

JULY 2020

# BCMA E~CREDIT NEWS

**BCMA - It is All About You!**

July 2020

## 1. What to Watch for When Your Customer Is in a Dying Industry

This month's topics...

- 1) [What to Watch for When Your Customer Is in a Dying Industry](#)
- 2) [Q&A from Credit Today's Third Online Discussion Panel](#)
- 3) [Working With Sales Makes Credit Work](#)



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**An article in CFO Magazine focused on the risks of being in a dying industry. If you have customers in, or selling into, a dying industry, it goes without saying that you need to watch their actions -- and finances -- carefully.**

When a company is in that position, there are many factors that often cause management to resist making the changes necessary to transition the company from selling buggy whips to selling automobile accessories. Some things to watch for include:

- Are they simply "milking" their current business model without planning changes to keep up with the times? This may help them look good on a short-term basis, but may indicate that they haven't got a plan in place to properly get with the times- as things change.
- Are they planning new technologies that will help them make the transition to the needs of the new marketplace? Keep in mind that while this may hurt their financial performance on a short-term basis, it is probably a positive on a long-term basis.
- What percentage of revenues are derived from the disappearing business sector? If it is a large percentage, watch out. You will want to see that the percentage of revenue from the dying sector is dropping in favor of other, more relevant, businesses.

One of the points made in CFO was that even "traditional" moves by management such as cutting costs and closing facilities may look good, but they are probably only short-term fixes if the basic business model is under fire. Those moves will buy the business time, but not fix it on a long-term basis. In addition, that is something that you need to pay attention to as a credit manager.

The classic example of a dying business has always been buggy whips. However, in a capitalist economy there is constantly "creative destruction" underway.

Here's a special report by 24/7 WallSt entitled "[America's 25 Dying Industries](#)." Some on this list we agree with (bookstores, newspapers, photographic film). Others, such as hydro power, not at all. Still, it is an instructive list, and a concept that an astute credit analyst keeps in the back of her mind.

## BCMA MEMBERS

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### GOT AN IDEA?

Would you like to contribute to the BCMA Newsletter? The most important part is your idea. We can handle the polishing. Just write to us at [BCMAEditor@CreditToday.net](mailto:BCMAEditor@CreditToday.net) with your idea!

## 2. Q&A from Credit Today's Third Online Discussion Panel

The following questions were submitted to our panelists, but could not be covered due to time constraints in our third Covid-19 webinar May 11, 2020.

**Question: Rocky Thomas:** Do you anticipate any additional legal restrictions in regards to collecting B2B receivables as a result of Covid 19?

**Richard Macias, Maynard Cooper & Gale:** *Other than the existing restrictions that accompany the automatic stay under the Bankruptcy Code when a business files under Chapter 7 or 11, I do not anticipate additional restrictions. I would anticipate, however, that the time from filing a collection case in court to trial and the general administration of civil litigation, will be substantially drawn out.*



**Q: Anonymous:** If you do business with very large companies and small companies and a small company asks for extended terms because they are struggling in the current environment, would granting those terms be violating the Robinson-Patman Act?



**Pete Knox, Nestlé:** Typically, the small customers are not in the same category as the very large customers, so it should not be an issue. However, we try to remain consistent in the extended terms offered, so as not to get into a Robinson Patman situation.

**RM:** As a basic matter, we have to look at the two companies, not as big versus small but as to whether they are competitors for the sales of the same products in the same market. The analysis would not necessarily end there. In the normal course of things, we would expect the bigger company to get more favorable terms than would be justified by differences in total sales volume. Here we are more likely looking at how we can foster competition by keeping the smaller company going with extended terms. These situations have no case precedent to date, but I believe the extended terms for the smaller company could be defended as a species of the "meeting competition" defense under Rob-Pat. This would mean keeping the change in place for a defined period of time to meet a clear sales need.

**Q: Bobbie Jo Arreola:** Where can I get information on the re-opening of states and sectors that Taylor has been discussing?

**Dave Schmidt:** Here is a good overview of the 50 states reopening plans:

<https://www.nga.org/coronavirus-reopening-plans/>

And for a variety of information related to Reopening and Recovery:

<https://www.nga.org/coronavirus/#reopen>



## 2. Q&A from Credit Today's Third Online Discussion Panel

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**Q: John LaRocca:** How does the panel recommend treating bad debt reserves when customers do not pay, ask for more time to pay, ask for reduction in the amount due?



**Taylor Ricketts, F&D Reports:** *No pay receivable bad-debt reserves are fairly standard. The issue at hand is that the quantity of no pay has shot through the roof and that is compounded by what you also reference (customers asking for more time / payment plans) and reduction in amount due... all of which are risk signs, and likely warrant some form of bad debt reserve. The best practice we are hearing is to keep prior reserves somewhat in place and add incremental reserves to the books. So as an example, you may add specific reserves for no-pay receivables and add some type of hybrid reserve or non-specific reserve for payment plan accounts. Or you may stratify the portfolio by risk type and employ multiple hybrids where 75% reserved for no-pay accounts (as hypothetical example), 50% for payment plans, etc.*

**PK:** Depending on the size of the customer balance, we may add to our bad debt reserve when a customer does not pay us. We will not reduce the amount due if a customer will be staying in business, but instead, will work out a payment plan. This will not affect our bad debt reserves.

**Q: John LaRocca:** When communicating back to customers, what guidance to your business (sales team) or impact do you see as to when revenue should be recognized when processing future orders for these same customers? For example, if one is extended payment terms, or reducing/forgiving any existing accounts receivable as may be requested by one's customer, does that cause a change of recognizing revenue from time of shipment to time of payment? (As when postponing revenue recognition one is usually postponing payment of sales commission.)

**TR:** It is probably easiest to bifurcate this issue. The first is revenue recognition related. IFRS/GAAP outline when to recognize revenue. Generally, revenue should be recognized when your performance obligation is satisfied. Yes, collectability of payment is a consideration for revenue recognition purposes, but I believe that what you are referencing is more bad debt-related (after revenue has already been recognized). The second issue is how this interplays with sales commissions. Some best practices we have seen in the past involve sales commissions based on cash flow from the collection of the sale vs. the sale itself. This can be especially important if you are relying on sales people to help collect the receivables or if your Company has concerns about sales personnel conducting shady sales, or just want to align all parties to cash flow right now considering the elevated risk in this environment.

**PK:** We recognize revenue when the product is received by the customer, regardless of the payment terms.

**Q: Lloyd Sarakin:** What is the impact on the ordinary course defense to preferences when you change terms? What can you do to avoid creating a preference when changing terms?

**RM:** Preference mitigation requires careful planning and requires a lot more information than we can look at in this format. For example, you might want to do an ordinary course analysis as part of the decision process. If the customer is on Net 20 terms but they are paying late at 40-45 days, allowing them Net 40 for payment may not create a preference at all since that would be consistent with the prior ordinary course of payment. You would need to be strict in keeping them to the new terms. There are two scenarios that will come up: (a) changing terms for future sales and (b) extending payment dates on existing invoices. Both will have an impact on how you assert an ordinary course defense in a preference action. Some changes are not preferential by their nature. For future sales, you could go to cash in advance or COD, neither of which would be preferential. Remember also,

## 2. Q&A from Credit Today's Third Online Discussion Panel

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the reach-back is only for the 90 days preceding the BK filing. So if you get paid today, 91 days later that payment is outside the preference window.

**Q:** Pete Knox mentioned talking with your credit peers...what are some of those best practices?

**PK:** When speaking with Credit peers, make sure you only discuss past actions, and not what you are planning to do in the future.

**TR:** Two key points here. One, it is ok to talk about concerns, what is going on, and what credit actions you have taken; however, you can't collude on forward looking credit actions. Two, a common pitfall I see new credit execs make is letting concern about coming across uninformed, or allowing only a limited relationship with a peer overshadow the need to ask questions and get information. In my opinion, the more contact, the better. I would estimate our analyst group is connecting directly with clients nearly 50 times a day right now to discuss credit issues. This is a very fluid time and the overall purpose is to keep the information flowing. Consistently we are seeing account issues pop up that require immediate action and we know nothing works better than direct contact.

## 3. Working With Sales Makes Credit Work

**Will the following suggestions eliminate the stress and discord between Sales and Credit? Absolutely not, but they will tend to reduce the problem. In addition, if you adopt all of these suggestions you are less likely to be criticized by senior management as working against the interests of the sales department in particular and, by implication, preventing the company from reaching its sales and profit targets. Suggestions for bringing Sales and Credit together:**

- Participating in training new sales personnel.
- Attending sales meetings and taking questions.
- Traveling to meet with customers.
- Providing detailed information to sales about risks, problems and concerns
- Making responses to inquiries from Sales a top priority.
- Listening with an open mind to input from Sales.
- Recognizing that Sales and Credit act as counter balances, and not being surprised when they challenge a negative credit decision.
- Trying to keep salespeople informed about problem accounts.
- Giving the sales department advanced notice of possible credit holds whenever possible.
- Asking the sales department to tell you what credit limits they need for their customers (with as much advanced notice to the credit department as possible).
- Making sure that releasing orders pending gets the credit department's top priority.
- Not delaying credit decisions on new accounts unnecessarily while waiting for complete or "perfect" information.

**One final thought:** Credit and Sales will disagree from time to time, and when this happens, disagree (discuss, debate, argue) in private. Public arguments tend to entrench the parties in their respective positions, and this makes it difficult for either side to back down even when new information is brought to light that changes the picture of the credit risk under review.