

Global Trade Credit ScoreCard & Limit Model (Generic)

**BarrettWells Credit Research
Ron Wells - Europe**



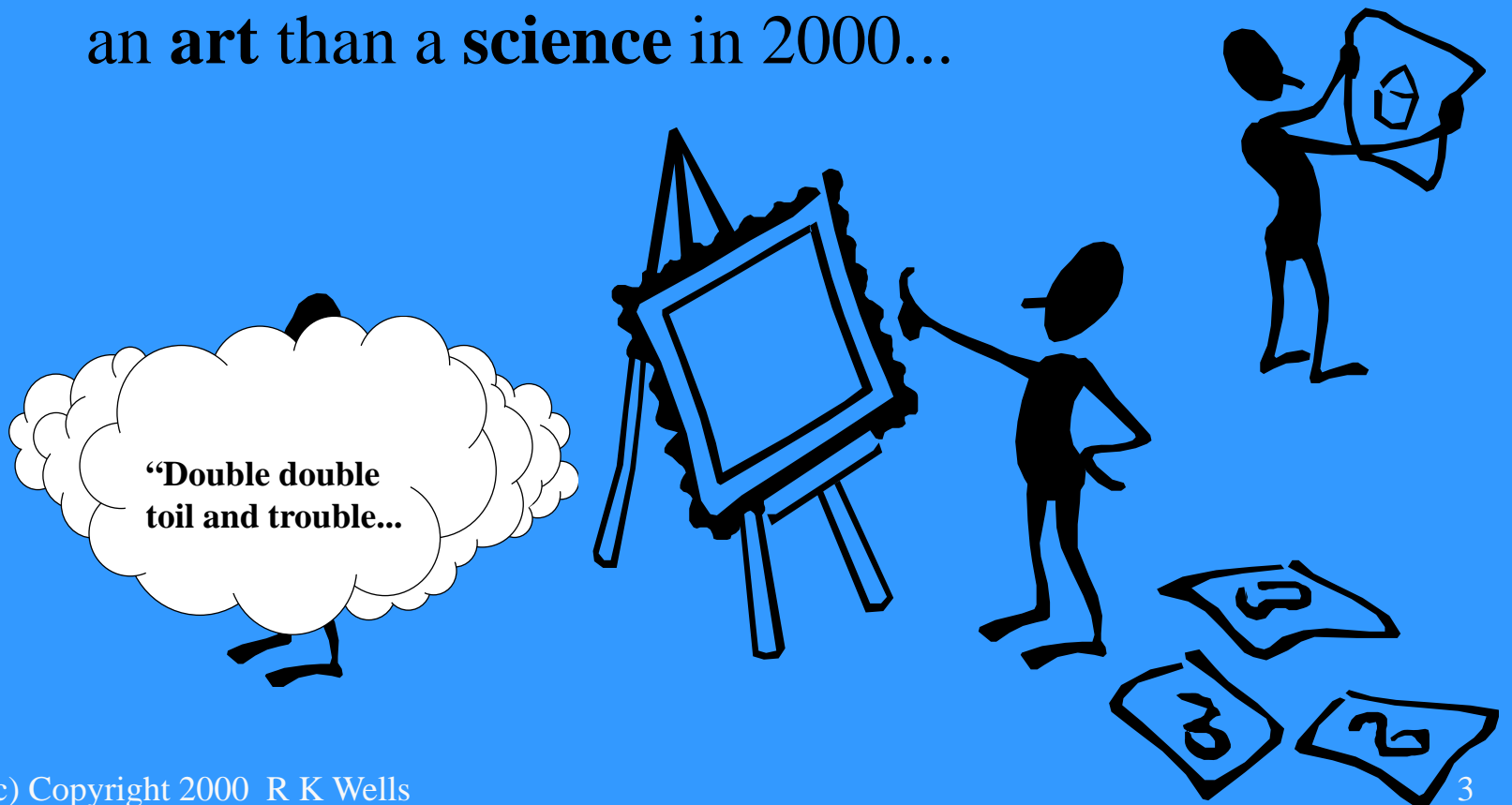
OBJECTIVES

- ◆ To make credit limit decisions in a standardised and systematic way, based on facts.
- ◆ To make credit decisions which align with and support the company strategy.
- ◆ To speed up credit decisions and enable the use of technology to a greater extent.



THE CHALLENGE

Credit Analysis is still more of an **art** than a **science** in 2000...



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CREDIT DECISIONS

Credit Analysts make subjective decisions based on;

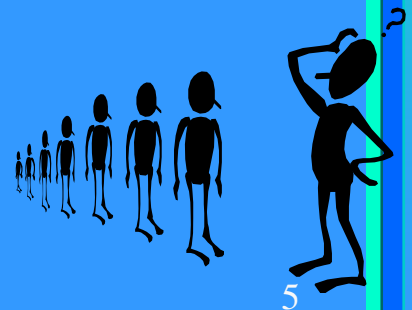
- old financial information, if available,
- a different set of facts and feelings in each case, and
- an intuitive weighting system based on personal experience.



HYPOTHESIS

It is possible to distill all of these factors into a manageable generic list of questions, which require factual answers, to weight these answers and thus to produce consistent credit decisions.

Hence to **systematically mimic** the usual activity of an experienced credit analyst.



CATEGORIES

- ◆ **FINANCIAL INFORMATION**
- ◆ **MANAGEMENT ABILITY & INTEGRITY**
- ◆ **STRATEGIC ALIGNMENT**
- ◆ **COUNTRY RISK**



FINANCIAL INFORMATION - PART I

- ◆ eCredit.com CCEx Expert Comments Summary 'Score' (see 'CCEx Score' worksheet below).

CCEx EXPERT COMMENTS -- SYNTHETIC SUMMARY SCORE

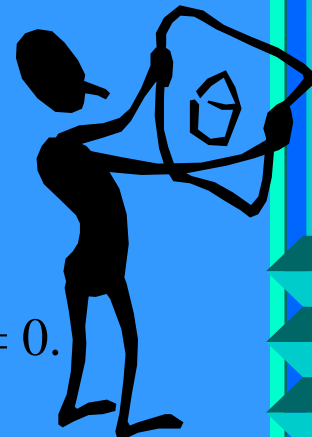
Summary: Customer's financial strength is judged to be



- ◆ ... excellent = 100.
- ◆ ... good = 80.
- ◆ ... above average = 60.
- ◆ ... average = 40.
- ◆ ... marginal = 20.
- ◆ ... poor = 0.

FINANCIAL INFORMATION - PART II

- "Clean" (Unqualified) Audit Report? Yes = 10. 'Qualified' or 'not audited' = 0.
- Financial Information age is
<6 months = 10; <1 year = 6; <18 months = 2; older = 0.
- Amount of 'Equity at Risk' is >twice proposed limit = 20;
equal to proposed limit = 10; >half proposed limit = 5; less = 0.
- Is 'defensive interval'
>32days = 20; >16days = 16; >8days = 10; >4days = 4; less = 0 ?
- Was operating cash flow minus dividends positive? Yes = 20. No = 0.
- Is 'accounts payable days' number equal to normal payment terms = 20; less than 150% of normal = 10; more = 0 ?



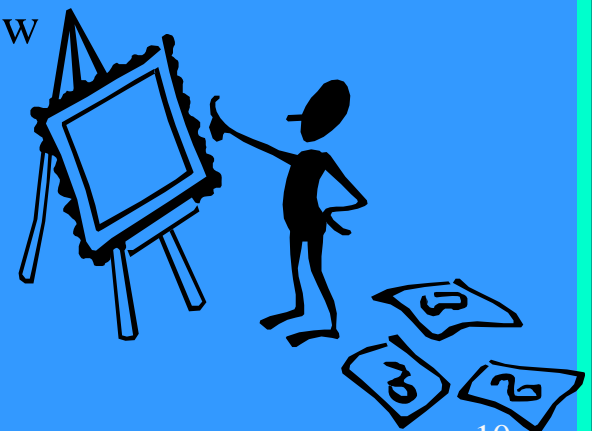
MANAGEMENT ABILITY & INTEGRITY

- Number of years the Target Company has been in relevant business?
>15years = 20; >7years = 10; less = 0.
- The CEO & CFO are both "Appointed on merit" = 20;
or if one is or both are "political appointee(s)" or
"family member(s)" = 0.
- No 'scandal' in past two years = 10
+ No 'dispute' with Authorities in last two years = 10.
- At least one Executive was a senior Government official
or Minister or is a "political appointee" = 10.
- There is evidence of an effective strategic response to market
and/or competitive forces in last three years = 30. No = 0.

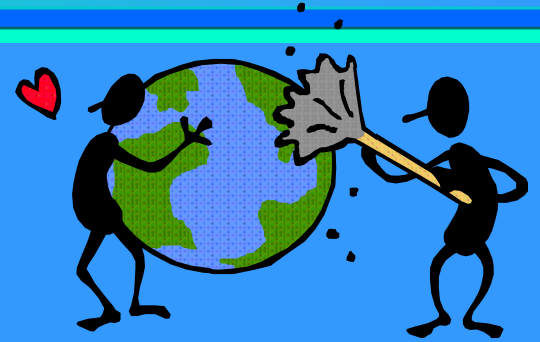


ALIGNMENT WITH OWN COMPANY'S STRATEGY

- Competitors are offering or providing unsecured credit to Customer?
Yes = 50. No = 0.
- Own company wants to increase its market share? Yes = 20. No = 0.
- Potential margin is High = 50; Medium = 20; Low = 5.
- Potential outlet for otherwise 'no-value-goods'
or for 'high-retention-cost-goods'? Yes = 40. No = 0.
- Transactions would support strategies of a fellow
Operating Unit? Yes = 20. No = 0.
- Transactions could lead to acquisition of
additional business? Yes = 20. No = 0.



COUNTRY RISK



- Headquartered in an OECD Member Country?
Yes = 100 (other questions in this section each = 0). No = 0 .

● OR

- Fitch IBCA, Duff & Phelps Country Rating is AAA/AA = 40;
A/BBB = 30; BB = 25; B = 20; CCC = 10; CC = 5; C/D = 0.

- Your politically sensitive or essential goods as % of domestic consumption are >75% =40; >50% = 30; >25% = 20; less = 0.

- Headquartered in a Country strategically important to your company.
Yes = 20. No = 5.

COMBINATION SCORE EXAGGERATOR

TOP
SECRET

- **Target Company Equity at Risk**
&
(Operating Cash Flow - Dividends)
&
Strategy
+
Own Profit Margin
+
Country Risk.



Apply simple algebraic
formula.

CREDIT LIMIT PARADIGM

- Limit not to exceed 10% of equity amount of own company, i.e. 10% of shareholders' own funds.
- Limit must not exceed the requested amount, bearing in mind the customer's normal purchasing pattern.
- Limit not to exceed customer's assessed ability to pay trade related obligations, in the normal course of business, within normal terms. Refer to 'CREDIT LIMIT MODEL' for an indication of this amount.....



TRADE CREDIT RATING & LIMIT MODEL

Credit Score		Trade Credit Rating	Limit Model (Equity*X)
0.50 - 0.74	⇒	AAA	25%
0.75 - 0.99	⇒	AA+	20%
1.00 - 1.24	⇒	AA	20% /Score
1.25 - 1.49	⇒	AA-	20% /Score
1.50 - 1.74	⇒	A+	16.7% /Score
1.75 - 1.99	⇒	A	16.7% /Score
2.00 - 2.24	⇒	A-	16.7% /Score
2.25 - 2.49	⇒	BBB+	12.5% /Score
2.50 - 2.74	⇒	BBB	12.5% /Score
2.75 - 2.99	⇒	BBB-	12.5% /Score

EXAMPLES

Customer	Score	Rating	Limit Model (\$Mio)	Limit Granted (\$Mio)	Defensive Interval (Days)
1	2.01	A-	90.11	-	0.73
2	22.44	X	-	-	0.92
3	1.84	A	160.68	50.0	10.46
4	1.06	AA	12,127.92	75.0	4.80
5	3.20	BB+	530.65	18.5	125.53
6	1.03	AA	352.98	60.0	1.64
7	1.08	AA	279.37	18.0	1.52
8	1.94	A	30.10	22.0	55.29
9	1.97	A	5.15	6.0	0.65
10	1.02	AA	2,036.38	75.0	35.41

BEFORE & AFTER

- Individual decisions made by each analyst.
 - Inconsistent decisions and inconsistent review of information available.
 - Difficult to adjust risk appetite.
 - No basis on which to analyse portfolio risk.
- The system drives decisions. Analysts feed the system.
 - Consistent decisions based on a mandatory list of factors.
 - Risk appetite adjusted centrally by amending weighting or limit model.
 - Portfolio risk apparent.

WEB SITES

■ OECD Member Countries

<http://www.oecd.org/about/general/member-countries>

■ Fitch IBCA Duff & Phelps

<http://www.fitchibca.com/>

■ International Credit Management Resources

BarrettWells Credit Research

<http://www.BarrettWells.co.uk/>

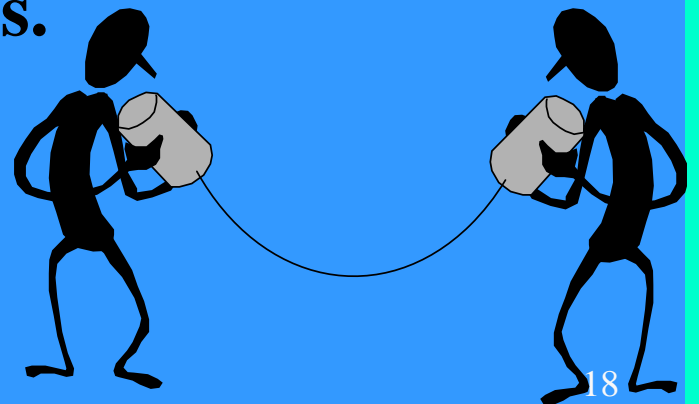


MY EMAIL ADDRESS



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**I look forward to hearing about
your Trade Credit ScoreCard ideas
and experiences.**



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