BUREAU VAN DIJK
A Moody's Analytics Company

Managing the tension between business growth and credit risk

Organizations that create a holistic, harmonized approach to credit risk are best placed to address the tension between business growth and risk management. Information about private companies and corporate structures is key to meeting this challenge.

Welcome to the business of certainty

Contents

About Bureau van Dijk

At Bureau van Dijk we're in the business of certainty. Leaders in informing business decisions, we are committed to capturing and treating the right data to deliver the richest, most reliable private company information on the market.

Our solutions help you to achieve greater efficiency and business growth. We provide you with access to precise, standardized information on private companies and corporate structures. We give you more than mere "data". We offer you a greater level of certainty.

Introduction

Companies are under pressure to grow – at the same time they are expected to manage financial risk and the developing challenges of not doing business with "dubious organizations".

And when that growth often needs to come from new and developing markets, where there is often less information available, you can easily see how there is a very present tension between growth and risk in many companies. Relatively slow growth in developed markets is pushing companies to consider the higher economic growth found within riskier emerging markets. How do you respond to both requirements at the same time?

Many business leaders are recognizing the need for a more holistic approach to credit risk management and sales – and they are taking action.

We will explore how some professionals in the credit industry have tackled credit risk management using a combination of reorganization, education, technology, sharing of resources and rigorous use of information. With increased transparency and informed decision-making, companies can relieve some of the tension between growth and risk.

Creating a holistic internal approach to credit risk

The role of the credit manager has become more demanding in response to increasing expectations of transparency and risk oversight. This role is integral in the goals of the business. Credit managers are expected to argue, challenge and influence decisions. They operate against a backdrop of continual global change in terms of technology, competitive pressure and regulation/reputation protection.

Managing risk at the organizational level

The importance of best practices, know your customer (KYC) and regulatory standards demand more attention on the boardroom agenda than ever before. To make matters more challenging, regulation and customer expectations have evolved considerably over the last decade as regulators in the United States, Europe and much of Asia have sought to improve standards of transparency.

For businesses to protect their reputation, there is a growing need to place risk management firmly at the centre of company plans rather than as an ancillary function. But this internal shift can be a huge undertaking.

To relieve the tension between business growth and credit risk reduction, a close working relationship between the credit risk teams and the rest of the business can be advantageous. According to Bert H McCuiston, international credit manager, Milliken & Company and board member at the International Credit and Trade Finance Association (ICTF), a more integrated approach to credit risk can benefit the organization as a whole: "The attitude starts at the top, that the company is one team with goals identified. The earlier the credit team is included and allowed to contribute, the better."

Consistency – or the lack of it – is a major challenge to effective credit risk management. For example, large organizations that have grown by acquisition over many years may find themselves without a common way of looking at risk.

"The attitude starts at the top, that the company is one team with goals identified. The earlier the credit team is included and allowed to contribute, the better."

Bert H McCuiston, international credit manager, Milliken & Company and board member at ICTF

This is a scenario that has been faced by many credit professionals, including Pia Porvari, head of customer operations, finance at Finland-based biofore (forest industry) company UPM. “Each business area within UPM had its own profit-loss strategy,” says Porvari. “I found myself not just dealing with one, but several approaches to credit risk.”

Porvari was able to resolve these issues successfully with standardization of customer onboarding, better information, systems integration and automation. But decision-makers should keep in mind that this kind of restructuring and reform works best when the people who work for the company understand and accept the new mindset, according to Mariusz Wolszczak, global credit and risk consultant, Dupont Poland, and member, ICTF:

> “Internally, the company needs to educate employees about higher standards of transparency, increase their awareness and keep processes clearly described, frequently reviewed and available.”
>
> Mariusz Wolszczak, global credit and risk consultant, Dupont Poland and member, ICTF

Case study: Empowering sales teams with shared technology and credit information

According to Pia Porvari at UPM in Finland, the key to resolving the credit risk-growth dilemma is to improve the quality of the information used to manage credit risk.

"There is a tension between credit risk and growth," says Porvari. "Without full transparency of the credit risk portfolio, you can't really manage it effectively. In the past, at UPM, the visibility of the full portfolio was only available once a month, at the end of the reporting period."

UPM completely changed the way it managed credit risk. Using an enterprise resource planning (ERP) system to integrate the important parts of its business, UPM built user portals designed for specific tasks, sitting above a common shared warehouse of data (see Figure 1).

Pia Porvari, UPM

Porvari has spent the last two decades in credit risk management. She is head of customer operations, finance for the UPM group, which trades in 120 countries, and chairperson of the European advisory council of the Finance, Credit and International Business Association (FCIB). She is also a member of the Business Credit Magazine editorial committee that is part of the US-headquartered National Association of Credit Management.

Existing customer collections

UPM began segmenting its customers between those that reliably paid on time, and those that did not. Using a tool called Credit Catalyst (see page 16) the company built scores based on the customer's payment history with UPM and on data such as company financials that were provided via Orbis – a database containing information on 300 million companies across all countries (see page 16). The score also includes UPM's estimate of the customer's ability to grow.

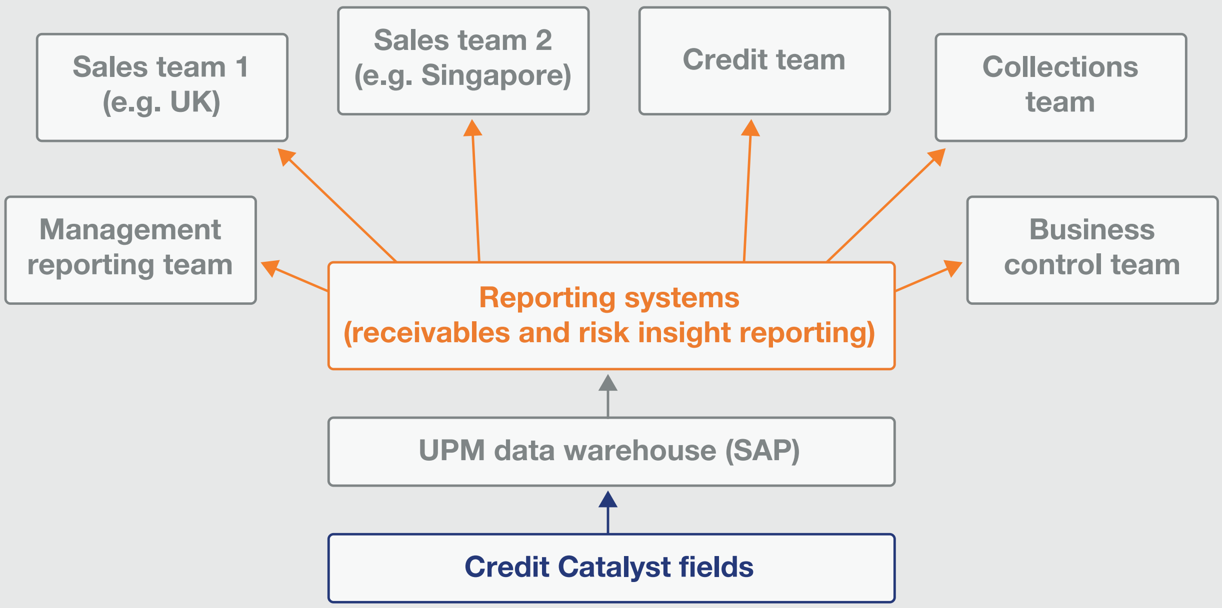
Details on each company were made available to sales teams, credit, customer collections and senior management through UPM's reporting tools. The analysis also included risk scoring, credit limits and the ability to see detail down to the invoice level.

"It does cause people to change behaviour," says Porvari. "The segmentation is run every quarter, so it's possible to track a deterioration in payment behaviour over time, or an improvement! That helps to motivate our sales team to manage the customer better."

"The segmentation is run every quarter, so it's possible to track a deterioration in payment behaviour over time, or an improvement! That helps to motivate our sales team to manage the customer better."

Pia Porvari, head of customer operations, finance, UPM

Figure 1: The UPM infrastructure



New customers

UPM is going through a transformation of its business model, business portfolio and business performance across its six separate business areas. Five of these business areas operate in healthily growing markets. Each business area is responsible for executing its own strategy and achieving targets, with group direction and support.

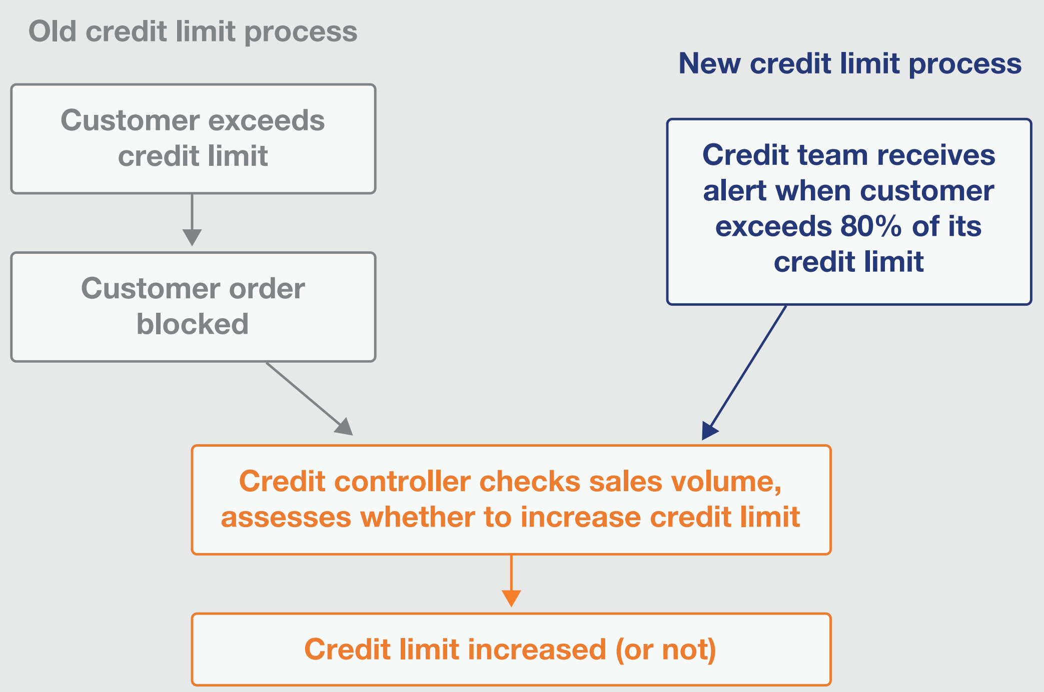
Porvari emphasises the importance of technology in helping the sales team prioritize their time. For example, the creation of two lead prospect portfolios – one listing attractive companies, the other listing companies that should be avoided. The idea is to make it available on the company's shared ERP system, so that important decisions about which counterparties to contact can be based on data, rather than the individual preferences of sales employees.

"When a salesperson looks at new customers, I want the customers organized consistently: Here is a goer, here is a no-goer. This is good. Leave it alone," says Porvari.

Technology and automation

To manage credit risk more effectively, Porvari also introduced a new, more proactive approach to credit limit increases (see figure 2). Previously, the company would simply block orders if a customer exceeded its credit limit. A credit controller would then check the details and usually increase the limit to release the order. But the impact on the business is reduced with automated accept/reject prompts. If a customer's balance exceeds 80% of their credit limit, UPM's credit controller checks whether their increased use of credit correlates with an increase in sales volume. If yes, then the credit controller carries out a risk assessment to decide whether the credit limit can be increased or not. "It saves a lot of time," says Porvari. Previously, no action would have been taken until the balance reached 100%, at which point the customer orders would be blocked. The new process means that credit risk processes are not hampering business growth unnecessarily.

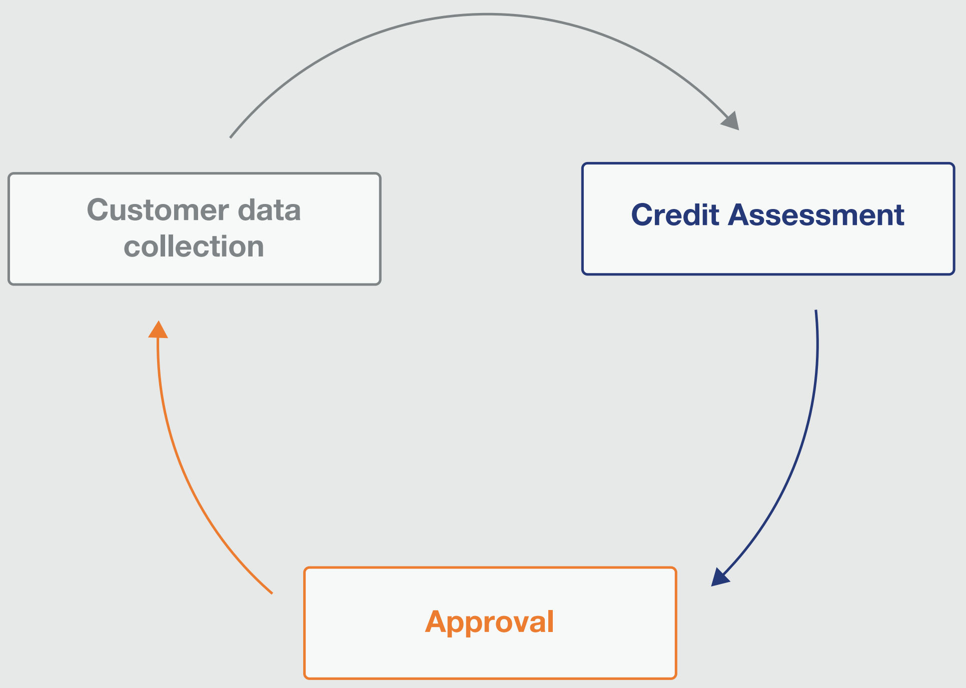
Figure 2: UPM's new approach to credit limits



In addition to automating credit limits, Credit Catalyst can also automate processes related to:

- **Customer data collection**. You can upload financial and other information to a secure portal, which feeds into Credit Catalyst and any risk models uploaded there. This cuts down on manual processing effort, saves time, and allows all companies to be assessed the same way as any other.
- **Credit assessment**. You can build internal scorecard models in Credit Catalyst so all companies are scored automatically. This eliminates the need to type information into the models manually to produce a credit score or limit.
- **Approval**. You can build approval workflows based on the companies' risk, credit limit, country and business unit. The approval will be sent to the relevant manager. Pending approvals can also be tracked. This makes a complex approval process much easier to manage.

Figure 3: The continuous loop of automating credit approvals using Credit Catalyst



Assessing potential counterparties; the information challenge

What data is available? Where are the gaps?

Finding detailed, accurate data on corporate financials, corporate structures, payment history and creditworthiness can be challenging. Even in developed markets such as the United States, the information published by private companies is limited, and making direct comparisons can be frustrated by differences in format and methodology.

Assessing a company's creditworthiness can be difficult, and can be affected by multiple factors. Understanding its corporate structure, including parent companies, subsidiaries, and even beneficial owner can be advantageous when it comes to knowing who you're doing business with and understanding group risk.

One of the most talked-about topics in the credit market today is how to enter new markets, especially Africa, Asia and Latin America. According to the International Monetary Fund in its October update, the collective GDP of emerging markets is expected to grow by 4.7% in 2018, well above the 2.4% anticipated in more developed economies[1].

Sourcing the information that credit managers in developed markets are accustomed to can be difficult. The challenges include:

- a lack of available data
- knowing where to source data from
- awareness of international and unilateral sanctions

In addition, there is no common international standard for company information. For example, in markets such as the UK and the Netherlands, detailed financials are often publicly available. But in other parts of the world, the culture around disclosure is often very different. Some countries have adopted International Financial Reporting Standards, which were developed by the IFRS Foundation as a set of generally accepted accounting principles (GAAP). These have been mandated in the US by the Securities and Exchange Commission, which regulates financial markets in the US.

Some countries require less disclosure than others, depending on national rules. In some countries, the information that is published may not list all line items in the same order, or may not include some details. This makes it impossible to compare companies consistently without some level of standardization.

Standardized financials

Orbis is the world's most powerful comparable data resource on private companies. It includes extensive information on corporate ownership structures and beneficial ownership and up to 10 years of standardized financials.

The standard format is designed to make it easier to compare companies across all countries. This would otherwise be difficult, because of regional variations in filing regulations and accountancy practices. In Orbis, detailed financial reports are available for around 30 million of the 300 million companies. The financial reports are detailed and comparable, and comprise:

- 26 balance sheet items
- 26 P&L account items
- 33 ratios

With standardized formats, users can compare and analyze companies in all countries using the same criteria, such as actual financials. Orbis users can also use a single set of activity codes when they search globally, because it is mapped against international and local industry codes.

Projected financials are also available on certain companies, based on models that assess a company, its region and industry.

[1]Source: IMF, World Economic Outlook October 2018

Quantitative scores

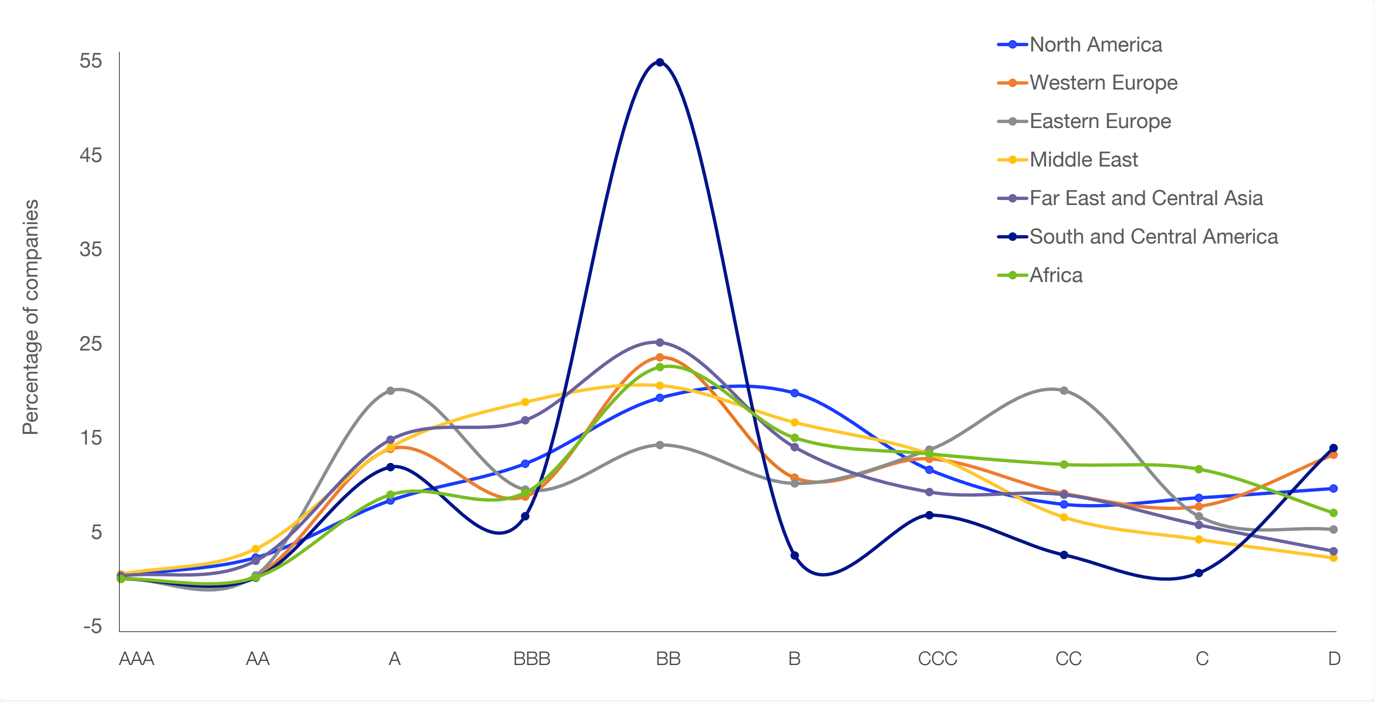
Detailed financials are available for around 30 million companies in Orbis. Where detailed financials on a company or selection of companies are available, quantitative scores can be used to assess their creditworthiness. One example of a quantitative score is ModeFinance's average MORE credit risk score.

Figure 4 shows the percentage of companies in each region rated AAA to D under the MORE credit risk scoring. This provides an overview of risk in each geographic region.

Country risk indicators are available in Orbis.

> "There are huge opportunities in the emerging markets. The main challenge is to support business growth in high-risk countries like some parts of Africa and some Latin American countries."
>
> Mariusz Wolszczak, global credit and risk consultant, Dupont Poland and member, ICTF

Figure 4: Credit risk by region (quantitative)



"Beside the country risk, the credit function should also focus on market sector related risk and try to anticipate upcoming challenges," adds Wolszczak at Dupont Poland.

Qualitative scores

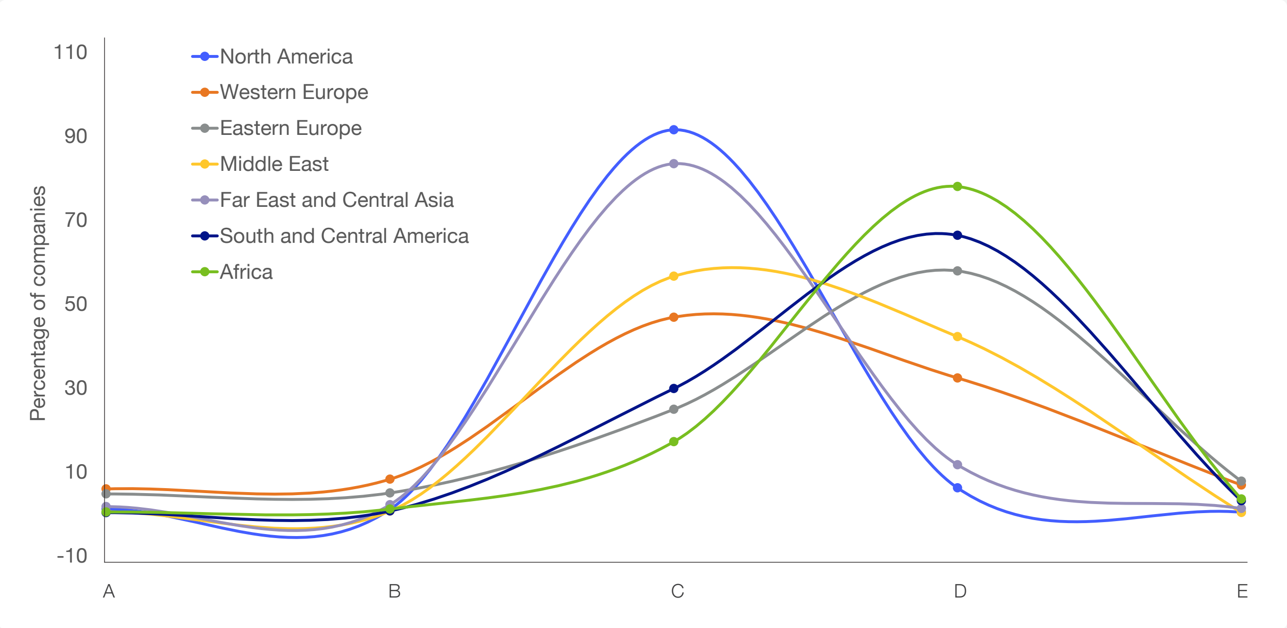
When you don't have financials, qualitative credit risk scores and limits can help in assessing a company's financial strength. Qualitative scoring considers factors such as:

- a company's management and number of directors
- number of employees
- structure, including shareholding companies, subsidiaries and legal form
- its "experience", for example year established

Figure 5, below, shows the percentage of companies in each region scored A to E by a qualitative score. The three regions with the highest proportion of high-risk companies are Africa, South and Central America and Eastern Europe. Conversely, North America, the Far East and Central Asia had the lowest proportion of high-risk companies.

The advantage of qualitative scores is that they can be used to assess a larger range of companies than with quantitative scores. This is because the detailed financials required for quantitative scoring are not always available, particularly within emerging markets.

Figure 5: Credit risk by region (qualitative)



In Orbis, out of a total coverage of 300 million companies, over 280 million companies include a qualitative risk score and over 285 million companies have a credit limit. Full documentation, access to formulae and underlying ratios are also included. Detailed financials are available for around 30 million companies.

Orbis users can also use the financial data on Orbis to create their own credit assessments customized to their risk appetite or internal method. In Credit Catalyst, users can create their own scorecard that automatically rates any company that they view. The scoring module is flexible and users can adjust the weight given to various elements and set conditional parameters. They can also combine data from Credit Catalyst with their own data points such as payment history, and set recommended credit limits.

Corporate ownership structures

Access to information on corporate ownership structures means you can assess the corporate group – or take the financial stability of the parent into account. This is important if financials don't exist for your subject company.

Rigorous data is vital here because the names of subsidiaries are not always recognizably linked to the parent company name and therefore you might not realize that a counterparty is a subsidiary of another organization (see Table 1).

"Being too conservative about which counterparties to trust will hamper your growth. Looking into corporate structures can help you to make the most of the available opportunities, whether that's extending existing relationships or building new ones," said Ryan Macromalli, director risk solutions, Bureau van Dijk

For example, even if you can't access financials on the subsidiary, you might be able to see financials on the parent company.

Table 1: Parent and subsidiary names

Corporate group	Example subsidiaries	Subsidiaries	Companies in corporate group
Royal Dutch Shell	Nova Scotia Company, Burtagaz, Cansolv Technologies Beijing	1,253	1,297
Volkswagen	Porsche Automobil Holding, Bentley Motor Cars, Scania GB	914	1,349
Total S.A.	Chartering & Shipping Services S.A., Elf Petroleum Iran, Hutchinson Corporation	1,024	1,326
BP (formerly British Petroleum)	Cape Vincent Wind Power, Grampian Aviation Fuelling Services, Ropemaker Deansgate	962	1,573
China Petroleum and Chemical Corporation	Harbin Electric Corporation, Shanghai Municipal People's Government, Zhoushan Ocean Fishery	180	17,060
Walmart	Azure Holdings, Benchmark Resources, Blueleaf Corporation	127	659

Source: Orbis, 15 October 2018

Blending data

Blending your internal data with corporate ownership data can help you to see your aggregate exposure to corporate groups and reveal concentrated risk. In Table 2, 'ledger accounts' are subsidiaries or trading entities which Bureau van Dijk can associate with the global ultimate owner (GUO).

By associating all ledger accounts correctly we can see that 19% of risk exposure is with just five global ultimate owners.

The credit limit for Anonymous Corp is lower than the total exposure to all of its ledger accounts. This could indicate a need to reduce exposure to this group.

The other four corporate groups, particularly The Blank Group which is only using 8% of its group credit limit, are not close to using their full group credit limits. This could indicate an opportunity to increase credit and revenue.

Table 2: Exposure to corporate groups

GUO – name	Ledger accounts	GUO exposure ($000)	GUO Credit Limit ($000)
General Company	80	45,000	100,000
Anonymous Corp	61	40,000	30,000
International Business S.A.	19	8,000	20,000
John Doe Holdings PLC	62	6,000	15,000
The Blank Group	120	4,000	50,000
Total incl other groups	5,000	550,000	

Setting up alerts and actions

Creating your own alerts to monitor your portfolio is a good idea. You can tailor alerts to look for important changes and include them in your dashboard or have them trigger independent emails. For example, you might want a change in a company's credit score to trigger an email to the relevant credit manager.

Within Credit Catalyst you can dictate what triggers alerts and actions, how frequently they're sent, and who gets them, so the appropriate analysts and line managers are notified.

"Being too conservative about which counterparties to trust will hamper your growth. Looking into corporate structures can help you to make the most of the available opportunities, whether that's extending existing relationships or building new ones."

Ryan Macromalli, director risk solutions, Bureau van Dijk

Mitigating the risk of trading with sanctioned entities

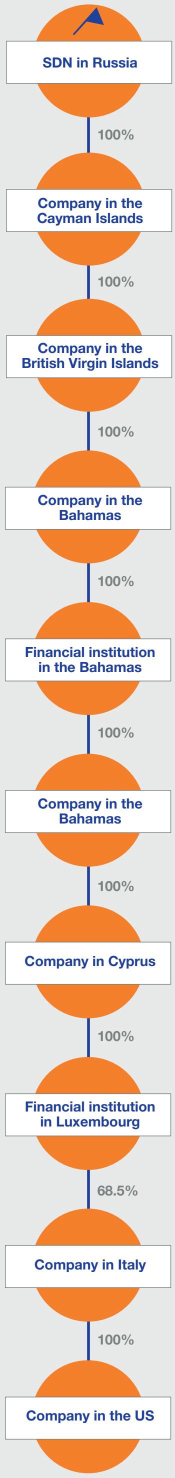
Access to information on corporate ownership structures can also help mitigate the risk of doing business with sanctioned companies or entities.

The Office of Foreign Assets Control (OFAC) administers US sanctions and its 50% rule means you cannot trade with a sanctioned entity, or an entity that is "sanctioned by extension". A company or entity is sanctioned by extension if it is owned, or part owned, by a sanctioned company or individual through a chain of ownership of 50% or more[2].

Figure 6 is a real example, using ownership data from Orbis, showing how a US registered company is connected to a sanctioned individual in Russia. All companies within this chain are sanctioned by extension.

In April 2018, OFAC added 12 Russian nationals to its Specially Designated Nationals (SDN) sanctions list for allegedly interfering with the 2016 US election. Orbis identified 1,300 companies that became sanctioned by extension through their ownership chains to the 12 Russian nationals, and 90% were registered outside of the US[3]. These companies do not appear on any sanctions lists but you could still be fined for trading with them.

Figure 6: Sanctioned by extension



Source: Orbis

[2]Source; Department of the Treasury (US), August 2014
[3]Source: Department of the Treasury (US), April 2018

Measuring risk with payment data

Payment data is often used as a risk-measuring metric where private companies are only required to file scant information, for example in the US. The significance of payment data on US companies is global given how central US companies are in the global economic system.

For example, the Cortera payment rating and the Cortera score, both available in Orbis, provide payment data on four million US business families and $1 trillion in purchase behaviour.

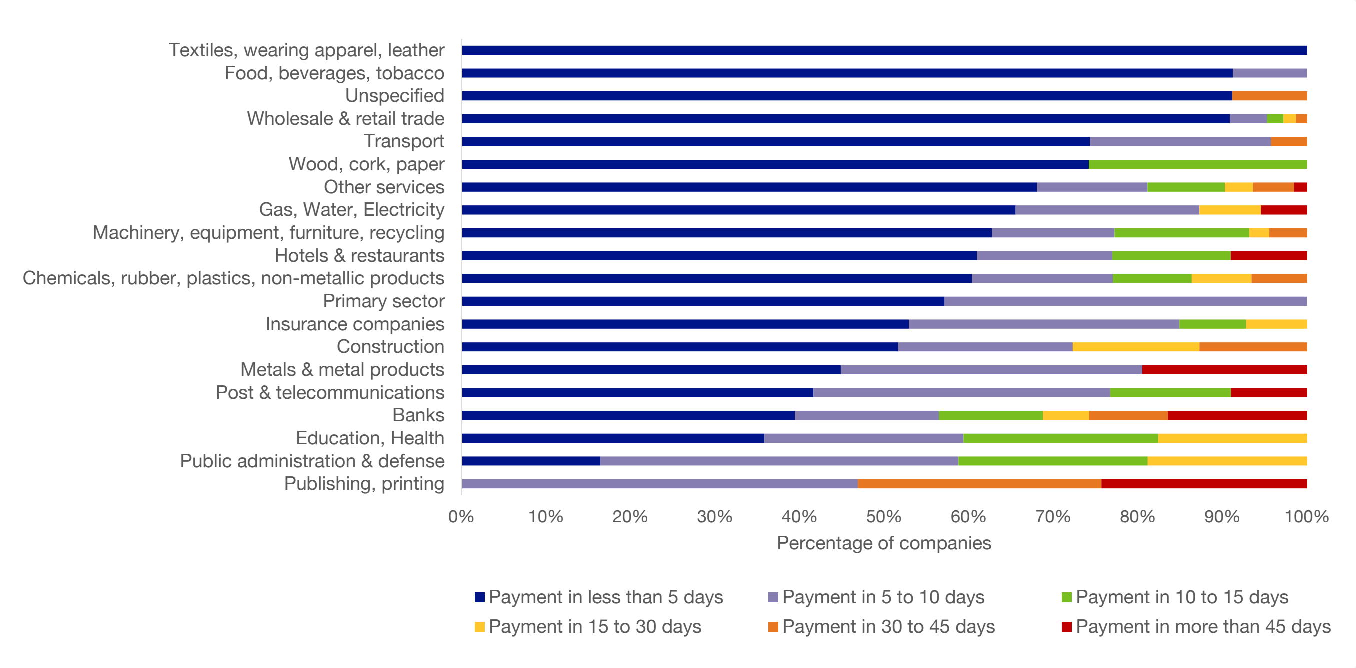
The Cortera payment rating:

- describes a company's payment behaviour over the past 3-6 months
- is predictive in the sense that companies often continue to pay in a similar manner unless conditions change
- is scaled from 100 (slow payer) to 900 (fast payer)

The Cortera score

- is a measure of the overall credit worthiness of a business
- is predictive of a company's likelihood to have severe payment delinquency over the next 6 months
- shows 60 and/or 90 days past due balances
- shows customers in default
- considers purchase history and trends, payment history and trends, public records, industry benchmarks, level of credit extended, demographics and more

Figure 6: Payment rating by industry



Information turns credit risk into an enabler of sales

Organizations that can master both internal structural factors and external data gathering challenges will be able to extend more credit than those that do not. This provides an opportunity to maximize performance while minimizing the risk to their business.

A holistic view of credit risk based on a consistent methodology and assessment of the best available information is good for revenue, sales targets and growth. Information is also good for the relationship between the business development and risk functions because it turns credit risk into an enabler of sales rather than an impediment.

Although the higher transparency demanded by modern regulation and customer expectations pose a challenge, companies today have access to more information and better technologies than ever before to manage their risk. As economies become increasingly globalized, the pressure on companies to find the optimal balance between growth and credit risk will only increase.

Legacy technologies and fragmented business practices will continue to test some of the world's largest and most successful companies. But their ability to use information to make the best and most informed decisions possible is likely to increase. As more data sources emerge, and more countries adopt techniques such as e-invoicing, which contribute to more accurate and complete data, companies should stay smart, harness the benefits and remain alert to risks and opportunities.

Although the higher transparency demanded by modern regulation and customer expectations pose a challenge, companies today have access to more information and better technologies than ever before to manage their risk.

Products you might be interested in

orbis

Orbis is the world's most powerful, comparable data resource on private companies. Use Orbis to research around 300 million companies across all countries.

Orbis includes:

- information on what companies do, their business activities, detailed company overviews and industry codes
- up to 10 years' standardized financial information so it's easy to compare companies in different countries[4]
- risk scores for 280 million companies and credit limits for 285 million companies
- projected financials based on models that assess a company, its region and industry
- extensive corporate structures so you can assess the complete group or take the financial stability of the parent into account
- legal information including unique identifiers, dates of incorporation, legal status and legal events
- news and adverse news filter
- reputational risk metrics and ratings
- politically exposed persons and sanctions
- M&A deals and rumours
- full documentation, access to formulae and underlying ratios

You can use the Orbis add-in to populate templates in Excel and PowerPoint with data from Orbis, including data points, formulae, graphs and text fields. You can view data instantly using your scoring methods, analysis or presentation methods. And you can search for companies within Excel. Your templates are automatically updated whenever Orbis is updated.

credit catalyst

Credit Catalyst, powered by Orbis, is a dynamic platform where your own knowledge of your counterparties is combined with our extensive company and risk intelligence.

It's a powerful tool that helps you assess financial risk and corporate stability more effectively, within one platform. It offers standardized reports to benchmark and compare companies.

Credit Catalyst also helps you to create:

- risk templates
- custom credit reports
- your own credit risk environment
- alerts for changes in your portfolio

[4]Orbis has reports of varying detail. Detailed financial information is available for 30 million of the 300 million companies included.

Contact information

Argentina
tel: 54 (11) 5246 5072
buenosaires@bvdinfo.com

Australia
tel: 61 2 9270 1499
sydney@bvdinfo.com

Austria
tel: 43 (1) 606 11 96 0
vienna@bvdinfo.com

Belgium
tel: 32 2 639 06 06
brussels@bvdinfo.com

Brazil
tel: 55 11 2348 5176
saopaulo@bvdinfo.com

China
tel: 86 10 8515 2255
beijing@bvdinfo.com

tel: 86 21 6101 0151
shanghai@bvdinfo.com

Denmark
tel: 45 33 4545 20
copenhagen@bvdinfo.com

France
tel: 33 1 53 45 46 00
paris@bvdinfo.com

Germany
tel: 49 (69) 963 665 0
frankfurt@bvdinfo.com

Hong Kong
tel. 852 2154 3822
hongkong@bvdinfo.com

Italy
tel: 39 02 43 98 22 77
milan@bvdinfo.com

tel: 39 06 840 4611
rome@bvdinfo.com

Japan
tel: 813 5775 3900
tokyo@bvdinfo.com

Mexico
tel: 5255 3683 8080
mexico@bvdinfo.com

Netherlands
tel: 31 (0) 20 5400 100
amsterdam@bvdinfo.com

Portugal
tel: 351 211 528 700
lisbon@bvdinfo.com

Russian Federation
tel: 7 495 228 61 51
moscow@bvdinfo.com

Singapore
tel: 65 6496 9000
singapore@bvdinfo.com

Slovakia
tel: 421 2 321 19 011
bratislava@bvdinfo.com

South Africa
tel: 27 (0) 11 881 5993
johannesburg@bvdinfo.com

South Korea
tel: 82 2 6138 3753
seoul@bvdinfo.com

Spain
tel: 34 91 310 38 04
madrid@bvdinfo.com

Sweden
tel: 46 8 51 51 04 80
stockholm@bvdinfo.com

Switzerland
tel: 41 22 707 83 00
geneva@bvdinfo.com

tel: 41 44 269 85 00
zurich@bvdinfo.com

United Arab Emirates
tel: 971 4 4391703
dubai@bvdinfo.com

United Kingdom
tel: 44 (0)20 7549 5000
london@bvdinfo.com

tel: 44 (0)161 829 0760
manchester@bvdinfo.com

United States
tel: 1 (312) 235 2515
chicago@bvdinfo.com

tel: 1 (212) 797 3550
newyork@bvdinfo.com

tel: 1 (415) 773 1107
sanfrancisco@bvdinfo.com

tel: 1 (202) 905 2079
washingtondc@bvdinfo.com

BUREAU VAN DIJK
A Moody's Analytics Company

bvd@bvdinfo.com
bvdinfo.com

LON-WP-10.18