

Extra Credit

Are your clients' businesses protected if their customers can't pay their bills? BY MARLENE Y. SATTER

The Big Three—Ford, GM, and Chrysler—had not yet even taken their corporate jets to Washington to beg Congress for a bailout when a bit of news surfaced that could have repercussions for far more than the auto industry. In mid-November, three large European credit insurers—Coface, Euler Hermes, and Atradius—declined to provide further coverage to suppliers for Ford and GM. Chrysler was not immune; a couple of days later, Ottawa-based Export Development Canada, which writes coverage for Canadian companies that it supplies with parts, announced that it would not be writing any new policies, nor could existing policyholders increase their coverage.

While this is certainly not good news for the automakers, it's worse news for their suppliers, those smaller companies whose risks just grew exponentially. Most U.S. auto parts suppliers operate without credit insurance and the implications can be scary.

You might want to consider whether your business-owning clients are prone to similar exposure. According to Peter Seneca, a partner at Securitas Global Risk Solutions LLC in Berwyn, Pennsylvania, there are quite a few industries in which businesses might find themselves holding the bag for customers who ordered and then defaulted on payments or simply went out of business. Securitas is a brokerage specializing in credit insurance, and Seneca explains that as business losses from debtors become more common, that's helped to generate interest among business owners in such coverage.

Seneca points out that this has been an issue in other industries, particularly retail, prior to the news of the Big Three's difficulties, as well as businesses in construction, real estate, homebuilding, lumber, and even they lose too large a part of their client base? Can they afford to take the risk that clients will not pay their bills? Or

banking. Can your clients' businesses require that customers pay up front for the goods or services they need, or will they simply cut off any customer who cannot meet these new conditions for a sale? In today's economic climate, these are all issues they might need to consider.

The current climate is changing insurers' business strategies, too. In underwriting, says Seneca, there's a greater emphasis on credit analysis, and a higher level of due diligence. "There's also a greater appreciation of knowing who you're trading with," he adds, explaining that people in businesses who use such coverage are working harder to understand both credit and their business partners. Being mindful of such issues may be required these days to get coverage. It used to be, he says, that the last check received from a customer was a pretty good indication of how sound the customer's business was, but not any more. "People will be paying their bills, and the next thing you know they're out of business."

Says Seneca, "An advisor who wants to take a holistic approach in helping clients and is involved in preservation of wealth by mitigating risk should be asking business owners questions related to their customers." He suggests that some of those questions should be: At what level would you not want to suffer a loss? At what level does a loss have a financial implication for everything you've accumulated? At what level would you not be able to afford a loss? And at what level would a loss threaten all your future plans?

Receivables are property, reminds Seneca, over which a business has no control. "If you have extended terms, then you have a risk of loss," he points out. He adds that translating a balance sheet into pie chart format would result in a receivables wedge in which the majority of a business' assets can be centered, and often that wedge is uninsured. But businesses are showing more interest in credit insurance

coverage, he says, due to "defaults by buyers who were creditworthy and weren't showing signs of weakness, and people being taken by surprise."

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Creditworthy

Peter Seneca, A partner at Securitas Global Risk Solutions LLC in Berwyn, Pennsylvania, says that credit insurance, in addition to protecting the receivables of a business, can function as a tool to offer businesses opportunities for growth that they might not otherwise have—a benefit that can prove very welcome in a time of tightening credit and tough conditions.

Coverage, he explains, can "help companies finance assets that banks won't traditionally finance, such as foreign receivables." Credit insurance can also allow a company to increase credit limits to some large clients without increasing their exposure, thus allowing the opportunity for greater sales and larger transactions. "We help people sell more than they would otherwise," Seneca adds, "by helping them transfer credit risk."

Companies using this type of coverage as a tool can also "go international" by having the ability to extend open account terms instead of operating under the constraints of a conventional commercial letter of credit; this provides more flexibility on both ends of the transaction and opens up opportunities that might otherwise go unnoticed.

Credit insurance is a product, says Seneca, that can serve a company on many different levels: It provides risk mitigation and financing; it can help a company grow its sales or its top line; and it can act as an alternative to a commercial letter of credit.