EULER HERMES
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SECURITY IN LENDING

Business owners and financial executives must continuously balance the cost of doing business with the risk of doing business. Each time a dollar of revenue is produced, all costs of generating that dollar have been thoroughly analyzed in an effort to maximize the profit margin, including costs associated with accounts receivable management. However, the hundreds of billions of dollars in losses associated with bad debt charge-offs in recent years have brought new attention to managing trade receivables from a risk perspective.

Accounts receivable, which typically represent more than 40% of a company's assets, are naturally a vital component of a healthy business. If a major customer is unable to pay its obligations, or if several customers are unable to pay their invoices, there will be a negative impact to cash flow, earnings, and capital. In a worst-case scenario, this could literally put a company out of business. These risks require thorough analysis.

A trade credit insurance policy also allows companies to feel secure in extending more credit to current customers, or to pursue new, larger customers that would have otherwise seemed too risky. It significantly reduces the risk of entering new markets.

Trade credit insurance can also improve a company's relationship with its lender. For example, a $25 million scrap metal dealer had extreme concentration in its accounts receivable because it only had eight active accounts. The smallest of these customers had A/R balances in the low six-figure range, and the largest was into the low seven-figure range. The company was seeking additional capital to further expand the business.

The company's bank was concerned about this concentration and it requested a trade credit program to fully leverage the accounts receivable as collateral. The scrap metal dealer purchased a trade credit insurance policy that specifically named all its buyers, providing the bank the comfort level it needed to increase the eligible receivables.

In fact, the bank increased its advance rate from 80% to 85% for this customer. The net result was that the scrap metal dealer was able to obtain an additional $400,000 in working capital because of its trade credit insurance coverage. The cost of the policy was $25,000 so the return on this investment was excellent, and the scrap dealer was able to use the additional cash to continue funding the growth of the company.

In the face of the global recessionary climate, increased business failures both domestically and globally, and the tightening of credit across the board, it becomes obvious that business leaders must be more vigilant than ever regarding the management of accounts receivable. A trade credit insurance policy, if used properly, provides a valuable extension to a company's credit management practices – a second pair of objective eyes when approving buyers, as well as an early warning system should things begin to decline so that exposure can be effectively managed. And, ultimately, should an unexpected loss occur, the trade credit insurance policy provides indemnification, thus protecting the policyholder's revenue and bottom line. By maintaining a strong relationship between the insurer and the credit management department, trade credit insurance may be the wisest investment a company can make to ensure its profits, cash flow, and capital are protected.