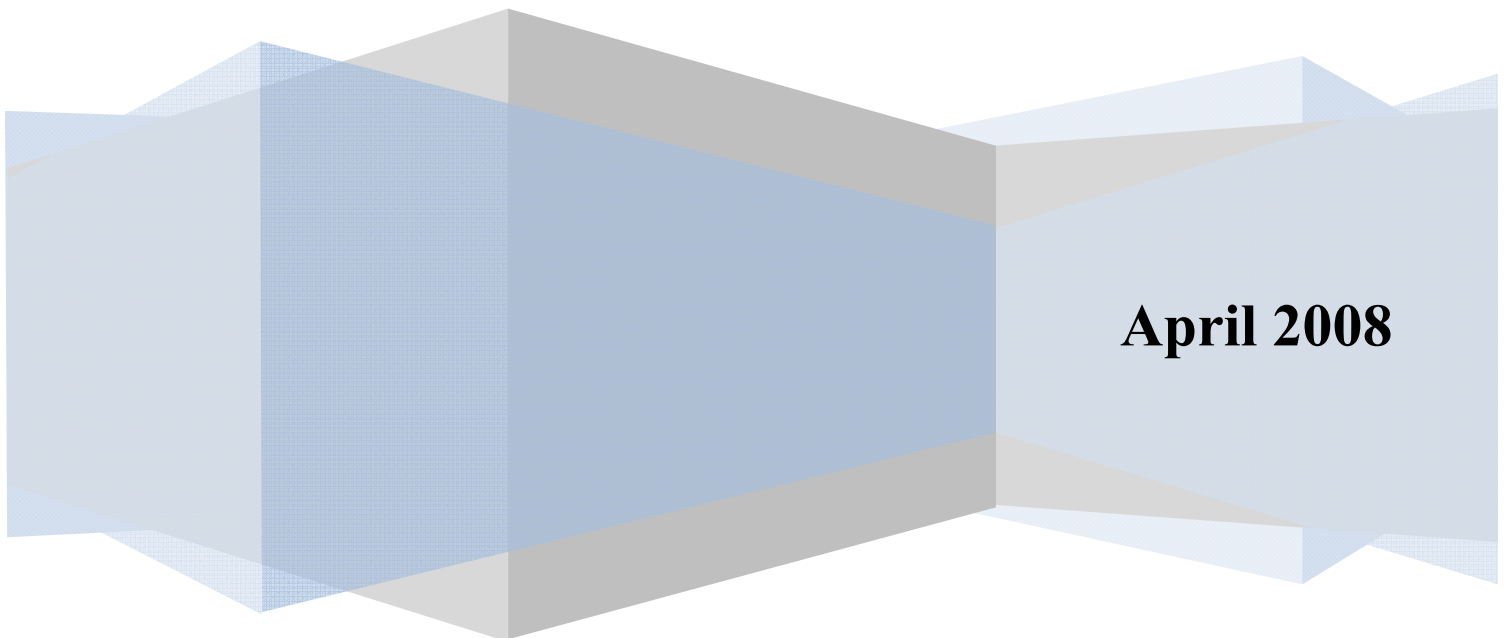




The Business Credit Index

April 2008

Published by the Credit Management Research Centre,
Leeds University Business School



April 2008

THE BUSINESS CREDIT INDEX

During the last ten years the Credit Management Research Centre at the University of Leeds in association with the Institute of Credit Management has compiled key credit management indicators from its main Credit Management Quarterly Review survey. The Quarterly Review now has over 2500 regular respondents from the credit industry. Seven of the Key Performance Indicators of the Review have been brought together to form the Business Credit Index (BCI) and analysis has been carried out according to broad industrial activity and size of each respondent company. Overall trends are shown representing a total of 36 quarterly time periods. The latest time period represents data collected from January to April 2008.

The indicators have been developed using a confidence scale of 1-100: 100 represents high (positive) confidence and 1 represents low (negative) confidence. The indicators are as follows;

- BCI 1 - Late Payment Confidence
- BCI 2 - Bad Debt Confidence
- BCI 3 - Credit Sales (Domestic)
- BCI 4 - Credit Sales (Export)
- BCI 5 - Economic Conditions
- BCI 6 - Product/Service Markets
- BCI 7 - Export Conditions

ECONOMIC CONTEXT

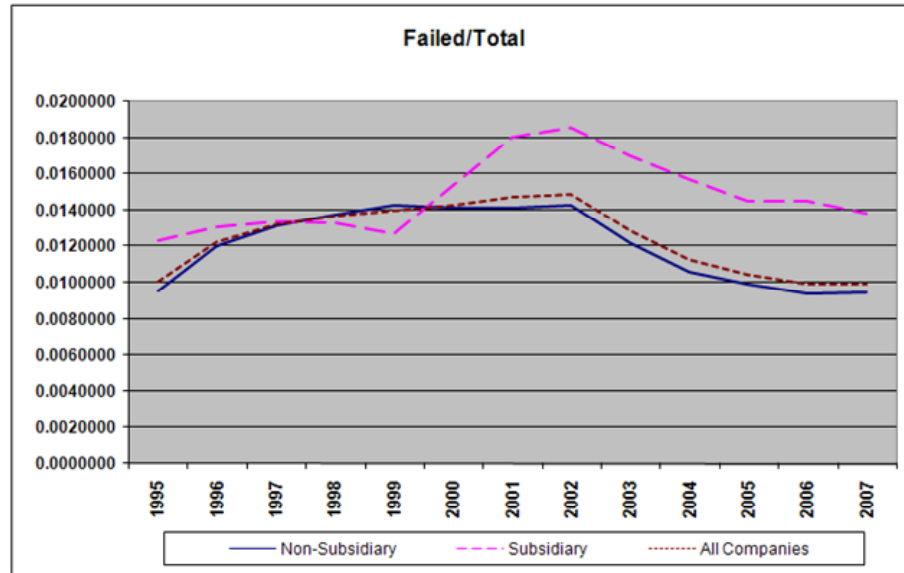
A striking feature of the past decade has been the increasing availability of credit to all sectors of the household and corporate sector. The growth in household debt, both in absolute terms and relative to household income has been spectacular. It is estimated that consumer credit has been rising by over to £1 billion per month with total outstanding debt in the region of £140 billion in 2007. Households owe sums equivalent to 160% of income. Much of the growth in consumer debt occurred within a confident economy with economic growth, high levels of employment, growing asset prices, easy access to credit and low interest rates and inflation. Despite obvious signs of some financial stress within the household sector most households, until the end of 2007 appear, to have managed to service their debts.

The economic climate has now changed: financial markets have highlighted the potential fragility of some lending portfolios that appear to be riskier than was anticipated; lenders have tightened credit policies and borrowers are becoming more cautious; interest rate rises are impacting on both the household and corporate sector; confidence in the housing market continues to falter; inflation is a real problem. Servicing debt may become more problematic for a larger proportion of the UK household sector particularly as mortgage repayments rise and the opportunities for refinancing and restructuring current debt decline with the tightening of lender credit policies. 'Trading out of trouble' and 'buying time' are not going to be options. Clearly, declining property prices and increasing uncertainty surrounding job security and future income exacerbates the problem. Levels of arrears, house repossession and bankruptcy/IVA's will continue to rise in 2008.

Evidence of the credit crunch impacting on the UK corporate sector is beginning to emerge. Clearly smaller businesses are likely to bear the brunt of tighter bank lending and the availability of short-term bank credit. CMRC research has observed an increase in the use of trade credit as a means of managing short-term finance and a greater extension of trade credit as a way of stimulating sales and/or managing customer cash-flow. A similar spike in trade credit was observed during the slight downturn at the end of the 90's. Corporate insolvencies have been stable since around 1995 but there are signs of an upturn in the insolvency rate. A forecasting model of aggregate corporate insolvencies shows that in the long term insolvency rate increases when income gearing or real CCJ values increase, and when the employment rate or real money stock decrease. The growth in real short term loans and business confidence are the short-run dynamics of the insolvency rate. That is, whereas short term increases in the growth in real short term loans are likely to create short term increases in the insolvency rate, short term decreases in business confidence are likely to create short term increases in the insolvency rate.

The relatively high levels of indebtedness in the corporate sector coupled with recent interest rate increases and a decline in business confidence suggest that corporate insolvencies are set to increase by over 20% in the next 2 years. More recent data derived from an analysis of UK Company accounts suggests that the ratio of total debts to total assets has risen quite sharply since 2004.

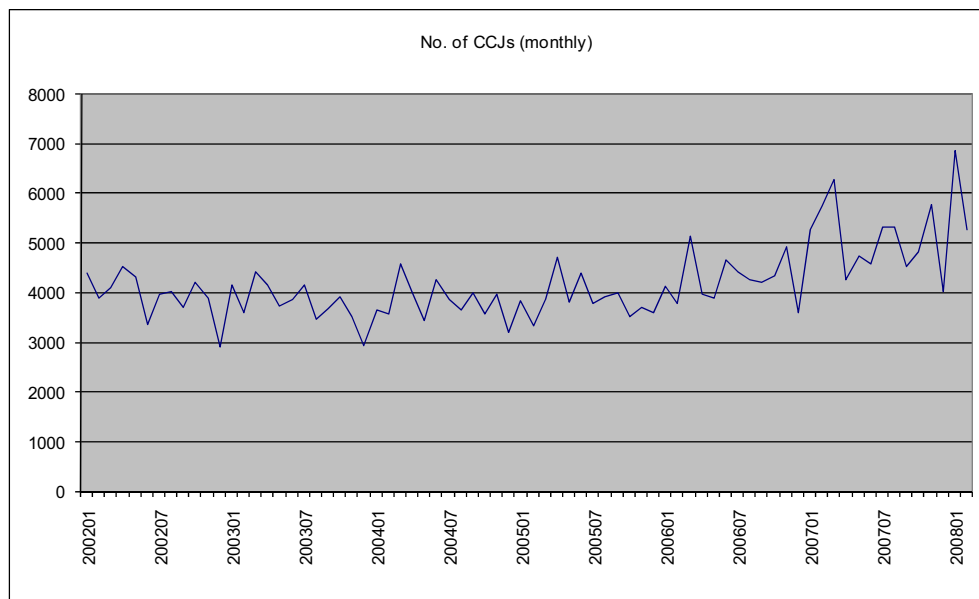
When we analyse ratios reflecting the ability of firms to cover their interest repayments on debt we observe a similar rise since 2004. This suggests that there are a large number of companies that are not generating sufficient profit to cover their interest payments. The considerable growth in private equity-backed leveraged buyouts has increased the role of debt in capital structures. It is estimated that value of investments LBO's in 2007 was around £22 bn. Of course, financial distress and insolvency in the corporate sector threatens jobs and household income in an already fragile economy. Recent analysis of the failure rate of UK limited companies over time shows a higher failure rate amongst subsidiary companies relative to the non-subsidiary population which is particularly apparent since 2000.

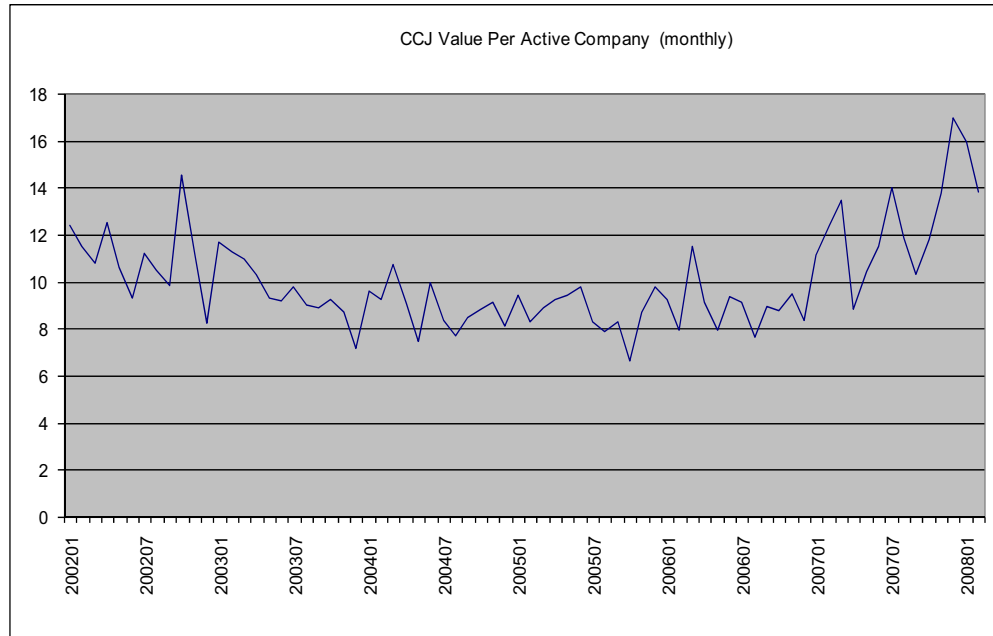


The Enterprise Act, the involvement of private equity and corporate restructuring and the effects of pension fund liabilities have been cited as possible explanations for the increasing failure rate.

The early signs of financial stress in the corporate sector are late payments and bad debts both of which are increasing. The late payment indicators show deterioration in payment behaviour and a higher incidence of bad debts. Recent signs of financial stress in the corporate sector can be gauged by the numbers and values of county court judgements against companies. The chart below shows the number of CCJ's against limited companies on a monthly basis and the values per active company.

CJJ's and Limited Companies

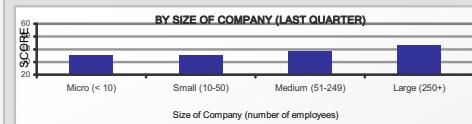
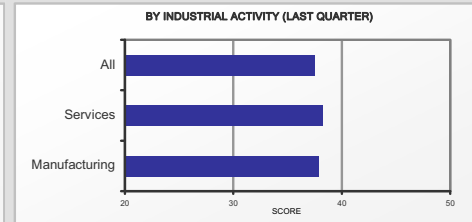
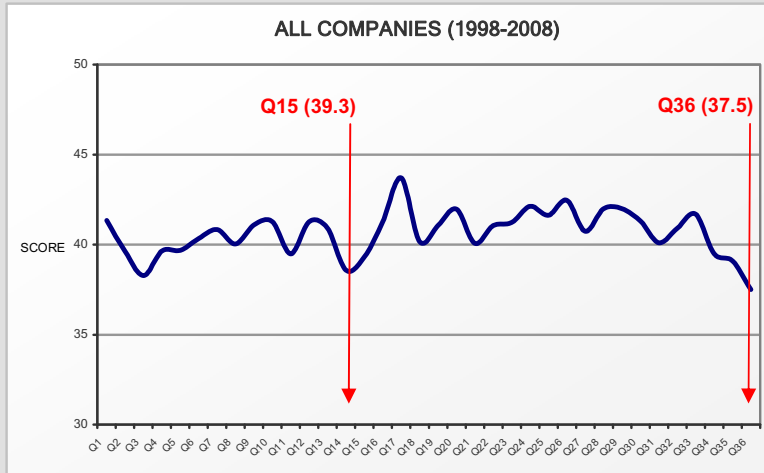




As illustrated, there has been a sharp increase in CCJ activity against companies since the middle of 2006. If we disaggregate the data by industrial sector then the upward trend is particularly pronounced in retail, real estate, transport and logistics, business services and is a leading indicator of insolvency.

BCI 1 – LATE PAYMENT CONFIDENCE

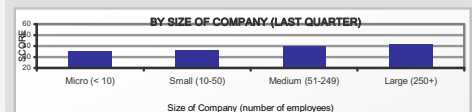
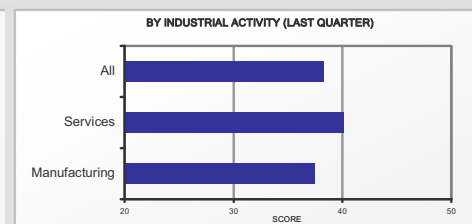
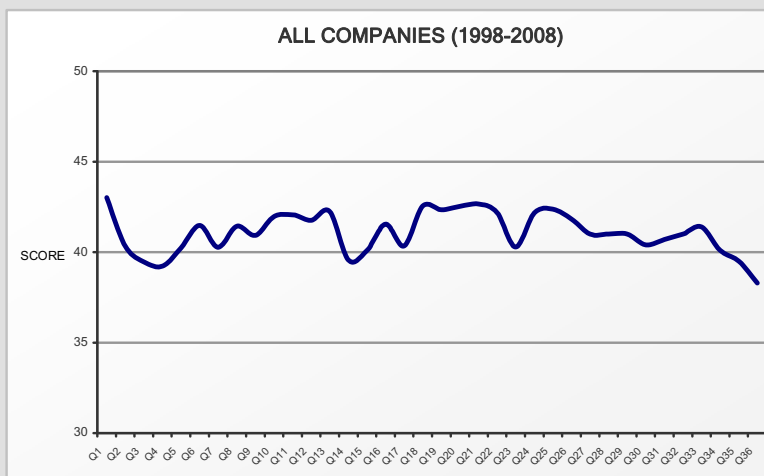
FALLING ▼



The chart above shows the **Late Payment** Indicator (CPI 1). This is a confidence indicator based on reports that payments from customers are being received on time. There has been a recent fall in confidence among the sample; and late payment confidence among UK businesses remains at its lowest point for the last five years. Figures from the latest quarter (Q36) show that in terms of business confidence, smaller companies are suffering the most in terms of late payment (36.2).

BCI 2 – BAD DEBT CONFIDENCE

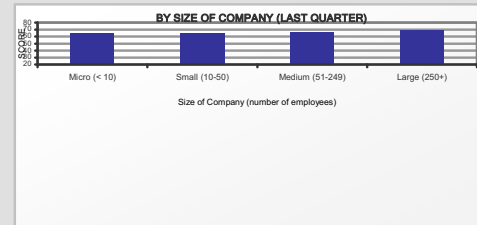
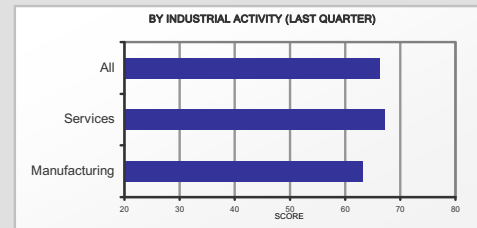
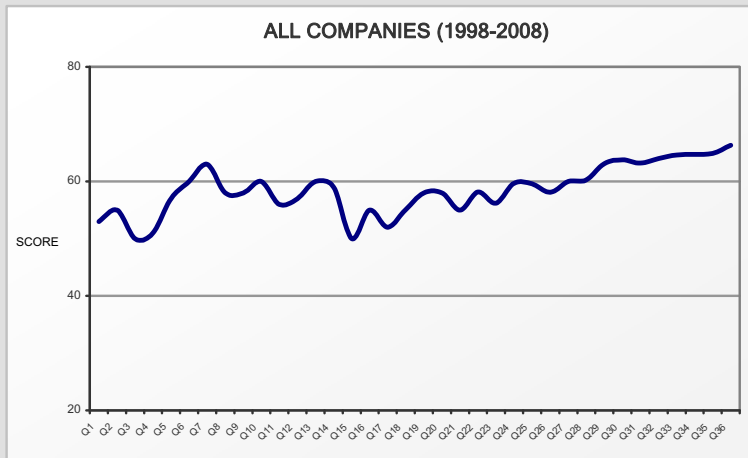
FALLING ▼



CPI 2 is a measure of the survey panel's confidence in their own **Bad Debt** position. This indicator is measured as a percentage of company sales with a higher figure representing a more favourable bad debt position among survey respondents. Confidence in the levels of bad debts which are being experienced have decreased in the last two quarters from 41.4 (Q33) to 38.3 (Q36). With regards to industry, the manufacturing sector displays less confidence in terms of bad debt levels than the service sector.

BCI 3 – CREDIT SALES (DOMESTIC)

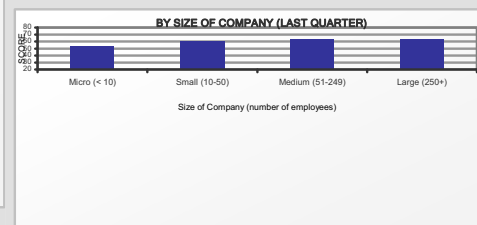
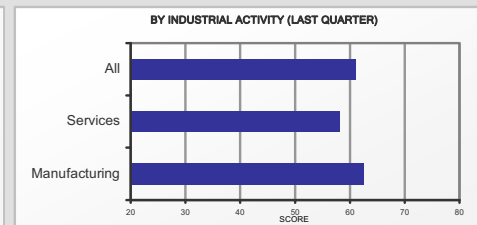
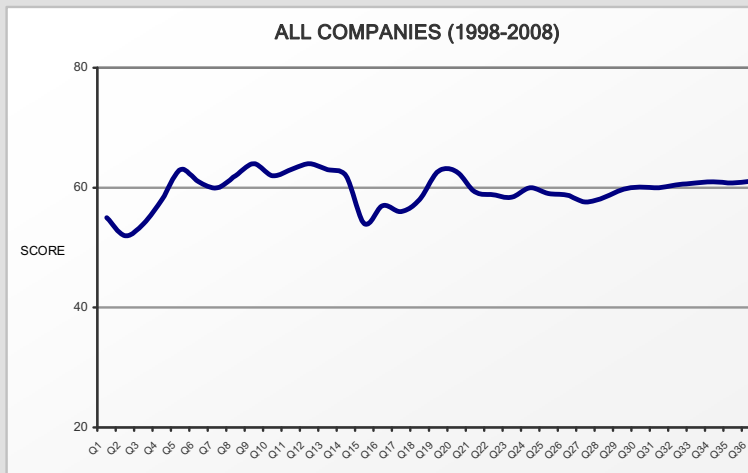
RISING ▲



The **Credit Sales (Domestic)** indicator shows the overall confidence in credit sales activity in the UK domestic market – possibly as a result of deteriorating confidence in late payment and bad debt. As can be seen, there has indeed been a steady rise in credit sales levels for the past few years and the confidence level for the overall sample now measures 66.3 (a rise from 55.1 five years ago). In the most recent quarter, the service sector reports greater levels of domestic credit sales.

BCI 4 – CREDIT SALES (EXPORT)

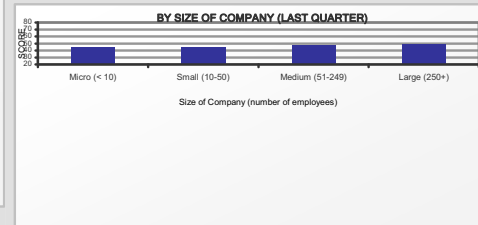
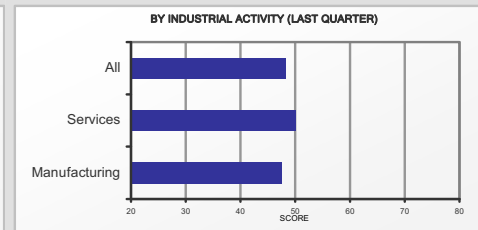
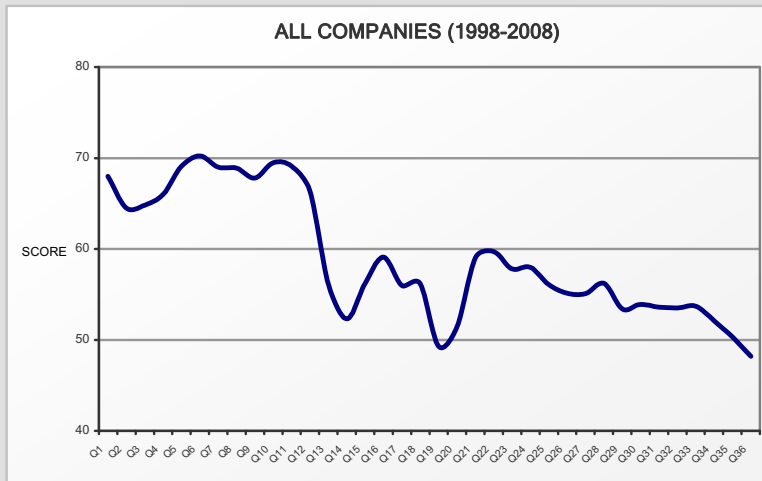
NO CHANGE ►



The **Credit Sales (Export)** indicator shows a more stable trend in recent years, although the last year has seen an increase of around four points on the confidence scale. The recent strength of the pound against foreign currencies may have helped to maintain this stability, however recent exchange rate movements may change this position in the coming months. In terms of industry sector, manufacturing companies report the highest confidence levels in export credit sales and larger businesses show the higher reported score on this indicator.

BCI 5 – ECONOMIC CONDITIONS

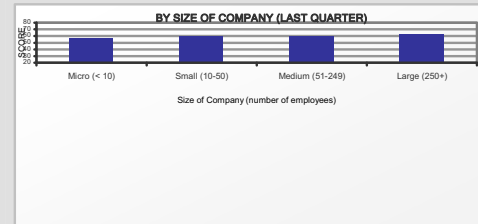
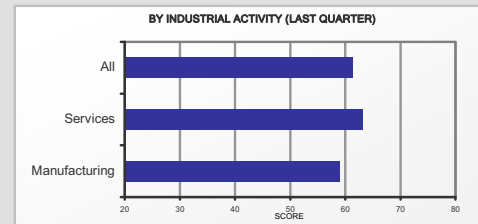
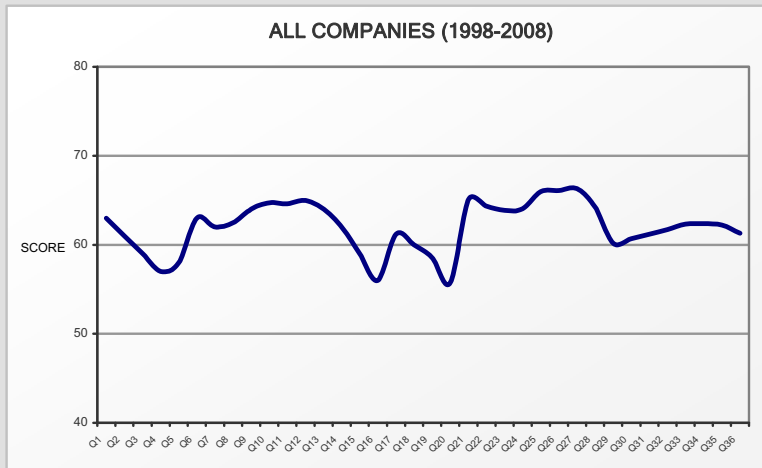
FALLING ▼



Perceptions of the state of **Economic Conditions** have declined in recent quarters (from 53.7 in Q1 2007 to 48.2 in Q3 2008) after a period of stability. Service sector companies appear more confident in the economy. In terms of size of the respondents there is little difference in confidence levels with all sizes of businesses showing a deterioration in recent quarters.

BCI 6 – PRODUCT/SERVICE MARKETS

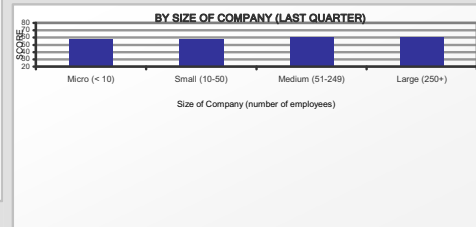
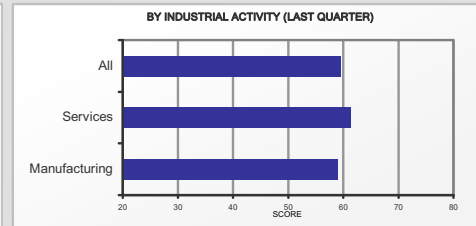
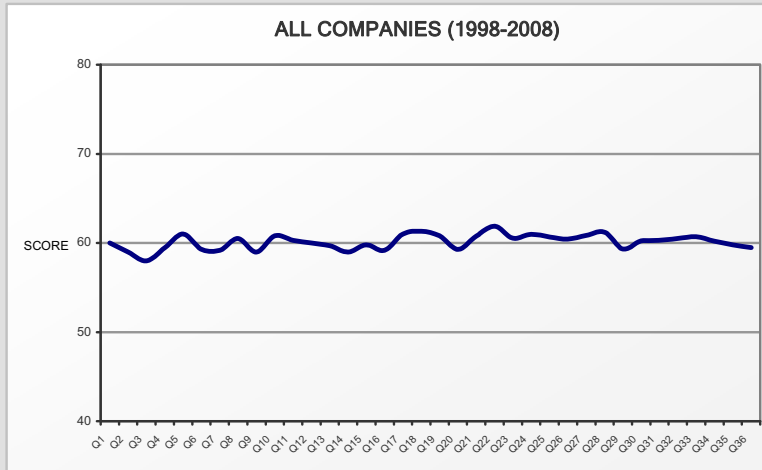
FALLING ▼



The **Product/Service Markets** Indicator has shown recent stability after a sharp decline in early 2006. However, previous surveys have shown a lag between economic conditions and product/service markets and previous survey results would suggest a decline in this confidence indicator in the coming months. Service sector companies in the sample enjoyed greater confidence with regard to product/service markets. In Q36 large companies reported a confidence level of 63.4 compared to 56.3 for micro businesses.

BCI 7 – EXPORT CONDITIONS

NO CHANGE ▶



Confidence in **Export Conditions** has taken a slight downturn in the last two quarters after a period of stability. The confidence indicator for exports now measures at 59.5 compared to 61.2 a year ago. In the latest quarter, medium sized businesses still report slightly more favourable export conditions than companies of other sizes in the survey. Service sector companies also appear to be experiencing a better international market environment than manufacturers.

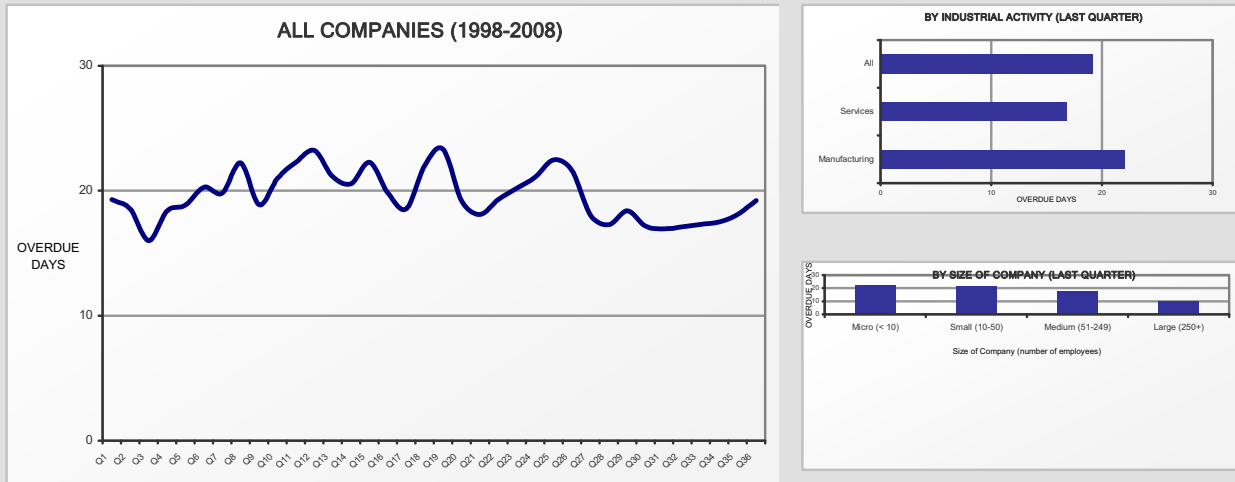
SECTION 2

Payment and Collection Times

Sales can only be profitable if they are turned into cash that is collected promptly within the agreed credit terms. So sales transactions are uncompleted until customers have honoured their financial obligation. Unless sales are turned into cash *on time*, profit will decline. Therefore, the prime objectives of any company must be to concentrate on sales that produce payment on time. Payment terms need to be agreed with customers in advance in writing. Moreover, customers need to know explicitly what the credit terms are to be able to judge whether they are capable of honouring them or otherwise. On the other hand, sellers need to be convinced that the terms are understood and that they are satisfied customers have the ability to pay according to the credit terms and conditions of the sales. In such circumstances at collection, firms face customers that know the terms, agreed them and have the ability to pay; consequently, collection costs are more likely to be kept at a minimum level.

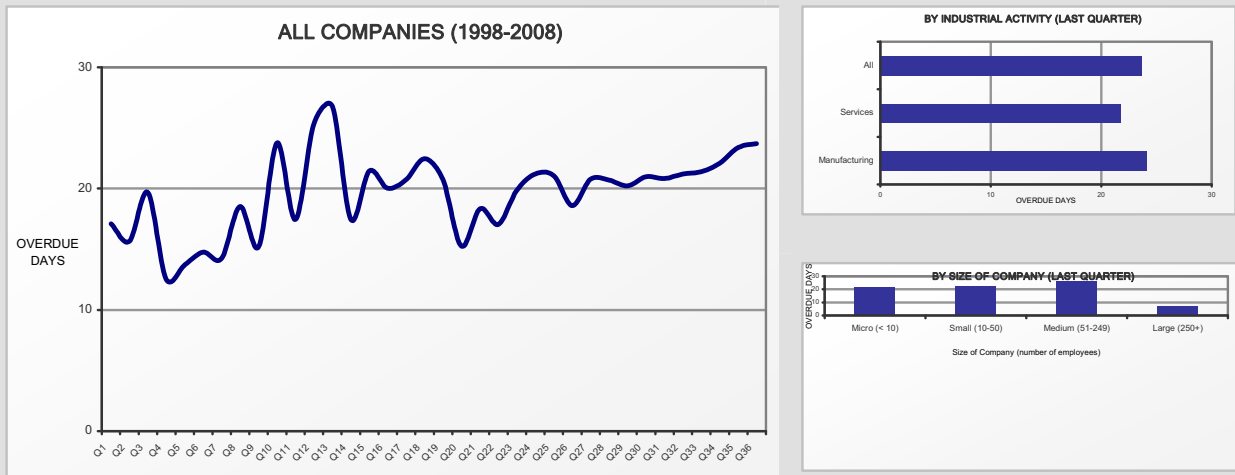
2.1 – PAYMENT BEYOND THE DUE DATE (FROM CUSTOMERS)

Domestic customers



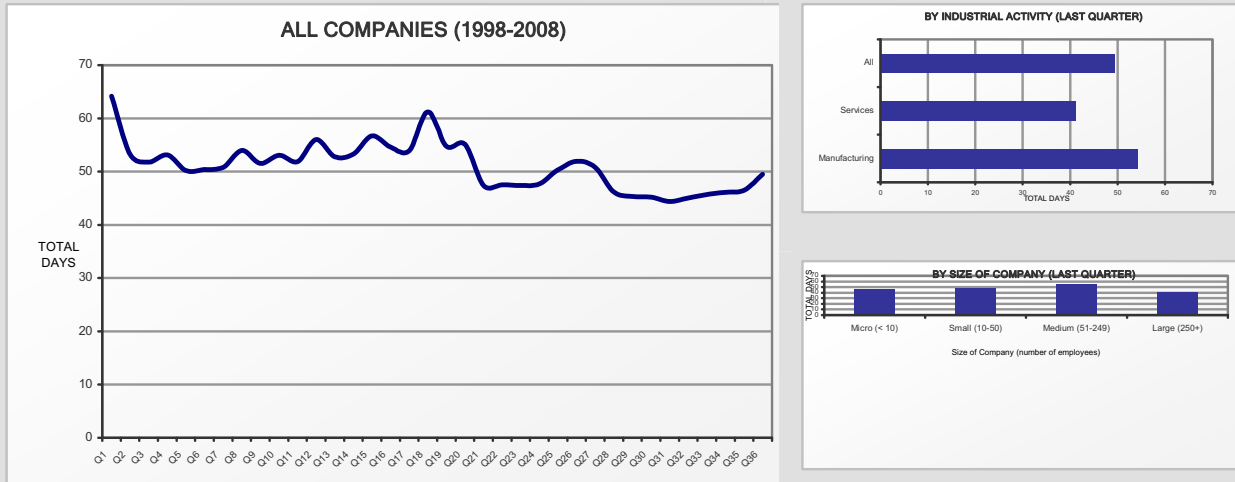
Payment from customers beyond the due date has remained fairly stable in the last year and remains at an average of 17.3 days in the latest quarter (Q33). As can be seen above, manufacturing companies suffer the longest late payment delays with an average of 22 days overdue compared with just 17 days for the service sector. As one might expect, micro and smaller companies report the longest payment delays (22 and 21 days respectively). In contrast, larger companies employing over 250 people indicate an average payment time delay of just 10 days.

Export customers



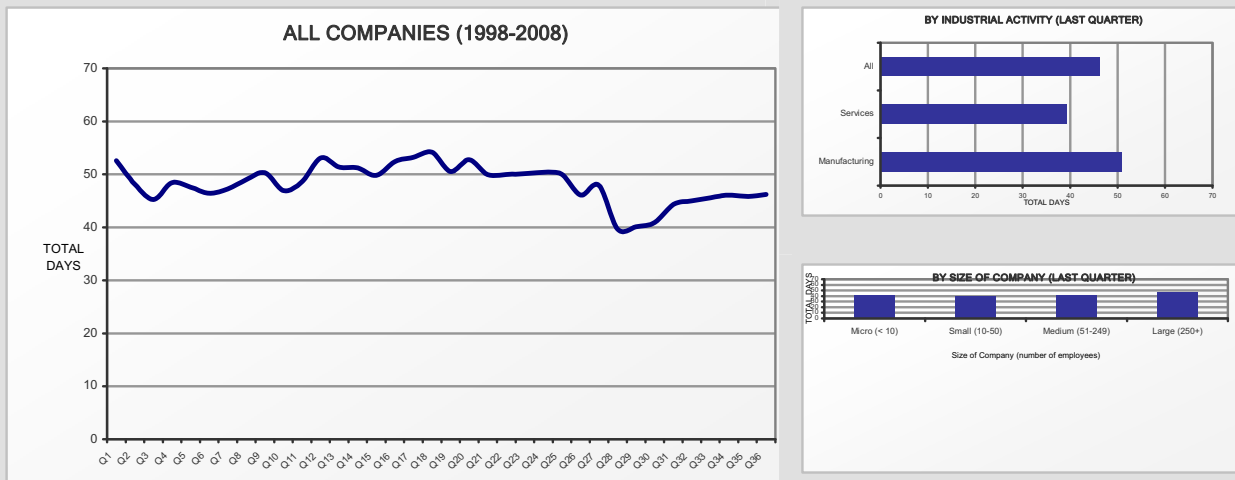
There has been a rise, over the last six months, in the overdue period reported by the survey panel in terms of exports. International trade, by its nature, represents a riskier proportion of the balance sheet and this appears to be reflected in the overdue periods which are being reported. Although there is little difference between the manufacturing and service industries, variations in export payment times can be seen by size of company, with medium sized firms (51-250 employees) indicating a current overdue period of 26 days compared to just 7 days for larger businesses.

2.2 – DEBTOR DAYS (OVERALL COLLECTION PERIOD - DSO)



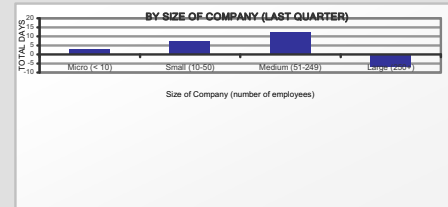
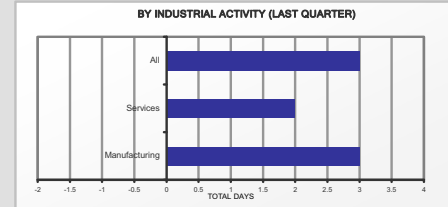
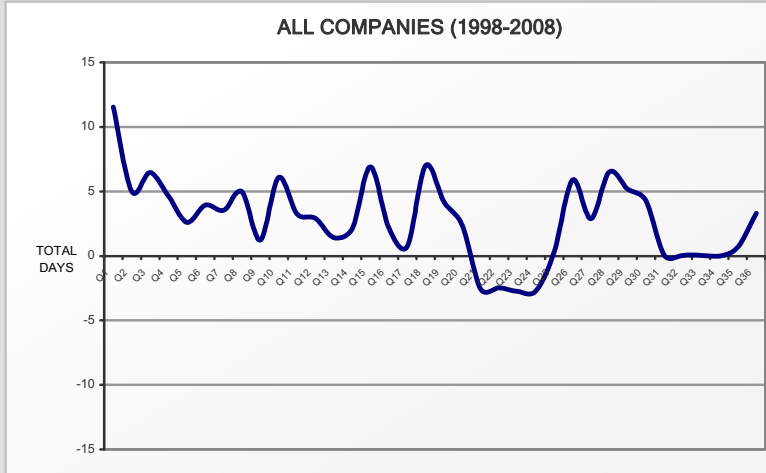
DSO reflects the total time it currently takes survey respondents to be paid by their customers in all markets. This figure includes the credit period offered, as well as any overdue days, and currently measures at 49 days across the entire sample. Again, manufacturing companies tend to suffer the longest total collection period at 54 days, compared with just 41 days for service sector companies. When this data is analysed by size of company differences also emerge. Medium sized businesses currently have the longest collection period at 55 days, which is 10 days longer than small sized firms in the sample.

2.4 – CREDITOR DAYS (OVERALL PAYMENT PERIOD)



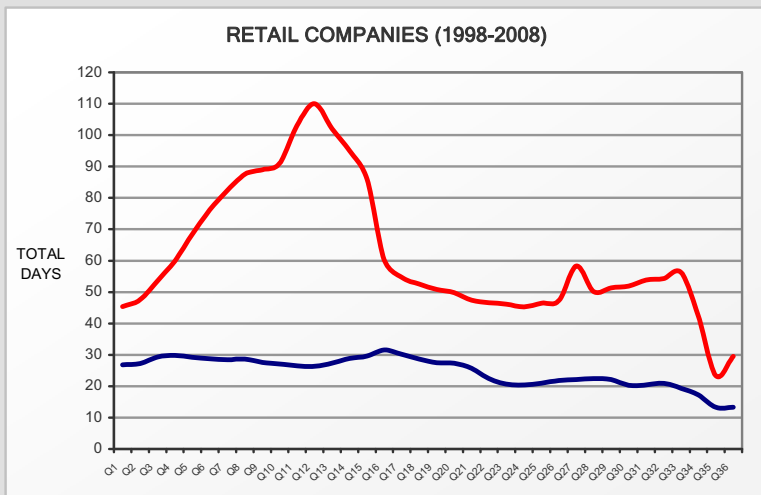
DSO reflects the total time it currently takes survey respondents to be paid by their customers in all markets. This figure includes the credit period offered as well as any overdue days. Again, manufacturing companies tend to suffer the longest total collection period at 51 days compared with just 39 days for service sector companies. When this data is analysed by size of company differences also emerge. Medium sized businesses currently have the longest collection period at 53 days which is 12 days longer than large firms in the sample.

2.5 – NET CREDIT DAYS (DEBTOR DAYS - CREDITOR DAYS)



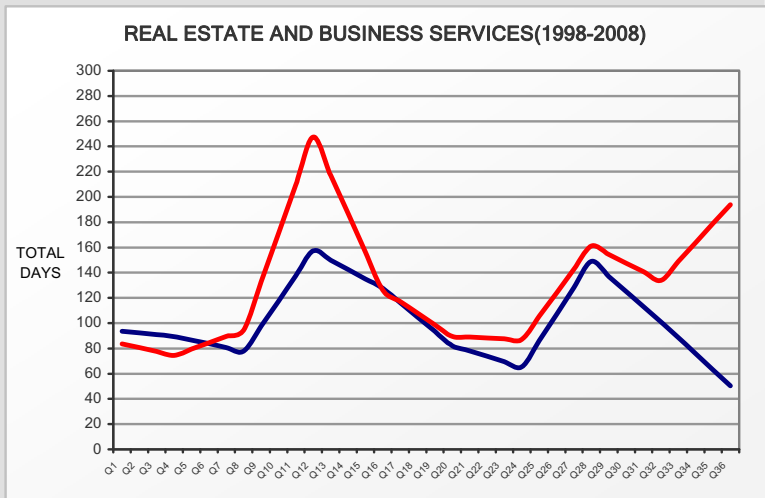
The net trade credit position among the sample has been calculated for the life of the survey. A positive value indicates that firms are extending more credit than is being received, whereas a negative figure suggests the company is receiving more credit than it is extending. The net trade position has risen sharply in the last quarter and now measures at 3 days.

2.5 – NET CREDIT DAYS BY INDUSTRY SECTOR – HIGHLIGHTS



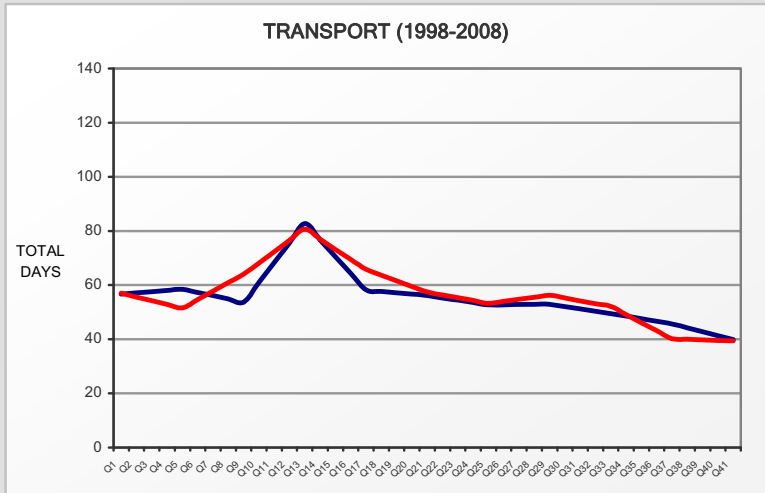
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CREDITOR DAYS



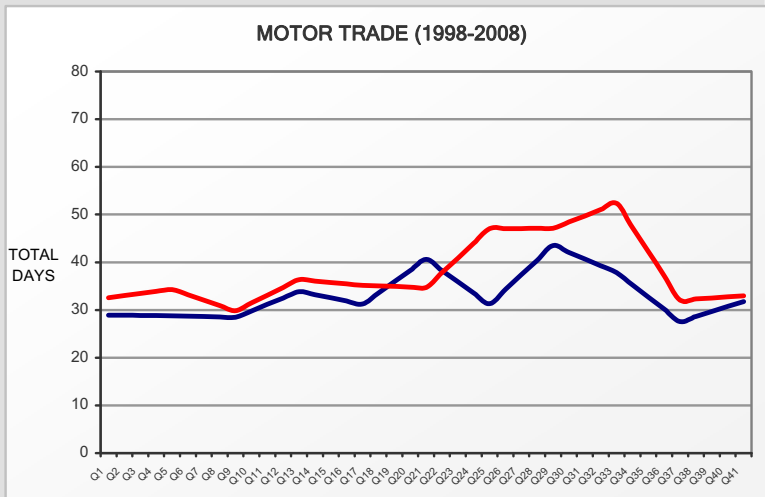
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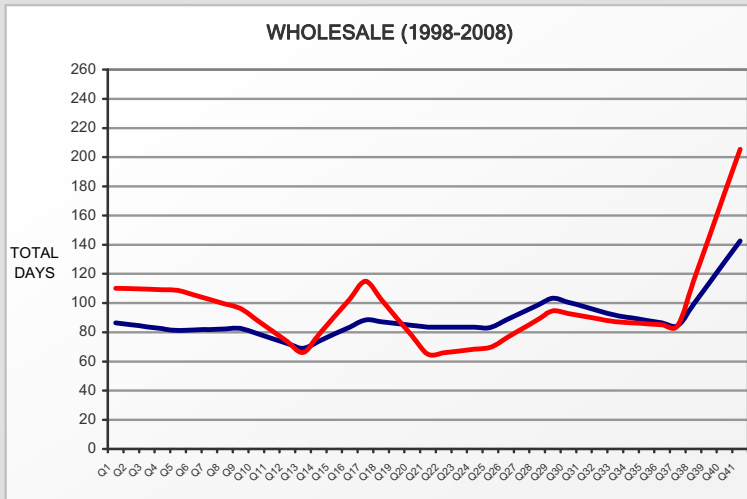
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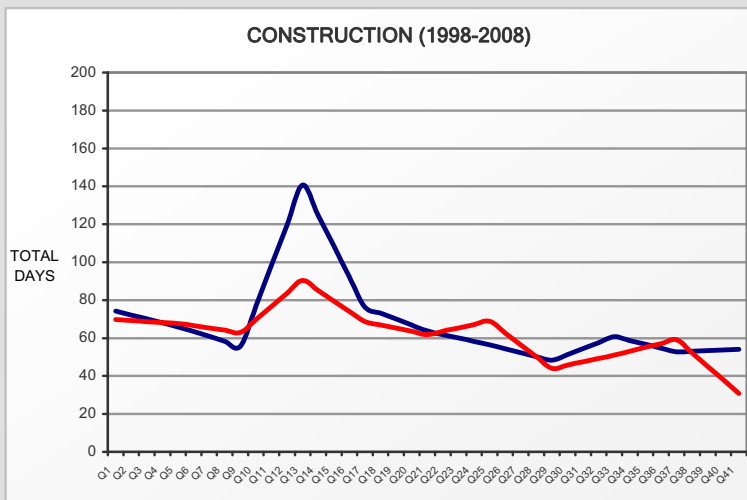
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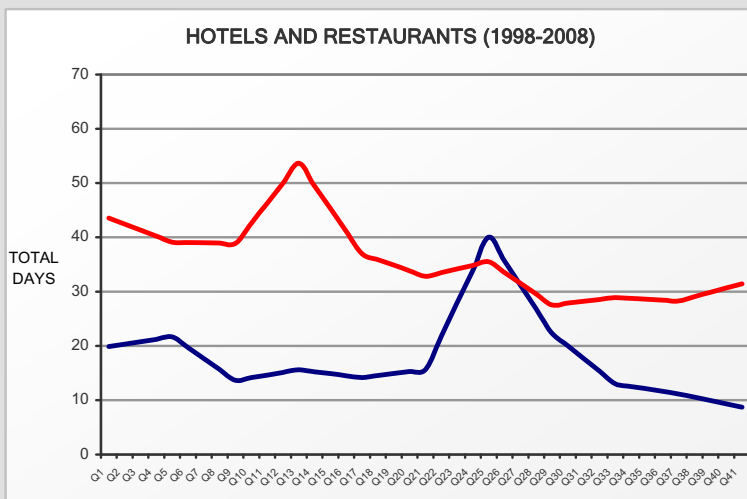
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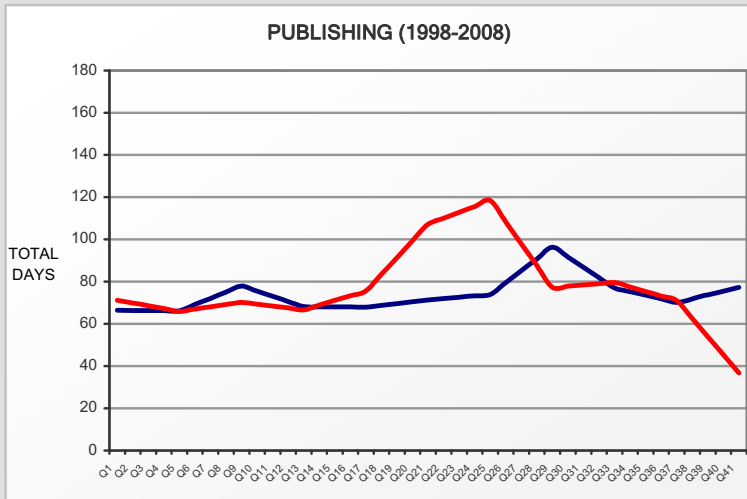
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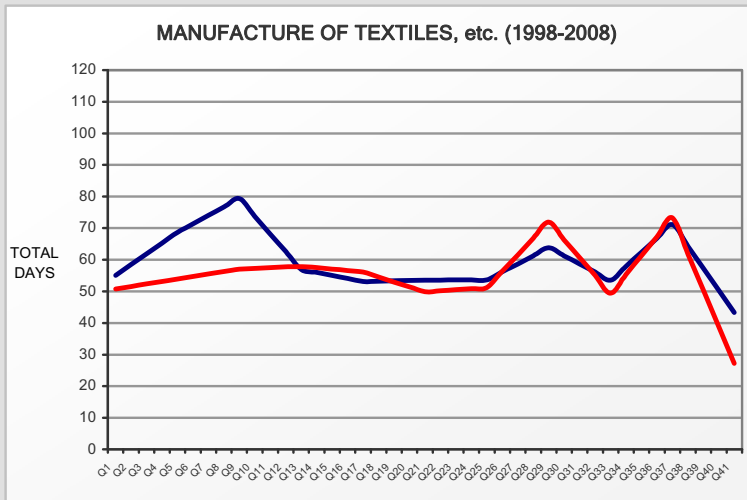
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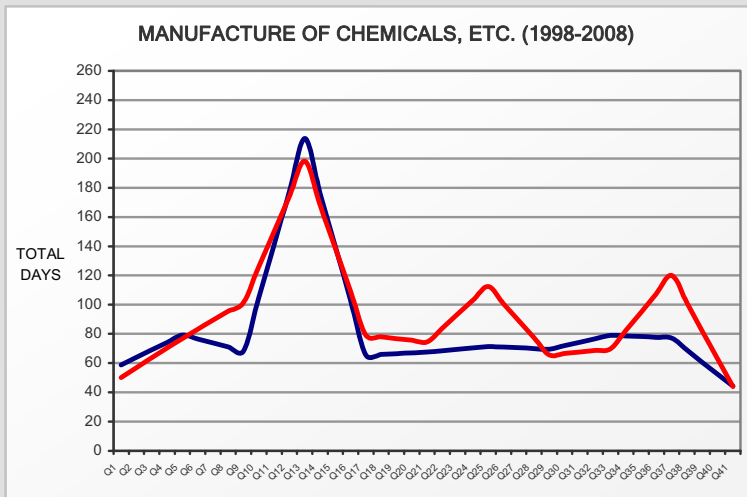
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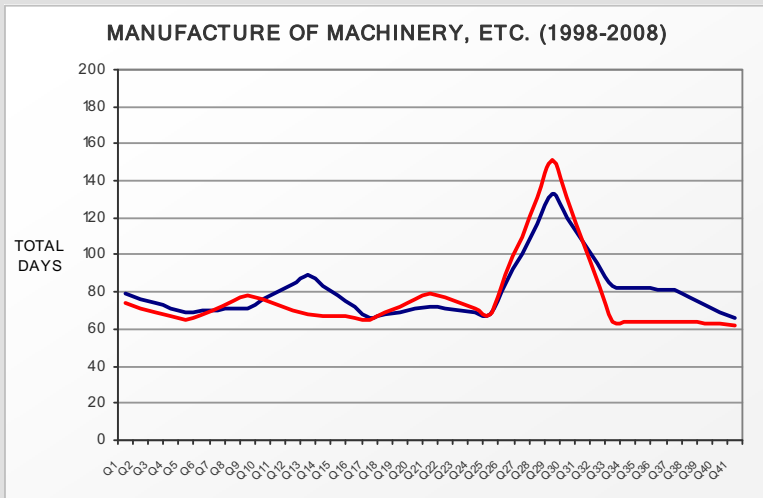
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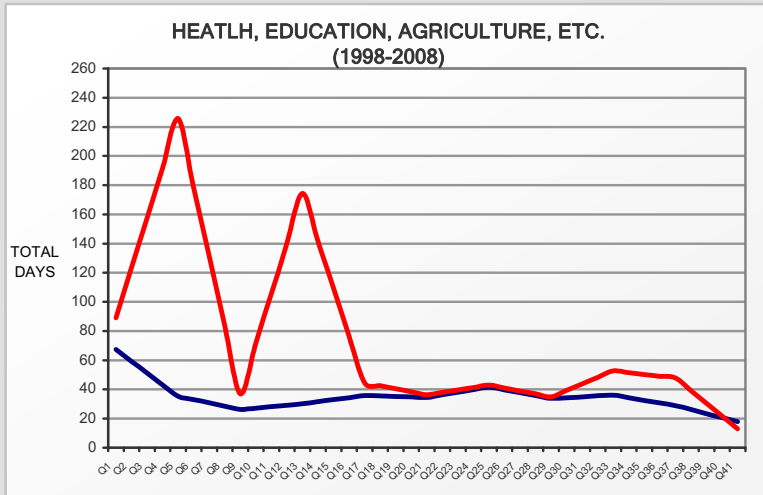
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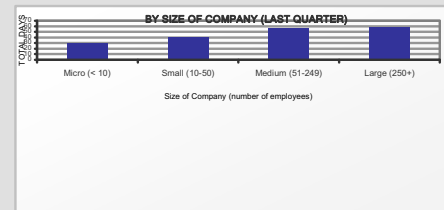
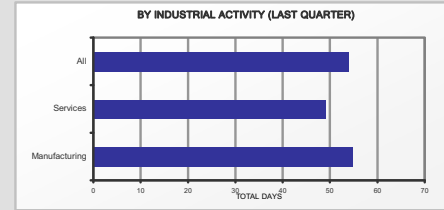
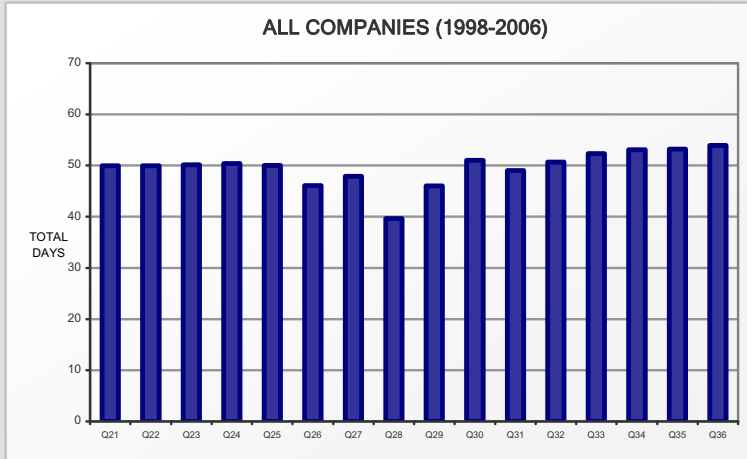
SECTION 3

RISK MANAGEMENT

The rational sales manager will want to sell as much as possible and to increase market share to a desirable level to stay competitive. This would seem to be a reasonable objective if all or the majority of the sales were paid before or on delivery. However, in the UK the bulk of business to business transactions take place on credit and therefore the credit managers' task is to make sure that the debtors remain a collectable asset. Thus risk minimisation is one of the main objectives of the credit manager who would only want to sell to those who may be paying as per the agreed terms. Trade credit can only be used proactively to reduce risk if credit managers are involved "up-front" and in the strategic decision making process and before the sale is agreed.

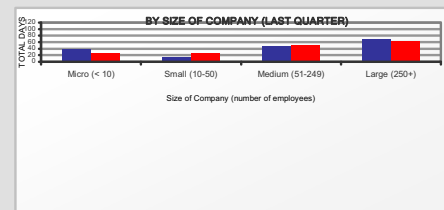
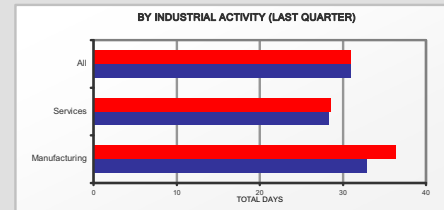
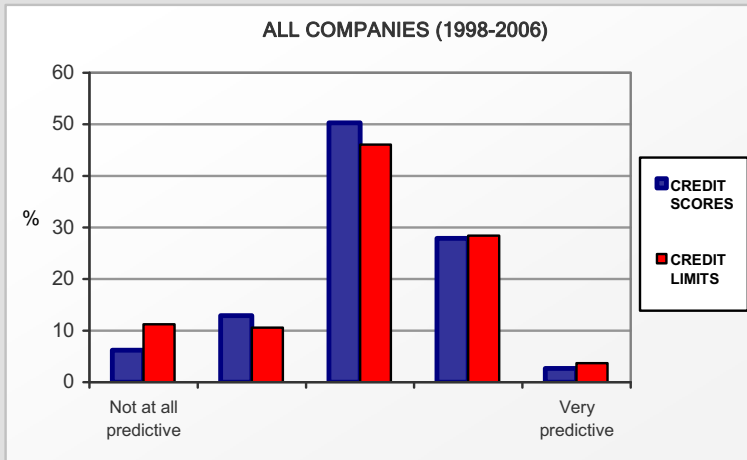
Generous credit may attract more customers and increase sales and market share, but unless debtors are then collected on time, companies may find the cost of financing, monitoring, chasing, collecting or writing off bad debts, unaffordable. If the valuable credit information collected in the process is used intelligently and proactively at the "front-end", this cost could be minimised. So, to stay competitive, companies need to strike the right balance between sales maximisation and risk minimisation through properly designed screening policies. Procedures for collecting creditworthiness information are required to discriminate between customers, without missing out on opportunities. Customers' classification according to their level of risk (initially) and their pattern of payment (over a certain period) allows companies to manage their risk properly.

3.1 – USE OF COMMERCIAL RISK SCORING TO ASSESS RISK



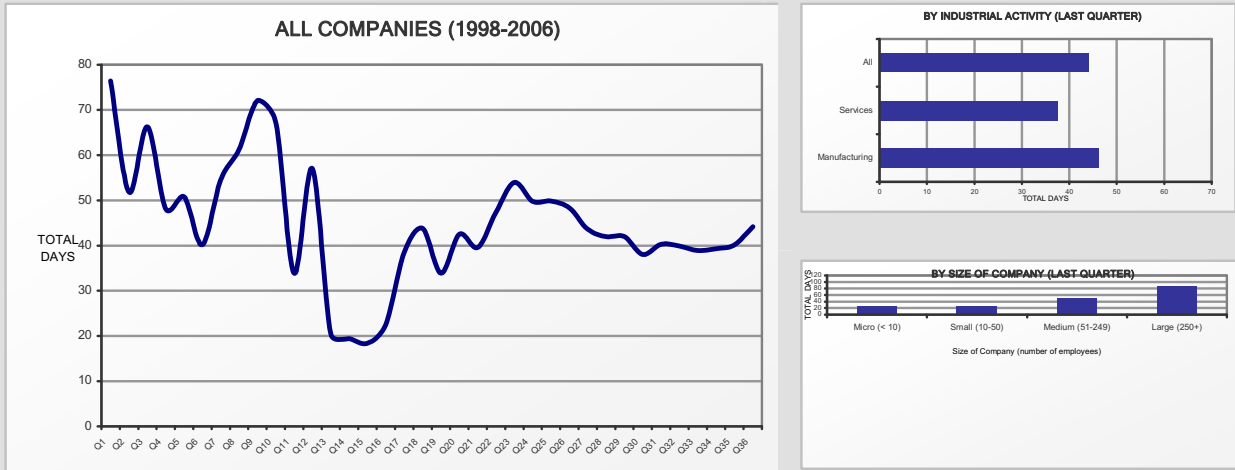
The use of commercial risk scores by the survey panel has increased in the last two quarters. On average, 54% of companies currently assess potential customer risk by using commercial risk scores in Q36. Manufacturing companies are more likely to use commercial scoring and, as one would expect, there is a correlation between the size of the business and the likelihood that they will use credit scores. Only 30% of micro businesses use scores compared to 57% of larger companies.

3.2 – PREDICTIVE ACCURACY OF COMMERCIAL SCORES



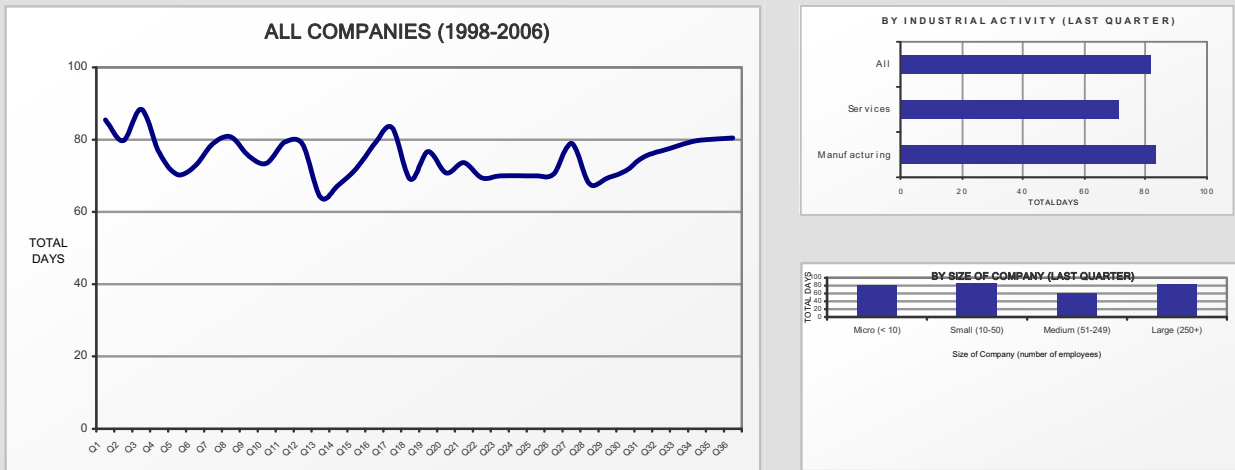
In terms of predictive accuracy of current scores and limits being used by respondents 31% of companies stated that the scores used were predictive and 19% thought that the scores being provided were not predictive. Companies were also asked about the limits which are produced by agencies. 31% of the survey panel thought these were a true reflection although 21% do not believe the limits which are advised are accurate. In terms of industry sector and size of company the charts above report the percentage of companies who do think that scores and limits are predictive. As can be seen, manufacturing companies and larger sized businesses in the panel are more likely to trust the predictive accuracy of scores and limits.

3.3 – PURCHASE OF CREDIT REPORTS



The number of credit reports bought on a quarterly basis has been falling steadily during the last two years. The average number of reports bought per company now stands at 44 reports. Manufacturing companies buy on average more reports than service sector companies (46 vs 38). Clearly the volume of reports is linked to size of company, with small companies averaging 25 reports per quarter compared with large companies averaging over 88 reports per quarter.

3.4 – PERCENTAGE OF CREDIT REQUESTS ACCEPTED



The percentage of credit requests accepted has risen since Q28 from an average of 67% to 81% in Q33. The percentage of requests being accepted is now at its highest level for 3 years. Manufacturing companies are more likely to accept requests for trade credit and, interestingly, small firms are equally as likely to accept credit requests as large firms in the sample.