Acknowledgements

CreditorWatch would like to thank the following for their contribution to this paper.

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Head of Credit Rating ANZ, Coface

Roberto Bastos is the head of corporate credit ratings for Australia and New Zealand in Coface. Managing a team of people across Sydney, Melbourne, Auckland and Bangalore, he is responsible for the a book of approximately 16,000 companies. An UNSW alum, prior to his role at Coface Roberto was a partner and credit trader at SPX Capital, a Brazilian investment management company based in Rio de Janeiro and London.

Shavantha Mallawa
CEO, CreditSource

Shavantha is the CEO of CreditSource, a company he founded in 2019. CreditSouce provide clients with innovative and industry leading solutions to better understand the financial viability of suppliers and customers. Shavantha has over 25 years of industry experience in risk management having led risk teams in ASX200 and NYSE listed multinational companies. He is a Fellow CPA , a Fellow of the Chartered Institute of Management Accountants UK and is a member of the Australian Institute of Company Directors.

Nick Pilavidis
CEO, AICM

Nick is an experienced credit professional with over 20 years of experience. He has held roles in technology, property management and debt collection, both in Australia and the UK. Prior to becoming CEO of AICM, he was National Credit Manager at Ricoh Australia. Nick was the 2005 Australian Young Credit Professional of the Year and served as a volunteer on the NSW Council and National Board. He holds a CCE and is a CPA.

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Patrict Coghlan

From our CEO
Patrick Coghlan

At CreditorWatch, we believe data is the lifeblood of every business. This has never been more important, with so many risks in the economic outlook.

We are fortunate to have one of the most comprehensive data sets on Australian businesses. So we have an obligation to contribute our insights to the collective knowledge pool.

This thought leadership paper is part of this commitment. We draw on up-to-the minute data about the payment landscape, supported by insights from experts to add context to the numbers..

The good news is, Australian businesses, by and large, are in great shape. Those faring best in this extremely challenging operating environment are drawing insights and making better business decisions from the information they have at their fingertips.

PATRICK COGHLAN
CEO, CREDITORWATCH

Taking risks in your stride

There's a plethora of risks in the current operating environment. Inflation, interest rates and the skills shortage are the top three challenges most businesses are facing. But they are also juggling a host of other issues, such as productivity, the accommodation crisis, climate change, supply chain disruptions and geopolitical uncertainty.

There is, however, much for businesses to be positive about as we exit the worst of the COVID period. There are also many tools businesses can use to help manage the risks to which they are exposed, such as information about customers' creditworthiness.
Against this backdrop, this thought leadership paper explores:

- The credit landscape, what's keeping business people awake at night and what they can do about it.
- The economic outlook and what it means for businesses.
- New ways of optimising working capital.
- View from the frontline: how credit managers see the commercial outlook.

Leading with data

First, let's take a look the data about the operating environment. While there has been a deterioration across some indicators, overall business conditions are manageable.

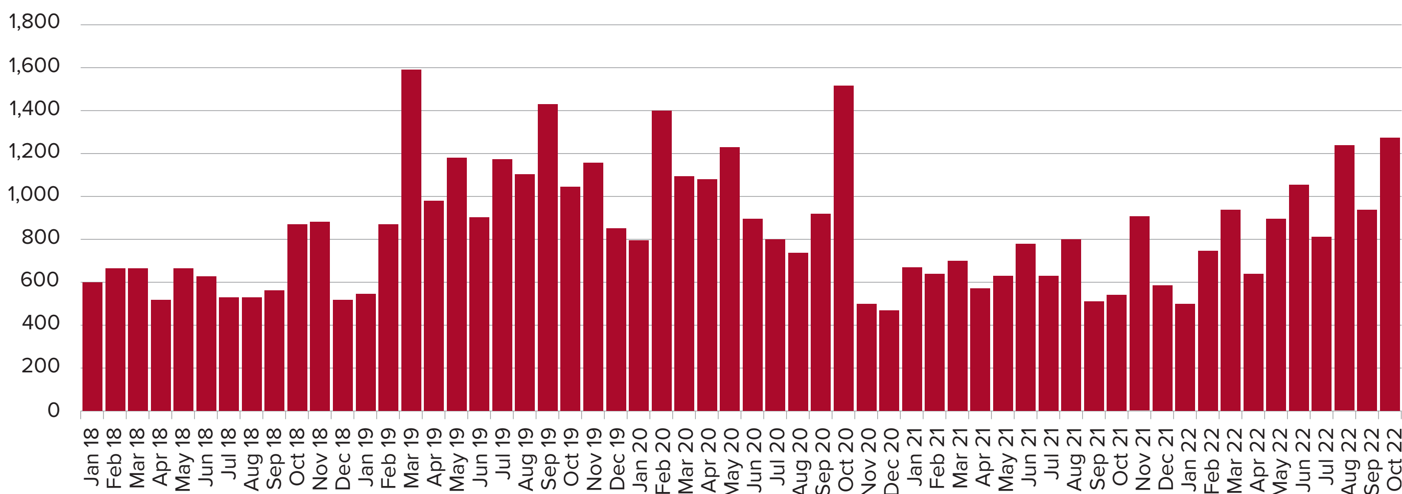
CreditorWatch's October 2022 Business Risk Index (BRI) reveals B2B trade receivables were up 45 per cent since January. Year-on-year growth in B2B trade receivables continues to increase, which points to the ongoing recovery in trade activity for small businesses.

The BRI also shows external administrations have dropped for the third month in a row, following a seasonal pattern. However, they are still up 59 per cent since January. Court actions are up 50 per cent year-on year.

The industries with the highest probability of default over the next 12 months are: food and beverage services (7.25 per cent), arts and recreation services (4.62 per cent) and transport, postal and warehousing: (4.57 per cent). However, the BRI does show the risk of default over the next 12 months has increased in all regions across Australia, with the exception of the Lower Hunter and Wyong in New South Wales.

CreditorWatch Chief Economist Anneke Thompson says the October BRI data broadly reflects the wider economy. "Trade activity is strong, but medium- and longer-term risk is heightened."

B2B TRADE PAYMENT DEFAULTS



Source: CreditorWatch Business Risk Index – October 2022

Dispatches from the frontline

It's a sentiment with which many other experts agree.

Nick Pilavidis, CEO, AICM sees strength in the economy. "I don't see a wall of insolvencies. But I also don't see insolvency numbers dropping. While payment times have not substantially deteriorated, some customers are starting to stretch out payment times and dispute invoices."

So, it's still important to be judicious when extending credit. A trend of which businesses should be aware is customers entering insolvency without any warning. As COVID stimulus payments have been unwound, this has exposed some businesses that were artificially supported during that period, but which have not addressed problems in their operations. These are among the businesses going into insolvency at the moment.

Roberto Bastos, Manager of The Enhanced Information Department, Coface notes some sectors have done very well, for example sectors associated with the reopening of the economy, such as hospitality and hotels. "Other sectors in which there was a high level of optimism 12 months ago due to low interest rates and government stimulus are now not performing as well," he notes, naming construction as an example.

CreditSource CEO Shavantha Mallawa says many businesses are facing specific short- and medium-term risks. These include escalating input prices, labour shortages and the rising cost of labour. An inability to pass on cost escalations to customers exacerbates these risks.

Mallawa directs his comments to companies in the food manufacturing, mining, construction and road transport sectors. "From a profitability perspective, the food manufacturing industry is able to pass on cost escalations to clients. The mining industry has also benfited from escalating commodity prices, with profitability growing exponentially between 2020 and 2022."

He says the outlook for the heavy civil construction industry is more concerning. "A lot of companies are making small profits and a significant portion have made losses, due to the escalation in material prices and labour."

According to Mallawa, construction businesses that have locked themselves into contracts that don't allow them to increase their prices are facing pressure. "This has resulted in significant issues for this sector. We have seen failed residential builders hit the headlines. But large commercial construction companies have been most affected in terms of not being able to pass on rising prices." They work on large multi-year contracts, the costings for which have been done when input costs have been much lower.

Road transport is another industry experiencing tough trading conditions, according to CreditSource's data. "Profitability levels from 2020 to 2022 plummeted. If a company has a strong balance sheet, it may survive, but many will fail, particularly small businesses," he adds. These businesses may have focused too much on cash flow by taking on contracts that are not profitable or sustainable.

Another telling data point is the change in the balance between company cash holdings and debt levels between June 2021 and June 2022. When COVID hit, companies reduced debt from pre-pandemic levels by about 25 per cent and cash holdings grew by 30 per cent. But since June 2021 this position has significantly reversed. So, cash holdings have come down for a majority of companies and debt levels have risen. This increases the risks in the operating environment and is a dynamic companies should be carefully managing.

"Our analysis of cash flow statements means we can see where companies are investing. A lot of cash has been used for working capital due to significant increases in material prices," says Mallawa.

The road ahead

Business is inherently risky. But there are many steps firms can take to mitigate their risks.

1. Collaborate with suppliers

From a payment perspective, companies have an opportunity to collaborate with suppliers in a mutually beneficial manner. For instance, large construction companies should bring suppliers along on the tendering journey. The idea is to identify points at which all parties have an opportunity to renegotiate contract terms to take account of changes in the external environment.

2. Match inflows and outflows

It's also essential in this part of the cycle to match inflows with outflows, says Mallawa. "Companies with low cash reserves or liquidity issues struggle more in this environment, because there is reluctance to offer payment terms seen previously.. We are seeing some firms pay suppliers not just on time but ahead of time to secure their products and services. So, companies with low cash reserves will struggle to compete."

3. Stay close to customers

One of the best ways to reduce the risk of non-payment or late payment is to understand customers' circumstances, says Pilavidis.

"Now is the time to stay close to your customer. Get a feel for how a business is tracking by visiting their sites. Understand individual customers' situations, not only to identify the risks but also to secure opportunities for your business, for instance maximising sales from good customers.

"Access to technology is key, as well as automation to improve processes and procedures. This frees up credit managers to build relationships with customers and proactively identify risks. This also allows you to harness data to identify changing customer behaviours. For instance, unusually prompt payment of invoices may be a sign of stress," he adds.

4. Enhance working capital management

Working capital management has always been a business fundamental to help guide business decisions. In an uncertain operating environment, it's never been more important for organisations to optimise this part of their enterprise so they can maintain sufficient cash-flow to meet short-term operating costs and debt obligations.

Reworq Consulting Founder and CEO John Field, says it's essential to recognise working capital as a source of value. "Working capital is not straightforward. So, put into place robust measures to improve accounts receivables, accounts payables and inventory management. Better management of working capital preserves cash and can provide a critical lifeline when the business faces significant trading or liquidity constraints."

He says most businesses have plentiful chances to identify opportunity across their operations to enhance working capital management. The idea is to develop a roadmap to support the company's strategy and business objectives.

"The key to success lies in embedding the right behaviours across the whole business, not just in finance, but driven by executive management with a sustained focus on change and future financial success," he notes.

5. Consider accessing trade credit insurance

Interest in credit insurance is higher than it has been for a long time, especially among exporters and the construction sector. This is a sector that traditionally makes good use of trade credit insurance.

"The smartest guys in the room take out trade insurance through the cycle," says Bastos.

"With trade credit insurance you can sleep at night, in the knowledge you're going to be able to pay your suppliers and your employees, and your business is going to be viable," he adds.

Outlook

The volume of risks is growing, such as inflation, margin pressures and the shift to renewable energy sources. Geopolitical risks also make it very difficult to know how the future will unfold.

Nevertheless, there are many actions debtors can take to put their business in the best position to manage their risks. These include fixing issues, changing processes and addressing labour shortages.

Additionally, now more than ever, it's essential to form a deep understanding of what's happening in the market. This includes assessing the impact of interest rate rises on customers, as well as doing due diligence on suppliers' solvency.

It's also important at this part of the cycle to consider the best way to invest in plant and equipment, growth and automation. This is because not investing in efficient equipment and automation will have flow-on effects in an environment in which labour is in short supply

Overall, expect a return to a more normal trading environment from 2023, including more regular settings for inflation and interest rates.