in turn can also inform your risk appetite and associated insurance policies;

> *"Engage your broker and/or contact at the insurer. Consider top-up insurance to deal with increasing exposure. Make sure that any exceptions (extended payment terms, payment plans or credit limit overruns) are in line with the credit insurance policy, or at least well understood for their impact."*
>
> René van Mil, Consultant, Credit Risk Collections

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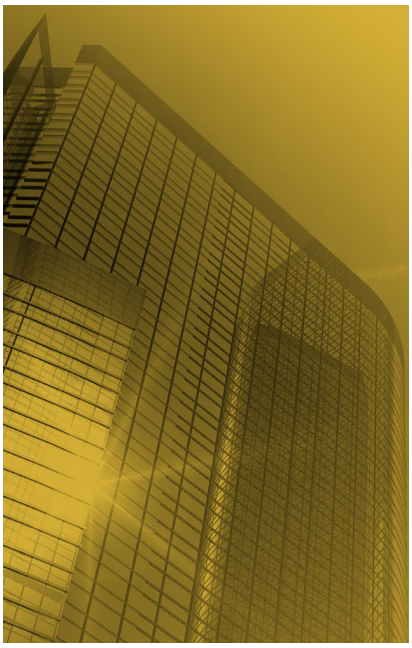

People

Headcount may have to change quickly over the coming months as workload rapidly expands initially (overwhelms, perhaps) before rapidly contracting again as the economic fallout matures. It may be difficult for some operations to adapt to a flexible headcount – both administratively and from a team dynamic perspective.

It is also important to consider new management styles and contingency management policies if this situation continues longer than expected.

> *"If the restrictions last longer than three weeks then we, as managers, are not just faced with ensuring performance and attendance during work hours is followed but, we will need to consider the health and wellbeing of our people more than ever. For some, going to work is their main social interaction. They have now lost that and, even with the modern technology, nothing beats being in a vibrant workplace environment.*
>
> Johnathan Swan, Head of Credit Services, Hachette UK

In addition, determining your company's amended appetite for risk and change in credit approval process could take time to identify; it is important key stake holders such as CFO's, Treasury and Sales understand this.

> ***"Understand your cash flow and forecast this for the coming quarters. Highlight peaks and troughs to the senior leadership team and have an action plan in place to improve the troughs."***
>
> Chris Snelson, Senior Director – International Credit, VF Corporation

Liaising with Senior Finance to change reporting metrics could be helpful; if you report in DBT then this may not be as helpful in contingency stages. Metrics such as Percentage of Outbound Calls Resulting in Promise to Pay (PTP) are more accurate KPIs for cash forecast in difficult times. You could also use Profit per Account (PPA) when you are establishing new categories of risk and trading measures.

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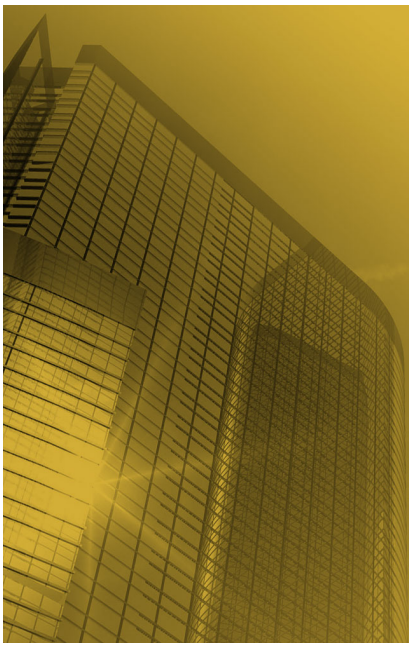

Payment behaviour

A cash flow slump and much tighter financing conditions will hurt creditworthiness. It is forecast that these factors will likely result in a surge in defaults, with a default rate on non-financial corporates in the U.S that may rise above 10%. In Europe, we also expect rates into the high single digits over the next 12 months.

"Governments are supporting wherever they can but many companies cannot wait until the financial support is up and running,"

René van Mil, Consultant, Credit Risk Collections

Credit information and shared payment intelligence from other sources is now critical to help make informed decisions. Industry Credit Circles such as Brent Cumming's "Let's Talk Credit Ltd." and Laurie Beagles 'Forums International Ltd.' could help. If there is not an existing Credit Circle for your industry, please contact Baker Ing International with your interest in setting one up or devising a route to share payment information on common clients. Credit brokers and underwriters are a rich source of information that is not always available in the public domain. Many insurance professionals are keen to speak with you and build relationships; ask for their expertise, knowledge and advice on gaining alerts to risk that you wouldn't normally be alerted to.

Managing the impact Covid-19 has on your receivables will require intuitive action. Predict future risk and the impact this will have on your clients' working capital. Interpret your clients' vulnerability by analysing, wherever possible, *their* clients' exposure to new risk. Many of your clients make their customer base information available via their website and media streams; you can determine threats in their supply chain and to their key account clients.

"There will be a need to educate your customers on the financial assistance that is available to them in their country. Use this information as part of the collection call. Your company should not act as the bank, albeit a secondary lender through payment extensions."

Chris Snelson, Senior Director – International Credit, VF Corporation.

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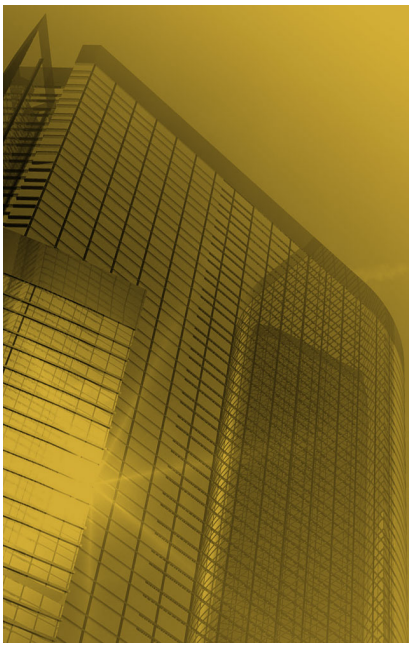

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Risk

Sovereign Risk will ultimately be affected; Dun & Bradstreet are closely monitoring the change in country trading conditions and providing 'real time' insightful intelligence. Baker Ing International recommend Markus Kuger of Dun & Bradstreet as a reliable source of in-depth information for economic status (Dun & Bradstreet have already upgraded China).

Governments are stepping up fiscal measures to manage the health situation and avoid a dramatic human impact from Covid-19, while supporting their populations and companies through a period of suspended economic activity. Most sovereigns benefit from extensive monetary, fiscal and regulatory measures for support during severe crises. However, some might come under more pressure – particularly emerging markets. The length of the crisis, the resilience of the country's economic and political base, and the speed and adequacy of policy response, will be key for sovereign ratings.

Receivables from certain countries most hard hit, such as Italy, China and Spain, will show the impact soonest but, companies from other territories who trade with businesses in these hard hit regions, will see the knock-on effect shortly afterwards. The 'domino effect' on a company's receivables, by country, can be predicted by the extent of exposure, the reliability of supply chains, and the amount of trade with other countries.

You can monitor the impact Covid-19 is having on your receivables by comparing current KPIs on a monthly basis to the previous year. Increase client contact to determine all payment intentions. Forecast ahead losses/default.

Face adversity 'head on' and proactively assist clients who have notified your company of working capital problems / likelihood of non-payment. Baker Ing International work with an industry leading, global restructuring company. We can assist your clients in obtaining capital injection and funding support whilst ensuring your company becomes a secured, primary creditor. Helping clients' during difficult trading periods creates loyalty; if you adopt an 'assist approach', as opposed to a 'cease approach', you can ensure you become a primary creditor above other vendors.

"Having professional Credit Management who take time to get to know your customers, can contribute significant benefits; not only to the immediate cash position, but longer-term by supporting key customers' loyalty."

Andrea Baker FACP MCICM, Director Global Credit Management, Immarsat

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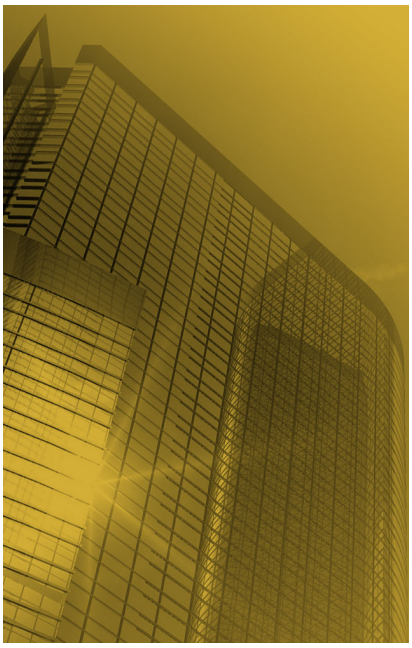

NEXT STEPS

We hope you can begin to gain some perspective on the new circumstances we are all operating in and implement some of the recommended actions in this initial briefing to gain control over the situation.

Broadly speaking, the next steps are to assess your prior position and your current position now that the business landscape has shifted. Some of the considerations in this paper will hopefully help you. Once you have determined this, it is a case of identifying gaps – what isn't going to work any longer that needs replacing, and what is missing because you've never had to deal with the issue before. Then implement changes, prioritising any quick wins, as things are moving fast.

> *"Plan for what happens next. Look to the short and medium-term. Can your team be used better to support more difficult markets? What happens when you are still homeworking and an impacted country improves and goes back to work? Understand that when everything is back to normal, the credit department will have an increased workload. How will you manage this? How will you ship against a limit that includes debt that has been piled up? How will you support revenue growth whilst protecting against loss?"*
> Chris Snelson, Senior Director – International Credit, VF Corporation.

We hope this will help you to get a handle on things and gain some control, ready to tackle the new challenges coming our way in the weeks and months ahead. We'll be releasing updated briefings and detailed drill-downs on topics in an effort to support you throughout.

Fundamentally, we must hold our nerve – controlling credit risk whilst ensuring we remain in a strong position when this storm has passed.

> ***"Targets and credit policies need to be fluid and be able to support what is happening now, what will happen in 4 months, what will happen is 8 months…eventually it will be back to BAU."***
> Chris Snelson, Senior Director – International Credit, VF Corporation.

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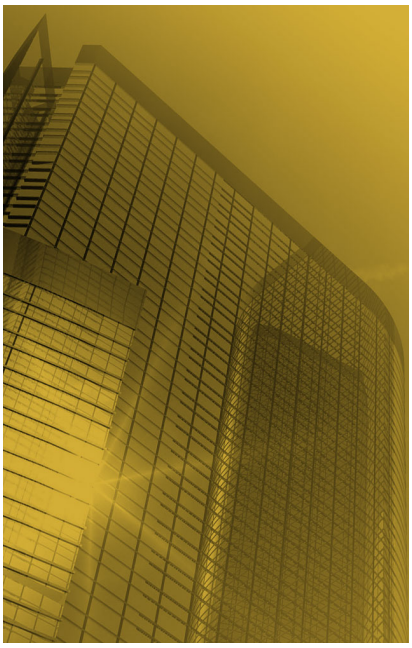

THANK YOU

We would like to take this opportunity to thank all of our clients, partners and employees around the world for working with us.

We are thinking of you and your loved ones at this time and we wish you all the very best of health.

Do not hesitate to contact us if we can help you in any way at all.

This is more than just business.

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