What Makes a Great E/CTRM? Part 8 – Credit Management

After meeting with Donna from the Operations team, Bob turned his attention to his company's credit management group. If you missed Bob's interview with Donna from Operations, you can find a transcript here. Bob has been conducting interviews with many of his company's organizations as part of a project to define his company needs for a C/ETRM system.

Hi Steve. Thanks for meeting with me today. Bob greeted Steve and shook hands across a conference table situated in the middle of a small conference room. Bob pushed the conference room door closed.

So, Steve, you manage and report credit exposure to management each day, I understand. Can you tell me what sort of features you would need to have in your idea of a dream C/ETRM system? Bob knew Steve was an important part of his company's management team. Whatever system Bob's company acquired, or built, that system would absolutely need to provide value to Steve and his credit team. Poor credit management was

a very real risk to his company's continued operations.

No worries, Bob. Steve said warmly. I am very happy to meet with you any time, and especially with regards to getting new software to manage our business operations. Frankly, with our current credit management system, I feel somewhat out-of-touch with the day-in-day-out operations. I want the Credit group to be more involved, somehow, and integrated with all that happens each day.

Why don't you tell me why you feel the way you do, for starters, then? Bob said, fishing for Steve's reasons for feeling isolated. Steve seemed very open and willing to share. We use a credit management system, Steve began, which gets its data from our general ledger package. We can set credit limits and even block transactions based on general ledger data. Bob nodded. Well, you see, the general ledger data is at the backend of the whole operation. Bob didn't see, and Steve could tell.

You met with the Operations team, right? Bob nodded again. They generate invoices, right?

For delivered cargos. And, then the invoices are converted into journal entries, and posted to the general ledger, right? Bob nodded a third time. I know about credit exposure only after the journal entries hit the general ledger system, which means the cargo has already been delivered. How can I block a cargo delivery after the cargo has been delivered? Bob took a moment to process that thought. Seemed like the old "Cart before the horse" situation, Bob suggested. Exactly! Steve agreed.

So, you see, I need my credit exposure data generated directly from data in the trading system. By the time our current credit system shows any exposure, it's too late!

Bob could see the problem now. So, you want our future C/ETRM system to have its own, built-in credit exposure report, right? Definitely, Steve agreed. Yes. And, the report should be based on trade valuations and scheduled quantities. It will make my life much easier. Bob made a note of this important requirement in his notebook. It seemed incredible to Bob that his company should be managing business after the fact. Like driving somewhere by looking in the rearview mirror rather than through the windshield. You only see where you've been after you passed the place. Quite dangerous, frankly.

Here's a copy of what our credit exposure report looks like today. Steve handed Bob a piece of paper. The paper showed a list of Bob's company's customers. Each customer had a credit limit and other columns of data across the page on the same line as the customer's name. This last column shows our net credit exposure, which is this gross exposure less the credit limit, Steve said pointing at another column. The calculation is pretty straightforward, if we can get all these other columns of data from the trading system. Can I keep this? Bob asked. Sure. No worries, Steve replied.

What's else? Said Bob following up. Well, there is one thing, Steve continued. I would

like this report to separate credit exposure by exposure type. You may not know what exposure type is by that name. Bob didn't. Exposure type is like Secured and Unsecured. If I have secured credit exposure, I don't worry about it too much, except when the exposure gets close to the limit. But I do worry about unsecured exposure. True, I regularly set and update the credit limit for unsecured exposure based on our customer's financial statements. But, still, I worry that I may have set the credit limit too high. The financial health of our customers is always changing.

That isn't your worry, of course, Steve said matter-of-factly. I don't think any C/ETRM system credit reporting feature is going to solve this issue for me. Then, Steve added hopefully. Although I have heard of credit management systems that somehow scrape the internet sites of our customers and update financial values inside credit management systems. I would be very interested to know if a C/ETRM vendor has this capability. It would save me time having to do research and enter manually all those values for every customer periodically. But it isn't an absolute necessity.

Bob decided to interrupt Steve's narrative by asking a question. Can you tell me what you mean by Secured and Unsecured? Absolutely, Steve said delighted. It is pretty simple, really. Secured credit, for our business, generally means LC, or secured with/by an LC. Bob knew the term from his interview with Operations. He said, Letters of Credit, right? Yes. Yes, Steve replied. So, any invoice payment secured by an LC is one type of credit exposure. And, you know that there a several LC types, like Stand-by, At-site, and Documentary. For credit reporting purposes, they can be treated similarly. Knowing the LC type would be a nice-to-have.

I suppose, Steve continued, that payment guarantees are secured forms of payment, too, from the perspective of a customer's credit exposure. But, in this case, we would then need to monitor any guarantor's credit

exposure, too. Steve sat in thought with his finger on his lips. And, he said, shaking his forefinger now, Advanced payment, or pre-payment, is always a secure form of payment, since payment is already received. I am just listing secured forms of payment. I think the important take-away is that each form of payment should be tagged as being either secured or unsecured so that we can calculate credit exposure on this basis. The important thing is to separate credit exposure by exposure type.

Bob made several more notes. Scraping customer financials—Nice-to-have. Separating credit exposure by secured or unsecured type. Bob tapped his pen on his notepad indicating he was ready for more. What else you got for me today? Just a couple of other reporting items, Steve replied. First, I would like this C/ETRM system to show me a credit history for each customer. This report just tells me how many deals, the amounts, and payment history for each customer within a given range of dates. Bob made a note.

And, I would like to see, Steve continued, a report showing me a forecast of daily credit exposure for each customer for a future period of time. A forecast, inquired Bob? Steve continued as though he hadn't heard Bob's question. This forecast is a simulation of sorts estimating what credit exposure will look like each day within a given range of dates. You see, said Steve, credit exposure changes from

unrealized to realized when a cargo is loaded, or title changes hands. While credit exposure is unrealized, the amount will be deal PNL, or mark-to-market exposure. But, after title is transferred, the credit exposure is the notional amount of the cargo's cash value. So, the exposure jumps dramatically on the date title is transferred.

Now, if a customer has several overlapping deals, and the titles are transferred at roughly the same time, credit exposure can compound. I would like to know what the maximum exposure is and when it supposed to occur. Bob nodded and made more notes in his notebook.

Last thing, Steve said. Check to see if any of these C/ETRM systems model credit default risk. Steve saw that Bob was caught off-guard. Steve said, with a wave of his hand. Just a curiosity. Could be a useful feature. Steve appeared to have said all he wanted to say.

Well, if there is nothing further, Bob closed, I appreciate your valuable time and attention. I will keep you posted on our progress. And, I will make sure you are invited to participate in vendor product demonstrations. They shook hands and left the conference room.

In our next instalment of Bob's C/ETRM adventures, we will follow Bob to his interviews with his own IT services team.