Given that credit reference agencies have been operating in the UK for almost a century, it’s perhaps surprising that so few companies take advantage of their services. Most people are aware that such organisations exist – after all, it’s impossible to obtain any kind of personal loan without having your creditworthiness checked by the consumer arm of the sector. Those involved in the money markets will also have encountered international credit reference agencies – Moody’s and Standard & Poor’s, for example – which provide services such as rating a company’s ability to repay its bond debts.

But, as far as the wider business community is concerned, only 20 to 30 per cent of firms use the commercial services offered by credit reference agencies. And, despite the growing financial risks associated with the global interlinking of businesses, the credit management market is showing few signs of growth. You might assume that most companies would think it prudent to use a service that checks their customers’ ability to pay up, yet it seems that a large number consider keeping their fingers crossed to be the better option – even though almost a quarter of all business failures result from poor credit control.

WOULD YOU CREDIT IT?

How would your business cope if one of its biggest clients were to go bust unexpectedly? If your answer is “not at all well”, perhaps it’s time to consider the services that credit reference agencies offer, writes Camilla Berens.

Illustrations: Gary Neill
Credit reference agencies generally fall into three categories. At one end of the scale are the standard web-based services. For as little as £10, such agencies will provide basic information on a company from public records, such as its annual accounts or county court judgments against it. The second category covers the more established services that offer a comprehensive overview by combining publicly accessible information with their own databases of credit activity and independent monitoring. The third type of agency specialises in providing various types of credit insurance.

Commercial credit reference agencies not only provide a good idea of the financial health of businesses applying for credit terms; they also advise on what credit limits can safely be applied. This, according to the agencies, is particularly useful for small and medium-sized businesses that lack the financial ballast of bigger organisations. Agency clients become part of a credit community where information on defaulters is pooled to provide an early-warning system for all members. But, despite a recent survey by GMAC Commercial Finance revealing that SMEs lose £6.6bn through unpaid invoices every year in the UK, this market remains largely untapped.

Seeking a bigger market share, some agencies have expanded to become specialists in areas such as credit insurance, collections management and business-to-business marketing services. According to Simon Marshall, a founding director of collections management and business-to-business marketing services. According to Simon Marshall, a founding director of receivables risk management broker, Co-Pilot, more companies may start taking advantage of such services as they face increasing compliance and performance pressures.

“It’s vital that this area of business is effectively managed,” he says. “Compliance demands are getting stronger all the time and investors especially want to look at how their company is protecting its revenue.”

So why is it that so few of the UK’s four million SMEs are using credit agencies as part of their financial management strategy? Wayne Davies, head of commercial products at credit reference agency Equifax, which has conducted research in this area, admits that he’s mystified.

“We asked ourselves whether these companies might be the ones that don’t offer credit, but the suggestion is that they do, because they have a consumer credit licence,” he says. “It was a bit of a shock to find that they weren’t doing anything to protect themselves.”

It’s possible that their lack of interest could result from a view that the agencies’ services are too expensive. But Davies thinks this is unlikely. Some of Equifax’s clients spend as little as £100 a year and seem happy to do so. “Perhaps some firms’ margins are so tight that they don’t want to spend £10 on a report,” he says.

Even when smaller companies use credit checks, they often do this inconsistently, according to Davies. “There’s a lot of evidence to show that, even when a firm does buy a report, it doesn’t continue to monitor its existing customers to ensure that they remain financially sound,” he says. “This should be just as important as checking out new customers.”

Davies adds that a typical SME will argue that it knows its main customers so well that credit checks are an unnecessary cost. Others will say that most of their clients fall into the non-limited category, making accurate financial data hard to find. “It’s always going to be a question of whether the benefits will justify the costs,” he says. “But what people don’t appreciate is the real cost of bad debt in terms of chasing people up and employing debt collectors.”

Some firms may simply be unaware that such services exist. But Jo Howard, marketing director at rival agency Experian, believes that many SMEs will be more concerned with increasing their cash flow than protecting it while the economy is enjoying a relatively stable period.

“It’s sad but true that many businesses are so focused on getting the next sale that they don’t consider the consequences of a key customer’s inability to pay them,” Howard says. “They are going to be the last to know when a client gets into difficulties – they will find out only when the cheque is late.”

**LIQUID AND SOLVENT: UKAY FUELS’ CREDIT INSURANCE POLICY**

Ukay Fuels supplies petrol, diesel, heating oil and lubricants to customers throughout the UK, including haulage companies, garages, farms and factories. Since it started in 1997 the business has grown by 50 to 60 per cent every year to a current turnover of around £3m. It employs 18 drivers and ten members of staff at its office in Grays, Essex.

Fuel distribution is a high-risk enterprise, because prices can fluctuate quickly, and there are extra currency considerations, because deals are done in dollars rather than in sterling.

“The effect of customer insolvency is extremely serious in this industry,” says Anthony Iameo, a director at the firm. “We needed a way to determine the likelihood of insolvency for individual customers and to protect ourselves against any payment default.”

After speaking to three major credit insurance providers, Iameo chose a policy from Coface UK. “I wanted to insure every account worth more than £1,000 – around 90 per cent of our business – excluding some customers with whom I already had a personal relationship but for whom it would be hard to secure cover,” he explains. “Coface agreed to set aside these clients so that we pay only for the cover that we actually need.”

Since Ukay Fuels took out the policy three years ago, it has extended its relationship with the insurer to include credit management, collections and legal advice. “We can conduct a credit check online and get a response immediately. If we can’t obtain a credit limit, Coface is at least prepared to discuss the issue and explain why,” Iameo says. “We have used the collections service when one of our clients wouldn’t pay and we’re also using the final-demand service to send reminders to customers whom we suspect will cause problems. We’re also being given legal advice in one case.”

Ukay Fuels has been fortunate enough not to have needed to file an insurance claim so far. “The fact that we’ve made no claims means that Coface is doing a good job in advising us about risk. After all, it is the expert and knows what to look for, which means I don’t have to worry,” Iameo says. “We’ve found that having the policy reflects well on the financial security of the business, too: our bank has been more willing to help and the oil companies feel more at ease when dealing with us, so it helps us to obtain better credit terms.”
Whatever the true reasons for the plateau in the market, the more established credit reference agencies are trying hard to change the situation. Online access and more tailored packages are attracting new business as firms start to appreciate the benefits of real-time data monitoring.

Agencies are trying to supply more up-to-date intelligence, according to Paul Flanagan, director of risk underwriting at credit insurer Euler Hermes UK. “Companies are going from reasonable profitability to bust very quickly these days,” he says. “We’re developing ways of providing much fresherer information. A firm can’t afford to wait a year to see what the figures look like. It has to get as close as possible to the current situation.”

Annie Guerard ACMA, finance director at fashion retailer Diesel, echoes the demand for more of the very latest information. She uses a credit reference agency as part of her risk management strategy but stresses that she treats the data it provides only as general reference material. “It gives me an idea of what is going on, but I don’t take it as gospel,” she says.

From her own experiences, Guerard has found that, because much of the core financial information obtained is based on annual reports, it dates quickly. Her company’s financial risk management strategy is supported by a number of other measures, including credit insurance on high-value accounts and trade references.

A strong internal credit management team is also vital. “It’s like brushing your teeth,” Guerard explains. “You’ve got the toothbrush, but you need the toothpaste as well.”

In response, Trevor Byrne, marketing manager of credit insurer Coface UK, points out that a credit agency can provide valuable extra services. “Companies that use credit insurance receive advice from people who are experts in their particular trade, as well as economic information and guidance on how to improve their overall credit management,” he says.

Traditionally, credit insurance has had a reputation for being time-consuming and expensive to use. Insurers require policyholders to report back on customers who default on their credit limits, while premiums can range from 0.5 per cent to one per cent of turnover. For these reasons many companies still prefer to self-insure by putting cash aside to cover bad debts.

But Byrne points out that the self-insurance option doesn’t offer much flexibility. “The disadvantage is that it freezes cash that could be used to invest in the business. And there’s no guarantee that the funds will be sufficient to cover a large debt,” he says. “The benefit of credit insurance is that you’re covering a very real risk out there in the marketplace.”

But are such policies still too costly for smaller firms to contemplate? “It’s certainly an additional cost,” Byrne admits. “But a typical SME has three or four major customers that bring in 50 to 60 per cent of its total revenue. If it were to lose only one of those, it’s questionable whether the business could survive.”

A recent report by BDO Stoy Hayward predicted that almost 50,000 UK businesses would go bust in the next three years if economic conditions declined. Byrne says that now is a good time for businesses to consider a more prudent approach to protecting their cash flow.

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As their IT capability has improved, credit insurers have been able to attract new clients with cheaper, more user-friendly packages. Experian’s Jo Howard says it’s early days, but developments in credit management software could make a significant difference in the long term. “Credit departments are not the most sexy areas of a business and they’re often the last to receive investment, but organisations are gradually obtaining technology that will allow their staff to evolve from simply processing applications to providing good management information,” she explains.

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“Credit insurance premiums are highly competitive at the moment,” he claims. “If the economy takes a downturn, taking out such cover could mean the difference between survival and failure.”