



CREDIT RISK MONITORING

KEY CHECKPOINTS AND ILLUSTRATIONS



Pernod Ricard
Créateurs de convivialité

INTRODUCTION

The adverse economic situation in some of our markets has resulted in an increasing number of payment defaults or overdue situations. This has reinforced the necessity to have solid organisation and processes to monitor credit risk.

To support affiliates in this effort, and in the wake of other Group's initiatives addressing the cash matter (e.g. cash toolkit or more recently new Treasury KPIs), we have designed a credit risk monitoring digital book providing with both structured guidelines and concrete illustrations.

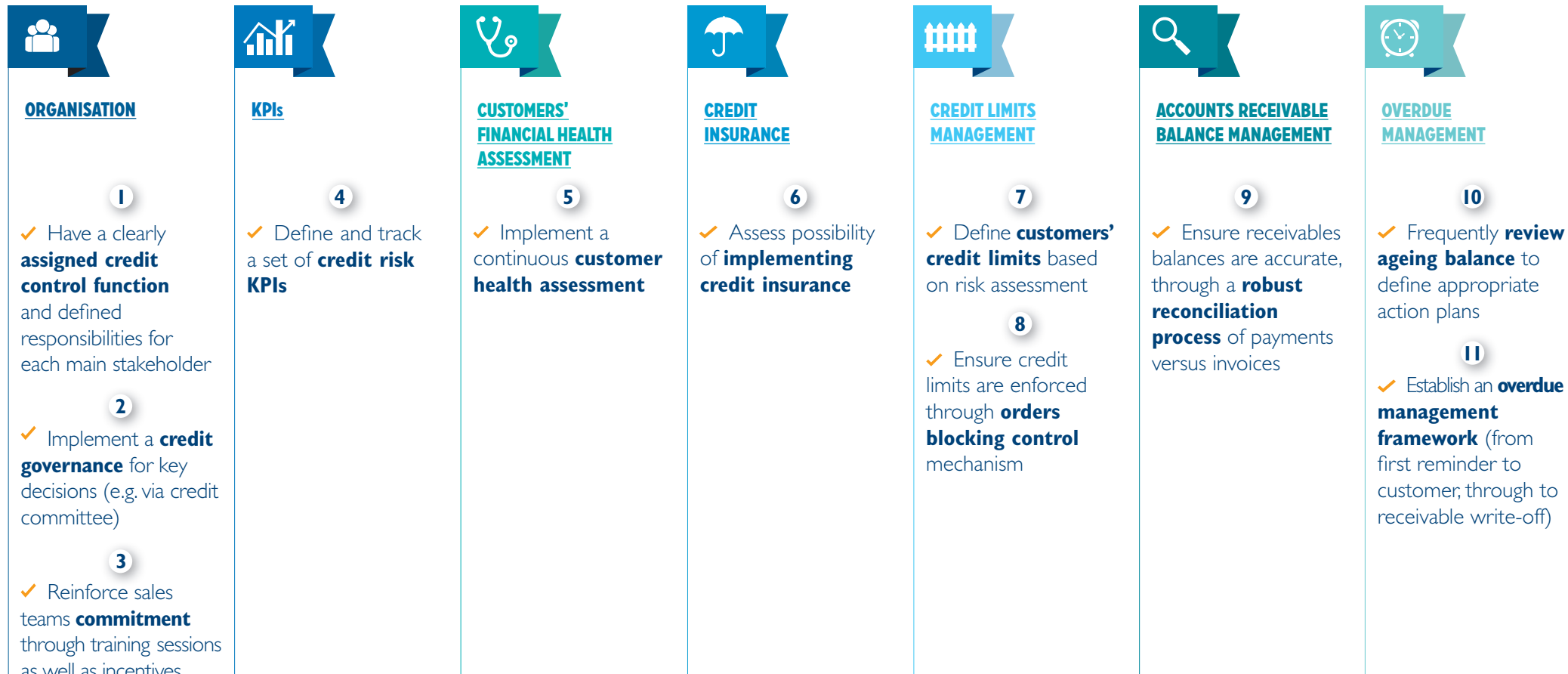
It is articulated into a series of 'checkpoints' which correspond to key questions raised to encourage affiliates to challenge themselves and improve where needed. Checkpoints address the main areas of credit risk monitoring according to the following sections:

-  **ORGANISATION**
-  **KPIs**
-  **CUSTOMERS' FINANCIAL HEALTH ASSESSMENT**
-  **CREDIT INSURANCE**
-  **CREDIT LIMITS MANAGEMENT**
-  **ACCOUNTS RECEIVABLE BALANCE MANAGEMENT**
-  **OVERDUE MANAGEMENT**


In order to reflect how those guidelines can be implemented concretely, we have selected a sample of local procedures, methodologies, reports, templates, etc. thanks to the contribution of 20 affiliates which were part of a dedicated survey. Examples presented should be considered as experience sharing to be tailored at the light of local context (risk environment, size, constraints...).

Credit risk monitoring: Organisation and processes in place to mitigate the risk of delayed payment or non payment by a customer

KEY CHECKPOINTS OF CREDIT RISK MONITORING



Each of the above 11 checkpoints is detailed in an individual page, which is built up as follows:

- On the left-hand side: detailed guidelines or recommended approaches
- On the right-hand side: brief description of illustrations from PR affiliates, including attachment where applicable (please click on the icon  to access it)



Have a clearly **assigned credit control function** and defined responsibilities for each main stakeholder

THERE SHOULD BE A CLEARLY ASSIGNED CREDIT CONTROL FUNCTION IN THE ORGANISATION, ACCOUNTABLE FOR THE CREDIT RISK MONITORING

The typical roles of the credit controller* include the following areas:

- Performing customer risk analysis (new and existing customers)
- Alerting management on material risks identified
- Coordinating credit limit definition and modification
- Releasing blocked orders after due approval (according to defined thresholds)
- Managing unreconciled payments vs. invoices
- Supporting overdue settlement
- Assisting in customers disputes resolution
- Preparing KPIs and analyses
- Communicating with external service providers (e.g. credit insurance if applicable, credit agency)

IT IS STRONGLY RECOMMENDED THAT CREDIT CONTROL REPORTS TO FINANCE TO ENSURE ITS INDEPENDENCE

However no specific target organisation is advised due to the high diversity of local structures and market practices


ROLES OF EACH MAIN STAKEHOLDER (FINANCE, SALES, LEGAL TEAMS) NEED TO BE STATED AND FORMALISED


- Comprehensive set of procedures (cf. illustrations)
- Employees' job description

ILLUSTRATIONS

Book of procedures:

- PR Romania "commercial policy gap grid": provides a list of key controls of the 'order to cash' internal control cycle, with significant attention dedicated to credit risk monitoring matters 
- PR Australia "accounts receivable policy": details credit policies vis-à-vis customers, responsibilities of the credit control team including day-to-day tasks, controls and applicable financial thresholds 

- PR USA "credit and collection processes & policies": details all key procedures and controls applicable to each step of the credit monitoring process 

- PR India "credit risk management policy": lists guidelines for the definition / revision of credit limits and for the customer rating methodology 

Credit controller's job description

* In smaller affiliates, function may be covered in part time by one or several employees

2



Implement a
credit governance
for key decisions
(e.g. via credit committee)

KEY DECISIONS IN TERMS OF CREDIT RISK NEED JOINT APPROVAL FROM SENIOR MANAGEMENT (FINANCE AND SALES)

It may include:

- Definition / change of credit limits
- Approval of credit limit overrides (i.e. release of blocked orders)
- Definition of action plans for material overdues
- Update of credit policy

THE SET-UP OF A CREDIT COMMITTEE* IS THE PREFERRED OPTION

- Formal meeting, taking place on a regular basis (preferably monthly)
- Involving CFO, sales director, credit controller and other relevant stakeholders (e.g. sales channel managers, senior finance manager, legal director)
- Requesting arbitration by CEO if necessary

A decision making process should be pre-defined for urgent situations (e.g. release of large orders, disputes with customers)


ILLUSTRATIONS

Credit committee format:

- PR España: credit committee meets monthly, involving finance and sales directors, credit control manager, customer accounting manager and on-trade sales manager.

Topics addressed:

- Review of credit limits and financial status of customers with risk of above €200k (i.e. €200k above insurance cover) as well as those with significant collection issues.
- Update of credit policies.

Approval form is circulated to committee members for any decision made between monthly meetings 

- PR Italia: credit committee meets monthly, involving CFO, channel managers, administration and credit managers, customer management manager, legal supervisor and legal specialist (due to the number of customers in litigation).

Topics addressed: receivables ageing situation, DSO by market / sub-channel, credit limit review, status of key accounts and specific customers issues highlighted during the period

- PR UK: credit committee meets monthly (and ad hoc), involving commercial directors, finance director, managing director and credit controller (secretary of the committee). Topics addressed: approval of credit limits overrides / increases, approval of new customers, etc. Emails are circulated between the members for any urgent decision 

* In smaller affiliates, this function may be performed by Management committee

3



Reinforce sales teams
commitment through training
sessions as well as incentives

SALES TEAMS TRAINING SESSIONS ARE USEFUL TOOLS TO REINFORCE CREDIT RISK COMMITMENT

They may comprise the following steps:

- Introduction to the company credit risk strategy
- Presentation of amounts at stake (market context, losses during previous fiscal years, credit insurance, etc.)
- Description of the role of sales teams in the customers' risk assessment
- Description of the responsibility of sales teams in the cash collection process
- Walk-through of company's procedures (e.g. order blocking controls, escalation process vis-à-vis customers)

SALES TEAMS OBJECTIVES PREFERABLY INCLUDE A CREDIT RISK RELATED COMPONENT

- Its weight should depend on the risk environment and the involvement of sales teams in the collection process
- Proposed indicator: % of overdues vs. total accounts receivables for each sales person



ILLUSTRATIONS

Awareness / training

- Ricard: presentation of Customer Service team to the Sales managers including credit management processes (new customer creation, definition of credit limits, control on sales orders, overdue collection), nature of involvement of Finance in credit decisions, list of KPIs monitored 
- PR Korea: presentation of credit management definitions within local context and explanation of internal credit rating methodology 

Incentives

A growing number of affiliates have been introducing incentives on cash collection for sales teams. Schemes observed are often specific to local markets and may therefore be difficult to replicate in other affiliates. Below are 2 overdue-based schemes for illustration:

- PR Rouss: the overdue target (i.e. overdue cannot exceed 10% of receivables and 7 days) represents 5% of sales managers quarterly objectives 
- Ricard: the overdue target (i.e. overdue above 60 days vs. turnover cannot exceed a defined %) accounts for up to 10% of on-trade sales representatives annual objectives (% at the discretion of regional sales management) 

4

 Define and track a set of **credit risk KPIs**

A SET OF CREDIT RISK KPIs NEEDS TO BE DEFINED AND TRACKED, DEPENDING ON MARKET ENVIRONMENT AND AVAILABLE DATA. EXAMPLES BELOW

Overdue accounts receivable

- Accounts receivable ageing balance in absolute value and in %:
 - Breakdown between not due and overdue receivables
 - Overdues by time range (0-30 days, 30-60 days, etc.)
- List of main cash collection issues with root cause analysis
- % of overdue receivables with customers in dispute and in litigation

Other risk indicators

- % of accounts receivable covered by credit insurance or other guarantees (by customer and in total)
- % of credit limit level reached (i.e. open accounts receivable ÷ credit limit)
- List of main customers recording a risk rating deterioration

Provision for bad debt and write-off






- Provisions ÷ total receivables, provisions ÷ total overdue receivables > 30 days
- Provisions ÷ overdue receivables for each time range (0-30 days, 30-60 days, etc.)
- Receivables write-off ÷ turnover

SOME OF THE KPIs LISTED ABOVE ARE ALREADY TRACKED AS PART OF MONTHLY TREASURY REPORTING

SOME KPIs MAY BE GATHERED WITHIN A DASHBOARD FOR MONTHLY DISTRIBUTION TO CFO / SALES DIRECTOR / CREDIT COMMITTEE

ILLUSTRATIONS

KPIs tracked by PR affiliates

- PR India: monthly accounts receivable report including overdues, DSO and collection target achievement at national and regional levels 
- Ricard: monthly dashboard showing evolution of credit indicators (overdues, DSO, disputes, litigation) per channel 
- PR Deutschland: monthly table showing differences between accounts receivables and credit insurance coverage per customer 
- PR Hellas: monthly table showing differences between accounts receivables, internal credit limit and insurance coverage for top 100 customers 
- PR Japan: monthly table showing level reached of customer credit limits 

Other illustrations:

- Corporate Treasury guidelines as regards Group's credit risk KPIs (in place since August 2013) 
- Examples of charts / tables which may be part of a broader cash / finance dashboard 

5



Implement a continuous
**customer health
assessment**

**A CONTINUOUS INTELLIGENCE PROCESS
SHOULD BE IN PLACE, COVERING
THE CUSTOMER PORTFOLIO**

It may include:

- Quantitative information: e.g. customers' financial statements (published or obtained from customers), research from external databases
- Qualitative information: e.g. adverse signals provided by sales representatives, trade association, or credit insurer

**RISK RATING IS A RECOMMENDED WAY
TO ASSESS CUSTOMER FINANCIAL HEALTH**






- It can be provided by credit agencies (rating based on financial and legal analyses)
- Alternatively or in addition, internal rating methodology can be implemented using both internal and external information (depending on its availability and reliability) such as:
 - External financial data (customers' financial statements, research from external database, etc.)
 - Internal financial indicators (e.g. frequent delayed payments, request for credit extension)

**A STANDARD FORM SHOULD BE COMPLETED
FOR NEW CUSTOMERS ACCEPTANCE**



- Materializing the risk analysis (based on pre-defined criteria)
- Including appropriate sign-off according to the affiliate's governance

ILLUSTRATIONS

Credit rating process:

- PR Deutschland: risk index provided by a credit agency based on customer's financial statements and other financial / legal information 
- PR Hellas: quarterly risk rating combining external sources (customers' financial statements, extract from databases, credit insurance feedback, informal information collected from the market) and internal review involving sales teams (e.g. longer credit terms requested, turnover trends:
 - rating methodology 
 - customer evaluation template 
- PR Korea: bi-annual risk rating resulting from internal financial review: quantitative (secured collaterals, DSO, delayed payment, etc.) and qualitative ("business soundness" and credit team opinion) 
- PR India: risk rating based on internal indicators: 70% quantitative (checks bounced, credit terms, average overdues, balance confirmation sign-off in last 12 months, etc.) and 30% qualitative (risk appraisal by Region Head) 

New customer form:

- PR India: new customer form evidencing the analysis of credit worthiness (trade reference checks, financial statements, ability to invest in business & infrastructure, various business information, etc.) as well as management sign-off 
- PR Australia: checklist of tasks required for the validation of a new customer (e.g. external credit report obtained, trade references requested, customer maintenance form completed, approved by credit controlling, confirmation letter sent to the customer) 



6



Assess possibility of implementing credit insurance

ALL AFFILIATES SHOULD REGULARLY ASSESS THE POSSIBILITY OF IMPLEMENTING CREDIT INSURANCE

- First considering one of the Group insurance programs (Euler Hermes or Coface)
- But local contract may be an alternative option if cost and coverage are more attractive

Implementation may not be possible due to local constraints (e.g. lack of knowledge from credit insurers on customers). However opportunity of implementation should be considered even if bad debt record is low: a deterioration of the economic environment could result in a sudden acceleration of customers' defaults, then it would be too expensive to introduce credit insurance

ALL EFFORTS SHOULD BE MADE TO OPTIMIZE INSURANCE COVERAGE

For example, several affiliates are getting extra coverage at peak season without incurring additional cost.

The following communication channels can be activated:

- Frequent contact with the local insurer
- Assistance from the group broker *Assurance Universelle* when needed, in coordination with Holding

OTHER FINANCIAL GUARANTEES MAY BE OBTAINED, SHOULD INSURANCE BE TOO COMPLEX TO IMPLEMENT OR NOT PROVIDE ADEQUATE COVERAGE

For instance:

- Bank guarantees
- Collaterals arrangements
- Goods returns arrangements
- Upfront payments

The ability to effectively activate these guarantees in practice should be checked upfront

ILLUSTRATIONS

Group insurance programs are likely to provide more favorable conditions than local contracts

They are characterized by the following clauses:

- A discretionary limit
- A unique defined insured percentage
- A delayed application of the credit limit reduction or withdrawal (generally 3 months)
- The possibility to recourse to arbitrage
- An individual and annual profit sharing clause

In addition, group programs allow a mutualization of risks

7



Define **customers' credit limits** based on risk assessment

A CLEAR RULE TO DEFINE CREDIT LIMITS SHOULD BE ESTABLISHED, IN RELATION TO THE RISK ENVIRONMENT OF THE MARKET

- Where credit insurance provides adequate coverage – as regards expected turnover and payment terms –, internal credit limit may be based upon the amount of insurance guarantee of each customer
- Where credit insurance is not in place or does not provide sufficient coverage, credit limits should be related to the level of risk associated with the customer:
 - Either directly derived from the credit rating
 - Or including other risk parameters (e.g. quality of payment history, qualitative assessment from sales / finance departments, etc.).

It is recommended to adapt the credit limits to sales seasonality, for example by having a limit for peak season and another for the regular season

CREDIT LIMITS NEED TO BE REGULARLY UPDATED

- At least annually for all customers
- And monitored on an ongoing basis for risky customers (e.g. customers with overdue balances or approaching their current credit limit)

CREDIT LIMIT DEFINITION / CHANGE REQUIRES A FORMAL APPROVAL

- Jointly by finance and sales functions (and ultimately under the governance of credit committee or Management committee)

ILLUSTRATIONS

Credit limit definition methodologies related to customers risk assessment:

- Ricard: the external risk rating of the customer determines the credit limit
- PR Romania: the internal risk rating of the customer determines the applicable credit limit
- PR Brasil: computation includes a risk coefficient based on several criteria (rating and comments from credit agencies, payment delays, financial statements analysis). When approving the limit, credit limits granted by other FMCG suppliers and insurance are also looked at

Credit limit computation taking into account seasonality:

- PR China: 4 different credit limits are set at the beginning of the FY based on the phasing of estimated cash-in per customer

Credit limit update process:

- PR Brasil and PR Ukraine review all credit limits twice per year (peak and low seasons)
- PR Australia reviews credit limits at end of month for all customers having exceeded their credit limit or having reached more than 90%

Credit limit approval process:

- PR India: level of management approving credit limit depends on both the risk rating and the size of the proposed credit limit:
 - approval procedure
 - application form
- PR España: credit limit approved by credit committee if exceeding by €300k and / or by twice the insurance coverage

8



Ensure credit limits are enforced through **orders blocking control** mechanism

AUTOMATED BLOCKING CONTROL OF NEW SALES ORDERS NEEDS TO BE SET UP IN THE ERP WHEN RESPECTIVE CREDIT LIMIT IS EXCEEDED

In order to pro-actively minimize the number of held orders, the list of customers approaching their respective credit limits may be shared with sales teams

ACCESS RIGHTS TO CUSTOMER MASTER DATA SHOULD BE STRICTLY RESTRICTED

Limited to Finance and in line with segregation of duties principles

CREDIT LIMIT OVERRIDES SHOULD BE SUBJECT TO A FORMAL APPROVAL

Through an authority matrix involving both finance and sales functions, and ultimately under the governance of credit or Management committee

If override is not granted, upfront payment may need to be requested from the customer before releasing new order

ILLUSTRATIONS

Control to limit the number of blocked orders:

- On top of orders blocking control, PR Ukraine has put in place an alert to sales representatives when customers exceed 85% of their credit limit

Credit limit override approval process:

- PR Brasil: CFO and sales director approval above \$50k; their respective direct reports below \$50k
- PR Korea: authority matrix includes 3 approval thresholds for credit limit overrides involving both sales and finance
- PR India: gradual approval process of credit limit increase, depending on the amount of excess and the duration of the approval validity:
 - override and increase approval procedure
 - application form



9



Ensure receivables balances are accurate, through a **robust reconciliation process** of payments versus invoices

RECONCILIATION BETWEEN CUSTOMERS' PAYMENT AND RESPECTIVE INVOICES RELIES ON ROBUST INTERNAL MONITORING PROCESSES

- Prompt cash allocation by Finance and liaising with the sales teams when needed
- Adequate discounts tracking facilitating the detection of any undue deduction by the customer
- Follow-up of disputes with customers, preferably flagged in the ERP (unresolved deductions, disagreement on prices or discounts applied, differences on quantities invoiced / delivered / returned, etc.)
- Periodic ledger clean-up in order to clear any pending item

More generally, a strict maintenance of databases (prices lists, customer master file, etc.) also reduces disputes occurrence

STANDARDIZED INTERACTION WITH CUSTOMERS CAN EASE THE RECONCILIATION, DEPENDING ON THE TYPE OF CUSTOMERS AND LOCAL PRACTICES

- Standardized process to obtain remittance advice. The remittance advice slip should disclose:
 - respective invoices' number and amount
 - any deduction from the payment (e.g. promotion, service paid)
- With some customers in modern trade channel, access via the customer's web portal to the list of pending invoices registered by the customer (with respective due dates)
- Automated pre-matching system of payments vs. invoices
- Contact with customer's accounting team (either before due date for validation of future payment, or afterwards to clear unreconciled items)

PERIODIC BALANCE CONFIRMATION FROM THE CUSTOMERS SHOULD BE PUT IN PLACE WHEN DAY-TO-DAY RECONCILIATION IS NOT RELIABLE OR NOT POSSIBLE

ILLUSTRATIONS

Local practices which facilitate reconciliation process:

- PR UK: designated email box for customers to send remittances; customer's deductions use a reference number which is identified and matched to either a claim or a rebate invoice
- Ricard: access to web portal of modern trade customer
- Ricard: currently finalizing the implementation of a checks scanning system which will allow automated matching with invoices (in on-trade)
- PR Japan: is provided by customers with the payment details before the payment itself, which allows to check the potential rebate amounts that will be deducted from payment and resolve potential customer's disagreement

Balance confirmation process with the customers:

- PR Mexico: confirmation of customer balance is obtained at least every six months: either through formal sign-off from the customers (wholesalers / convenient stores) on a standard confirmation template, or through access to web portal in modern off-trade



10



Frequently **review ageing balance** to define appropriate action plans

AGEING BALANCE PER CUSTOMER SHOULD BE FREQUENTLY REVIEWED BY CREDIT CONTROLLER, PREFERABLY WEEKLY

ROOT CAUSES NEED TO BE IDENTIFIED IN ORDER TO DEFINE APPROPRIATE ACTION PLANS (ONGOING DISPUTE, UNPREDICTED LATE PAYMENT, ETC.)

The analysis may include:

- A split by channel and / or region
- A focus on main overdue amounts and key customers

LEARNINGS OF THIS ANALYSIS SHOULD BE SHARED WITH RELEVANT STAKEHOLDERS

- Sales teams, for quick resolution with the customers when applicable
- CFO / Sales director / Credit committee, for regular review and validation of action plans when necessary

LEVEL OF PROVISIONS FOR BAD DEBT SHOULD BE REGULARLY EVALUATED

- Coverage of overdue receivables above a defined time span (e.g. 30 days)
- Coverage of major individual risks

ILLUSTRATIONS

Communication to sales teams:

- PR Brasil: outcomes and action plans are shared with the sales teams on a weekly basis following the review of the ageing balance ⓘ
- PR Hellas: weekly communication of the ageing report to the sales teams
- PR España: sales teams have live access to the overdue amount of each customer in the CRM tool (updated daily) ⓘ



Establish an **overdue management framework**
(from first reminder to customer;
through to receivable write-off)

AN ESCALATION PROCESS VIS-À-VIS CUSTOMERS NEEDS TO BE PRE-DEFINED, SO THAT TIMELY AND PROGRESSIVE ACTIONS CAN BE IMPLEMENTED

- Informal reminders (by phone call / email)
- Dunning letter
- Customer placed on credit hold*
- Final notice
- Legal proceedings
- Other actions (e.g. involvement of a debt recovery agent)

Some of the above steps may require pre-approval from credit committee, as regard potential impact on commercial relationship (in particular with key customers). Process to be tailored by channel if necessary

OTHER KEY STEPS SHOULD ALSO BE KEPT IN MIND

- Alert of Region / Holding in case of material risk or default**
- Timely claim to the credit insurer and execution of financial guarantees if any (e.g. bank guarantees)
- And any other actions relevant within the local context

BAD DEBT WRITE-OFF HAS TO BE STRICTLY CONTROLLED

- Applicable conditions to be pre-assessed (depending on local legal requirements, e.g. final court decision requirement)
- Approval to be obtained from management

* Either through automated blocking control above a defined time span (e.g. 30 days or 60 days overdue) or through manual activation

** Affiliates part of factoring / securitization programs need to alert Holding before declaring any highly material claim to credit insurers (e.g. > €1m)

ILLUSTRATIONS

Example of the Ricard standard overdue escalation process

Order blocking controls in case of overdue occurrence:

- Ricard: if overdues balances are above 30 days
- PR Ukraine: if the oldest invoice is within maximum overdue period (tolerance vs. agreed collection terms)

INDEX OF ILLUSTRATIONS



ORGANISATION

1

- PR Romania - Commercial policy gap grid
- PR Australia - Accounts receivable policy
- PR USA - Credit and collection processes & policies
- PR India - Credit risk management policy
- Credit controller's job description

2

- PR España - Credit committee
- PR UK - Credit committee

3

- Ricard - Customer Service presentation to Sales managers
- PR Korea - Credit management definitions
- PR Rouss - Sales managers overdue based objectives
- Ricard - Sales representatives overdue based objectives



KPIs

4

- PR India - Accounts receivable report
- Ricard - Customer credit dashboard
- PR Deutschland - Insurance coverage gap
- PR Hellas - Credit report by customer
- PR Japan - Customer credit limit level reached
- Corporate Treasury - Follow-up of collection risk on receivables
- Examples of credit risk charts & tables



CUSTOMERS' FINANCIAL HEALTH ASSESSMENT

5

- PR Deutschland - Credit agency report
- PR Hellas:
 - Rating methodology
 - Customer evaluation template
- PR Korea - Wholesaler credit segmentation
- PR India - Credit risk rating
- PR India - New customer form
- PR Australia - New account worksheet



CREDIT LIMITS MANAGEMENT

7

- Ricard - Credit limit based on external rating
- PR Romania - Credit limit based on internal rating
- PR Brasil - Credit limit definition & revision form
- PR China - Credit limit definition linked to sales seasonality
- PR India:
 - Approval procedure
 - Application form

8

- PR Korea - Credit override approval matrix
- PR India:
 - Override and increase approval procedure
 - Application form



ACCOUNTS RECEIVABLE BALANCE MANAGEMENT

9

- PR UK - Example of customer remittance advice
- Ricard - Example of customer web portal
- PR Mexico - Customer balance confirmation template



OVERDUE MANAGEMENT

10

- PR Brasil - Communication of overdue & action plan to sales force
- PR España - Access to credit information in the CRM tool

11

- Ricard - Overdue escalation process



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