Managing the risk of bad debt.

How trade credit insurance can protect your receivables. And even grow your business.

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**Any sale carries risk.**

With every sale, there’s a chance the buyer won’t pay. That can be damaging — even catastrophic — to the seller. “One or two bad debts can wipe out our profits for the whole year,” said one chief executive officer we interviewed. Unfortunately, if a business operating on a low profit margin (e.g. 5%) doesn’t get paid a few times, they likely won’t be in business for long.

Unpaid invoices of accounts receivables can represent up to 40% or more of a company’s balance sheet assets.

**1 in 10 invoices become delinquent**

**Number of North American company bankruptcies:**

Nearly 30,000

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**Consequence** — When companies have been burned with bad debt, they can become Conservative, severely limiting their growth potential, especially internationally.

**Solution** — Trade credit insurance is one under-utilized tool that can help protect accounts receivables against bad debt loss due to insolvency or slow-paying customers. It also enables companies to confidently expand into new markets and offer customers more flexible credit terms.
How do companies manage the risk of bad debt?
As much as companies try to avoid them, bad debts still occur.

Self-insurance
Companies earmark cash for bad debt reserves. However, self-insurance fails to protect against very large, unexpected losses and can negatively impact cash flow and the balance sheet. Tying up capital with self-insurance can hamper a company’s ability to invest in growth opportunities, especially internationally. Plus, these companies must also take on the total responsibility for evaluating the credit-worthiness of customers.

Factoring
Some companies “sell” receivables to a third party. This has two major drawbacks:
• There is a significant cost.
• When collection of debt is turned over to an aggressive third party, companies risk alienating customers.

Letters of credit* and payment in advance
Normally only applies to international sales. And they...
• can limit the amount buyers can or will buy.
• are expensive (it can cost customers 3% per transaction).
• generally have to be set up on a transactional basis.

Trade credit insurance
Usually more modestly priced than other methods. Advantages are:
• Ensures you get paid for what you sell.
• Lets you confidently pursue international expansion.
• Enables you to accept orders from new customers.

* A letter of credit (LC) is a document from a bank guaranteeing that a seller will receive payment in full as long as certain delivery conditions have been met. In the event that the buyer is unable to make payment on the purchase, the bank will cover the outstanding amount. The use of letters of credit was historically a very important aspect of international trade, but today they are considered cumbersome and expensive.
Strategic reasons companies use trade credit insurance.

**Growth**
Global expansion can be lucrative for some companies. But global trade can also come with a greater risk of bad debt. Many companies require a wire transfer up front or a letter of credit. With trade credit insurance, companies can avoid these restrictive policies, and grow with confidence.

**Organizational alignment**
Trade credit insurance can bridge the traditional gap between the sales and credit departments. Companies can streamline the accounts receivables and collections departments, leaving most of the credit monitoring and credit evaluation to their insurance partner. All of which provides a more stable, confident environment for sales and marketing to penetrate new markets.

**Financial stability**
Receivables can represent up to 40% or more of a company’s balance sheet assets. Not only does that have a major impact on cash flow, it affects how investors and banks view that company’s financial viability. Banks will loan 80% more on insured receivables and can lend an advance against the receivables.

How trade credit insurance helped one business boost sales.
A company wanted to sell $4 million in product to a Russian customer that wouldn’t share all its financials.

Working with a trade credit insurer, the seller was able to offer $1 million initially, save the account and expand later.

If a business operates on a low margin (say 5%), and is unable to collect a $100,000 debt, it has to generate $2 million in new top-line sales just to break even.

$100K in bad debt

$2M in new sales
### Tactical reasons companies use trade credit insurance.

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<th>Customer bankruptcy</th>
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<td>If your customer goes bankrupt, full collection on an invoice is virtually impossible. Banks often urge their clients to purchase trade credit insurance, so they can feel more comfortable lending with accounts receivables as collateral.</td>
<td>International trade issues can prevent or seriously delay payments. These include: communication and culture issues; unforeseen cancellation of permits, and other disruptive global or political events like government intervention, currency inconvertibility or even expropriation.</td>
<td>When a business opportunity presents itself, a trade credit partner can help quickly and thoroughly analyze the viability and financial stability of a potential customer. They can provide access to extensive information databases to assess customer solvency, payment profile, trading history and risk.</td>
<td>Trade credit insurance lets you match a competitor’s credit limit and pay terms. If your competitor offers a $250,000 line of credit with 90-day terms, and you can only offer $100,000 with 15-day terms, who gets the business?</td>
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> “Having trade credit insurance allows me to sleep better at night, and that’s worth a lot.”

— Business Owner, Manufacturing
Insurance that may just pay for itself.

Though it may sound too good to be true, trade credit insurance can provide substantial benefits and essentially pay for itself.

Lower interest rate from banks — Companies that insure their receivables often receive lower bank interest rates. Lower rates mean lower interest costs.

Credit and collections cost — Credit monitoring services — that come with trade credit insurance — can save on credit and collections costs.

Better margins, more aggressive growth goals — Credit insurance enables confident business expansion, and more aggressive sales goals.

A small company has $10 million in annual sales and receivables of $1,000,000. It purchases trade credit insurance that costs $15,000 (0.15% of sales).

The savings and costs

- $14,000
- $3,000
- $4,000
+ $100,000
- $15,000

Credit research cost
(40% of one person’s job)

Eliminate bad debt reserve
(1% of sales at a 3% cost of capital)

Lower interest cost
(Bank lowers interest rate 0.2% on a $2-million credit line)

Company expands business
10% at a 10% margin

Cost of trade credit insurance

The results: $106,000 net gain from having trade credit insurance
3 principals of buying trade credit insurance

1. Supply chain expertise — Purchase from a company that understands supply chains and their inherent risks. Any deviation from an order being delivered on time, complete and damage-free, may cause a customer dispute and result in an invoice being uncollectable.

2. A true partner — Buy from a company willing to take the time to learn your business and suggest a strategic, customized policy. Select one who makes the claim collections process simple and easy.

3. Quick response customer evaluation — Choose a provider that can respond quickly with account research and strategic risk-mitigation guidance, especially when you’re trying to close a sale against aggressive competition.

Many bad debts have their roots in supply chain risk. A credit partner should be able to monitor changes in corporate solvency on a daily basis. The databases of the largest credit insurers include 40 million global companies.
Turn the worry of bad debt into a good night’s sleep.

With every sale, there’s always a chance your buyer might not pay. Don’t let that stop you from growing, especially internationally.

Our licensed trade credit insurance experts can help you put together the right plan to protect your domestic and international accounts receivables against unexpected bad-debt loss. So you can confidently expand into new markets and offer customers more flexible credit terms.

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All data represented within this document, unless otherwise noted, is derived from Protect against bad debt risk — what companies need to know about trade credit risk and insurance. The entire white paper may be found at https://upscapital.com/

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