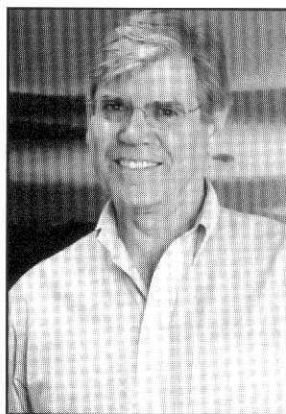


Customers Will Fail To Pay, But Which Will Fail And When?

Scenario Planning would benefit Credit Risk Management

By Ron Wells,
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As amounts of unsecured credit grow ever larger with the relentless increases in input costs – based on commodity and logistic shortages – but consumer prices are suppressed by excess supply, credit managers are increasingly concerned to judge which of their customers will fail, and when.

The question is: should we suffer “the slings and arrows of outrageous fortune, or ... take arms against a sea of troubles, and by opposing end them?”

The answer is obvious: we cannot sit on our hands while our employer companies slide toward the waiting abyss of bad debt. It is incumbent on professional credit managers to find a way to identify the unfortunate, the badly managed, the naively managed, the fraudulently managed, and the carelessly managed companies that are unlikely to survive.

While your CFO diligently watches DSO statistics - useless and misleading as they are – and traditional credit managers rely on the hopelessly outdated Z-score, or the questionable value of “through the cycle” S&P or Moody’s credit ratings, to foretell the future demise of this or that counterparty; there is something useful you can do to prepare the best possible defence for your company.

We have all been trained in the traditional art of credit management, with its emphasis on financial analysis and the scrutiny of umpteen ratios. All our training and processes are based on the belief that the future can be extrapolated or “foretold” by looking back at the past; all are useless in the present environment. All are built on the erroneous and often disproved assumption that next year will see progress from the base of last year. Those rear-view mirror gazers who run so many companies need to know that “*change has changed.*”

No longer is it additive. No longer does it move in a straight line. In the twenty-first century, change is discontinuous, abrupt, (and) seditious. The age of progress is dead. We now stand on the threshold of a new age – the age of revolution. In our minds we know the new age has already arrived; in our bellies, we’re not sure we like it. For we know it is going to be an age of upheaval, of tumult, of fortunes made and unmade at head-snapping speed. (*Leading the Revolution* - Gary Hamel)

The future is where we will be paid or not paid by our customers. Hence as credit managers we need to understand what the future may hold so we can prepare a range of plans that best fits what materializes in the fullness of time.

An understanding of what the future may hold can be gained through the use of the Scenario Planning technique.

Scenario planning derives from the observation that, given the impossibility of knowing precisely how the future will play out, a good decision or strategy to adopt is one that plays out well across several possible futures.

These sets of scenarios are, essentially, specially constructed stories about the future, each one modelling a distinct, plausible world in which (*Continued on page 26*)

About the Author

Ron Wells is a Credit Manager for Chevron Corporation’s office in London. Ron is an active member of the International Energy Credit Association (IECA) European Division and the Association for executives working in Finance, Credit and International Business (FCIB). He is the author of *Global Credit Management* - an Executive Summary, published by John Wiley & Sons Limited. This is a concise but authoritative work that exposes the power of credit (see www.barrettwells.com/gcm.html for details). The Chinese version of this book has now been published and is an ideal credit tool for Chinese business executives, see www.l3plimited.com for details. His free access international credit management web site www.barrettwells.co.uk is highly regarded as a valuable resource for those interested in trade finance and business-to-business credit management. Ron’s email address is: ron.wells@barrettwells.com.

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