Credit Risk Trends and Challenges: The contribution of new technologies to the deployment of best practices
"It may sound surprising to associate the notion of culture with risk management. Yet, to have an efficient risk management policy, company directors have to properly identify what drives different risk behaviours, especially during an economic slump. In fact, the global financial crisis drew attention to the decisive importance of such a notion in corporate bankruptcies.

This culture is at the root of all processes. Admittedly, there is no miracle solution but the company’s strategy, business model, practices and its tolerance to risk must all be consistent. We can then embrace a smart risk culture where all employees are made aware of the issue and adapt their attitudes to take the best decisions.

Lastly, a smart risk culture cannot be rigid. It is important to constantly measure it both qualitatively and quantitatively, in order to ensure it always supports the company. This also helps to identify where improvements can be made, and to adapt to changes in the market. By successfully developing a smart risk culture, companies will have a precious indicator of how they are managing and dealing with risk, and a genuine engine for developing its activity."

Jérôme Pezé, CEO and founder of Tinubu Square
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The credit risk landscape

There are distinct signs of economic recovery in the UK, where business confidence and the outlook for future growth is on the rise. Companies are looking for new and additional lines of credit and this indicates a marked increase in their appetite for risk. However, as recent figures show, there are areas still susceptible to outside forces.

• Continued recovery depends on consumer spend

Almost all indicators of economic health in different sectors of the UK, point in the same positive direction. The most recent Purchasing Managers’ Index for construction, for example, shows that construction output in Britain grew at its fastest pace in seven months during August 2014, exceeding all the forecasts in a Reuters poll of economists. Similarly the PMI for services reached an eight-month high in July.

However caution is still the watchword. UK manufacturing activity grew at the slowest rate in 14 months in August as factory orders slowed down. The recent UK Manufacturing Purchasing Managers’ Index (PMI) fell to 52.5 in August - its lowest level since June last year. It does hold above the 50-point threshold denoting growth, but suggests that the onus will fall on consumers to keep driving the UK’s economic upturn in the second half of 2014.

Experts suggest that while the UK market is generally improving, it is not immune to the effects of changing geopolitical and global market uncertainty, particularly in the Eurozone countries.

• The ICM index shows appetite for risk is improving

The Institute of Credit Management (ICM) is Europe’s largest credit management organisation and the second largest globally. ICM publishes a quarterly UK Credit Managers’ Index, sponsored by Tinubu Square, which is calculated using input from credit professionals and provides a detailed insight into the thoughts, attitudes and levels of confidence of UK credit managers.

The most recent Index, for Q2 2014, shows that actual levels of business are increasing and companies are demonstrating a broader appetite for risk. The headline index that has been on an upward trajectory for the last six quarters now stands at 59.2 - more than 10 points up on the low of September 2012.

Reflecting other research, the Index notes a further improvement in services and a slight dip in manufacturing although both areas remain healthy. New applications for credit have risen to a high of 67.2, although order book levels have fallen possibly due to the trend for longer term contracts to impact the figures, suggests ICM.

There is an increase in the number of rejected credit applications mirroring the rise in requests, but combined with an increase in bad debt provision, the figures suggest that the appetite for risk is becoming significantly stronger; this indicates confidence amongst business owners about their future prosperity.
Cashflow set to improve according to UK credit managers

Our own poll amongst credit managers in the UK during July reflects a similarly positive outlook. 60% anticipated improvements in their cash flow situation now that the UK economy is improving.

Interestingly, 54% said that they envisaged a change in the credit period taken by their customers in the current year, but 43% felt that it would remain the same. Only a quarter reported that the value of their bad debt had increased over the past year, whilst the rest said it had gone down or stayed the same.

Economic downturn and customer risk management

Looking back at the period from 2000 to 2012, the economic performances of small businesses across Europe struggled. Their average margin rates contracted and for many they still remain lower than those of mid-sized businesses and major groups. Taking into account all company sizes, margin shrank by 4 points, to 22% in 2012.

In this unpredictable economic context, companies found it difficult to innovate and identify new growth drivers. However, the needs of small and mid-sized businesses grew stronger, reaching their highest level. Indeed, 65% of them applied for new credit (+ 6 points in 3 months), to either run their business (44%, + 6 points) or to invest (32%, - 1 point).

As a result, in 2014 many companies are looking to optimise their cash position and their working capital requirements, which are particularly important as we emerge out of recession but continue to guard against risk. What many companies are looking for are alternative solutions and as part of this they are also re-evaluating their customer risk management process.

2014 priorities for CFOs: from management planning to digitization

According to a recent PwC/DFCG study, 71% of Chief Financial Officers rank management planning as their first, second or third priority. They state their intention to strengthen their policy in this field, by focusing particularly on data quality, the performance of processes and the rhythm of forecasts.

More than 42% of them have decided to implement new criteria for monitoring performance, especially by improving the return on capital employed, the guidance reference system and by purchasing and installing electronic credit risk management tools.

At the same time, 39% changed their financing plans in 2013 or are considering doing so in 2014, while around 50% of respondents consider that their plan is "no longer quite in line" with their short and medium term needs. The choices mentioned include: diversification of financial partners, a scenario-based approach to take the economy into account, as well as the staggering of financing maturities.

In addition, 53% of them confirmed their company's growth and expansion strategy. Asia remains the priority destination, North America and Latin America were demoted from second and seventh positions to the last positions, while Continental Europe gained three places, followed by Eastern Europe, Africa and the Middle East.

This growing area of activity at the heart of an organisation has been made possible through new technology, which allows the CFO to implement best practice to shape future directions. CFOs are reported to be increasingly attracted to the opportunities offered by SaaS and cloud models, and nine out of ten CFO's think that cloud computing will be a decisive factor in their company's success.

For 58% of respondents, the finance department must be more involved in the company's transformation and decision-making, working in particular on soft skills (innovation, accessibility, listening and creativity) and on technical skills. It was felt that CFOs have the information required to make strategic decisions, including the key performance indicators (or KPIs) that allow faster interpretation of market trends.
As all businesses know, outstanding debts can cripple cash flow. On average monies outstanding represent around one third of the balance sheet and more often than not, the managers of small businesses are spending precious time chasing money to ensure smooth cash flow, even if that also means securing short-term financing. This effort is distracting and time-consuming and companies need to look at mechanisms for improving credit risk management, not just in their own domestic market but to support exports and to facilitate compliance with corporate governance rules.

**Introducing a culture of credit risk management**

Establishing a culture of effective credit risk management is critical in SMBs. It allows specific processes for identifying, analysing and managing a company’s exposure to risk, so it can be established and mitigated against. The whole mechanism however, can only be effective if it is complied with by all relevant employees, who need to understand the process and the advantages of order-to-cash cycles, sales margins, turnover, and profit.

**To help bring this to fruition:**

- The sales team should be selective about customers it deals with: carry out detailed analysis of the market, qualify prospects and implement more robust commercial negotiations.
- The procedures implemented should be accurately defined across all the company’s functions for enhanced efficiency and risk control.
- The company should be capable of deciding between commercial requirement and risk taking.
- Existing customers should be monitored.
- Implement a faster response to negative information to reduce exposure to risks.

**Perfect knowledge and control of customer portfolio**

A company which puts its credit risk management house in order will also reassure suppliers and financial partners (credit insurers, banks, factoring agencies, etc) allowing them to feel confident about their working relationship. The company will have the advantage of access to:

- A concise segmentation of the portfolio, which leads to knowledge of the exact position of key commercial partners, their sectors of activity, payment patterns and methods and the portfolio concentration level in number and in value.
- An in-depth study of the solvency of the main customers.
- Daily monitoring of the change in customer portfolio.
- Better awareness of the legal and contractual aspects of the terms of sale, in particular concerning the retention of title clause (RTC).
• **Risk transfer to a credit insurer**

Businesses transfer risk when they purchase a credit insurance policy. This type of cover has different options: from the first pound (whole turn-over), with deductibles, political risks, Top-Up or by buyer. Regardless of the purchased policy, buyers benefit from numerous advantages:

- Thanks to the privileged access of the credit-insurer to data on companies in general and their sophisticated data processing tools, the policy holder is informed of its exposure to risk. This allows it to better anticipate and control risk to manage its business development.
- The recovery of past due claims by the credit insurer is particularly efficient on at-risk claims and export transactions.
- Compensation is then calculated on the basis of the past due amount, within the limit of the warranty granted, multiplied by the percentage fixed in the policy.
- Once compensation is paid, the credit-insurer takes over the rights to the claim, whether it is finally honoured or not.

• **Controlling export activities**

These rules are even more important in an international context, particularly for managing subsidiaries abroad, which is are neither simple nor risk-free. Outside factors whether political, commercial, financial, logistical or legal add to the risk environment making it harder to control.

The set-up of an ad hoc credit risk management policy is useful for automating a significant portion of the most important processes, such as monitoring the changes within customer organisations, tracking changes in standard terms & conditions and watching the geopolitical situation in the countries in which the company is trading. In an international context, it is also important to manage subsidiaries according to common rules of governance.

• **Immediately quantifiable benefits**

A well-applied credit risk policy helps the company to control this risk in real time and therefore to enhance its visibility. By assessing the capacity of commercial partners to meet their commitments, credit management limits risk and protect turnover. To this end, a supportive culture of risk anticipation, regulation and negotiation has to be implemented from the initial sale through to cash collection. The result is that the company limits the number and scope of possible disputes, secures better cash flow, establishes profitable and maintainable margins, and establishes conflict resolution processes.

Credit management allows the company to optimise its working capital and finance its operating cycle while limiting the use of external solutions, such as overdrafts. It also contributes to the development of corporate social responsibility since it promotes compliance with financial commitments and consolidates commercial relationships on a sound basis.

Once implemented, this mechanism improves the company’s operational performance and cuts receivables collection time by 25% and reduces the costs of risk and its management by as much as 50%...
New technology to leverage optimised credit risk management

To firmly establish a credit risk management culture, companies are increasingly looking for help from new technology, which can assist in the set up and dissemination of new processes, but also support changes in personnel behaviour.

New technology, particularly solutions made available in the ‘cloud’, has brought more transparency and pro-activity to credit risk management. The solutions support a collaborative workspace where it is now possible to automate customer monitoring, manage KPIs in real time, and circulate information. For many users, technology facilitates an efficient means to implement a controlled risk management policy.

- Cloud Computing: characteristics

Cloud computing allows the storage of data and software on remote servers, while guaranteeing service continuity and quality. It has radically changed how businesses work, delivering applications that are available anytime, anywhere for everyone. Depending on the level of clearance, all users have access to updated and reliable information. This type of IT solution provides a genuine competitive advantage as it allows the rapid, simple and reliable launch of strategic applications.

In a survey conducted in June 2014, the Cloud Industry Forum (CIF) found that 78% of organisations had adopted at least one cloud-based service, an annual increase of around 20% and an indicator that cloud computing is now achieving mainstream deployment in the UK.

The research also showed that large private enterprises are showing the highest rates of adoption at just over 80 per cent, whilst the sub 200 employee organisations are standing at around 75 per cent and the public sector is still lagging at around 68 per cent.

Of those using cloud services, 45 per cent use only one cloud service formally, 28 per cent use two cloud services, 13 per cent use three and the remaining 14 per cent use four or more.

CIF also found that UK businesses are becoming more competitive as a direct result of cloud services. 55 per cent of cloud users have experienced a competitive advantage from using cloud services and a further 23 per cent anticipate seeing one.

- The contribution of a software solution for credit risk management

Software solutions have transformed the workplace, and with SaaS applications being available anytime anywhere all users can be guaranteed to share the same information. This is why these solutions are particularly suitable for credit risk management. Easy to deploy on several sites worldwide, they allow data to be shared between the head office of a company and its different subsidiaries and between all the relevant parties within the organisation.

All the functions of the order-to-cash cycle benefit from centralised tasks and automated solutions, from the sales team and administrators, the supply chain department, deliveries and finally the client accounting and financial staff. Various stakeholders including brokers, insurers, factoring companies and advisers can also benefit from a system that automates and streamlines all procedures linked to credit management. With access to critical data in real time, it is much easier to track exposure to risk, accrued provisions, and cash flow, not just on a daily basis, but hourly, and be informed if a customer’s own financial situation deteriorates and put in place measure to limit the financial impact.

A software solution for credit risk management helps to reduce DSO, secure cash flow,
Effective risk analysis is fundamental to business growth. Despite the more positive economic outlook, companies are still struggling with late payments and payment defaults, and regardless of the economic climate, they will always be competing for market share and increased profit margins. To help them reach their goals and keep shareholders happy, the informed CFO is increasingly taking control of risk management and his or her weapon of choice is automated credit risk management delivered via a software-as-a-service model.

In our recent poll amongst credit managers, when asked for their wish list to better support their credit management, just over half said that they would change or improve their system software. Underline credit management policy and increase productivity. Thanks to its flexibility and responsiveness, it makes the company more proactive in managing and preventing risks, allows optimisation of costs and supports the performance of the credit insurance programme whilst also ensuring that all defined governance rules are applied on a daily basis.
Customer testimonies

« We needed a consolidated analysis of our trade receivables, for all the companies in the group and all countries concerned. The Tinubu Risk Management Center platform in SaaS mode is the perfect answer: this precious tool accessible anywhere, updated in real time, gives us a strategic edge for controlling and managing our credit risk, by reducing our exposure and giving us the means to optimise our credit insurance programmes for the 80 subsidiaries. »

Dentsu Aegis Network

« Because the Tinubu solution works internationally it can be easily adapted to suit whichever territory our client is located in and will work out the cost and the cover that can be applied in that territory based on local, real-time intelligence. Frankly, we couldn’t do this without Tinubu Square. »

Bibby Financial Services

« We wanted the capacity to immediately identify our major risks and make the necessary adjustments in real time. Our credit performance is sound because we have taken the precaution of purchasing insurance policies. However, our operating methods were not efficient, and we wanted to be more proactive in our risk management. »

Linpac Packaging

« We have a day-to-day relationship with Tinubu Square, and we maintain a close relationship with them. Tinubu Square perfectly understood our needs and our specific requirements. »

Eurotoll

A brief look at Tinubu Square

TINUBU SQUARE is the technological benchmark of credit risk management in cloud computing. TINUBU SQUARE develops and delivers innovative solutions that meet the specific and changing needs of the credit risk market.

It provides its customers with software solutions and business services ranging from risk analysis and monitoring through to a single full web interface. Thanks to its cloud-based platform and its highly-qualified teams of credit analysts, TINUBU SQUARE is able to offer a comprehensive range of solutions dedicated to the optimisation of credit management processes.

- Founded in 2000
- Head office in Paris
- Offices in London, Singapore and Mumbai
- €16 M in turnover in 2013
- 200+ international customers

Tinubu Square’s customers and partners include...

200 companies including Kering, Dentsu Aegis Network, Alcatel-Lucent, Bibby FinancialServices, Eugène Perma, Eurotoll, Fraikin, Linpac Packaging...

25 credit insurers including Atradius, GCNA, ICIEC, CESCE, National Insurance, SACE...

Leading credit-insurance brokers including AON, Marsh, Millennium, Gras Savoye, RKH, Willis...