



## A Study of Canadian Commercial Credit Granting Practices- 2009 - 2011

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### Executive Summary

This study provides a bird's eye view of the pressures faced by Canadian credit managers and the steps they are taking to protect their companies' Accounts Receivables, often a company's second largest asset.

Canadian professional credit grantors were fully aware of the global financial crisis commencing early in the last decade and steps were made by most to protect their credit portfolios prior to the 2009 Credit Institute of Canada National Conference. Thirty eight CIC member companies responded to the 2009 Pre-Conference survey. Prior to the 2011 National Conference a second survey was conducted with responses received from 78 member companies. From the survey responses and ensuing Trade Credit Workshop conducted at both 2009 and 2011 National Conferences it appears as though Canada's Credit professionals are successfully protecting their domestic and foreign trade credit exposures.

This is reinforced by statistics posted on the website of the Office of the Superintendent of Bankruptcy, OSB. These statistics are available monthly from: [http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/h\\_br01011.html](http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/h_br01011.html)

Following a rise in commercial insolvency filings in 2007 to early 2009, there are significant reductions in key business sectors through the latter half of 2009 and into 2011. Canadian Credit professionals reported at the 2011 National Conference that their companies have become more agile in adapting to changing financial conditions within their business markets and have been able to expand sales to other territories providing higher risks with compensating margins or lower margins with perceived safer credit or overall business risk.

The survey respondents reported that their top three customers, by business sector were:

1. Manufacturing (50%)
2. Construction (45%)
3. Wholesale Trade (33%)
4. Retail Trade (26%)
5. Agriculture, Forestry, Fishing and Hunting (18%)
6. Mining, Oil and Gas (18%)

Forty six percent of respondents report seeing a general deterioration in the risk ranking for their Canadian customers over the last 12-18 months, down from 86% in 2009.

The 2011 survey respondents identified the three main industries of greatest deterioration were: Construction (56%), Manufacturing (44%) and Retail Trade (31%).

There is an air of "cautious optimism" selling into the Construction Sector with evidence of some taking on more risk than in the past. The need to review financial statements from almost all existing and prospective customers has developed over the past couple of years as normal practice. Registration of liens are on the rise with tighter control over collections.

Those selling into the Retail and Wholesale sectors report the closure of several auto dealerships over the past few years has negatively impacted this sector. However there is evidence of the industry starting to rebound. Tighter credit controls by credit insurers has resulted in decreased sales.

Three major concerns to those supplying the Retail sector are the increased use of consumer credit cards, overall rising levels of consumer debt and unstable housing prices.

In the Agricultural Sector, sales overall are down over the past two years, due to a decrease in the number of producers and to a general decline of general crop production. Suppliers are becoming more inclined to stop orders sooner on delinquent customers, as few as 30 days past due, down from the former norm of 60 days. Deeper financial reviews are being conducted on existing and new customers. As a result of downsizing of many credit departments across Canada there has been an increased use of collection agencies to help, as part of credit policy steps, to effect collections. There is general concern over the stability of the Hog market.

Those selling into the Mining and Oil & Gas Extraction sector are negatively impacted by large or "Senior" Oil and Gas producer companies unilaterally deciding terms of payment to their suppliers. Slow payments create a domino effect meaning that small to medium sized companies in this sector are forced to provide extended credit terms amongst themselves and those that were paying in 60 days before are now taking 90 or more days to pay. The use of third party security devices such as third party credit insurers, bank letters of credit, security deposits and pre-payments is becoming more standard.

In the Transportation Sector physical product volumes remain steady but rising fuel prices, while increasing revenues are creating higher credit exposures, thereby increasing the credit risk of the customer. Credit managers with customers in this sector report having to be more diligent with collection follow-ups and work more closely with sales force. Improved status of the credit departments with operations and sales departments as sales force have become part of setting corporate targets of various key

performance indicators, such as days sales outstanding. The inclusion of General Security Agreements has become a standard part of the Credit Application form as has the increased use of pre-authorized debit payment mechanisms.

**Background:**

Two years ago the Credit Institute of Canada (CIC) published a White Paper called "Dealing in Today's Volatile Credit Environment". The paper was put together with information taken prior to the 2009 National Conference from a survey of CIC Members followed by direct feedback given in roundtable discussions at the 2009 National Conference.

Leading up to the 2011 National Conference the CIC decided to produce a follow-up report and re-evaluate the current credit environment with the aim of determining if the economic recession was behind us or simply less visible. Considering Canada's relatively strong economy, a pre-conferences survey was again conducted using generally the same criteria as in 2009. Then at our 2011 National Conference, round table discussions were held, in workshop format, to determine if credit managers were seeing any signs of a return to a healthy and growing economy or if the effects of the recession were still being felt.

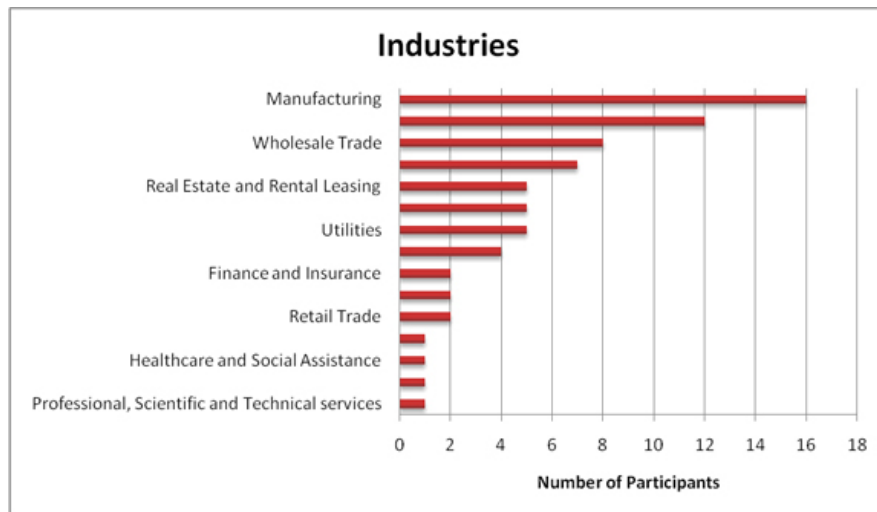
While news reports and articles are being published daily about market volatility and stock prices, the role credit plays in business today is crucial. A prime example of this is the economic fallout from the Credit Crisis of the mid-2000's, whereby banks and businesses alike decreased limits in an effort to protect themselves from toxic debt from the housing bubble. This precipitated an economic spiral from which the global economy is still struggling.

This report is the result of information gathered in two steps from Canadian Credit Professionals represented by their membership in the Credit Institute of Canada. The first half of this paper represents the collection of data obtained from information provided by members invited to participate in the 2011 Pre-Conference Survey. The first part of the report contains general observations resulting from the detailed results of the pre-conference survey. The second half contains a recap of discussions from the round table workshop conducted at the 2011 National Conference in Ottawa June 16, 2011.

**Summary of Pre-conference Industry Survey**

**Methodology:**

The survey was conducted from May 9th, 2011 through June 8th, 2011. Overall, 78 respondents completed a survey compared to 38 responses to the 2009 survey. The survey respondents were a diverse group, including these industries:



**Four respondents did not indicate their corporation's business sector Trends:**

Approximately a third of respondents (34%) reported having annual sales over \$500 million, with a further 18% and 16% reporting sales in the \$251 - \$500 million and \$151 - \$250 million ranges. This shows an increase over the previous survey of 10%, 0% and 10% respectively. The groups reporting sales in the \$75 - \$150 million and under \$75 million both decreased in size (12% and 8% respectively).

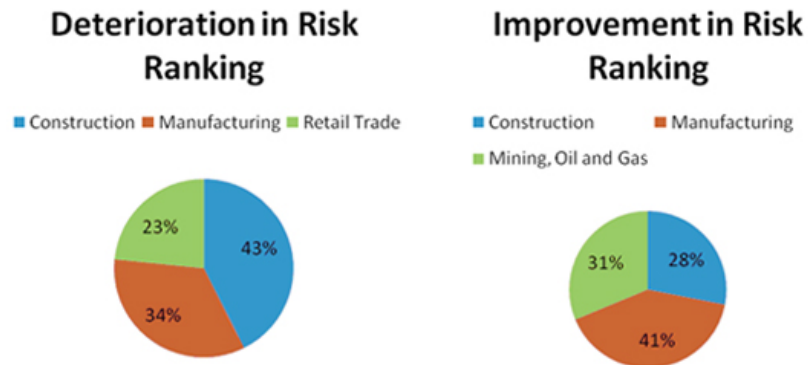
The survey respondents reported that their top three customers, by business sector were:

1. Manufacturing (50%)
2. Construction (45%)
3. Wholesale Trade (33%)
4. Retail Trade (26%)
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The major change was the rebound in the manufacturing group. In 2009 manufacturing accounted for only 39% of customers, which had by 2011 grown to be 50%.

Forty six percent of respondents report seeing a general deterioration in the risk ranking for their Canadian customers over the last 12-18 months. Although this still seems high, it is a drastic decrease from 2009 when 86% had reported seeing a deterioration. The 2011 survey respondents identified the three main industries of greatest deteriorations were: Construction (56%), Manufacturing (44%) and Retail Trade (31%). There is little change from 2009, where the same three occupied the same spots with slightly different percentages (56%, 41% and 29% respectively).

In the 2011 survey, respondents were also asked if they had seen an improvement in any and which ones those were.

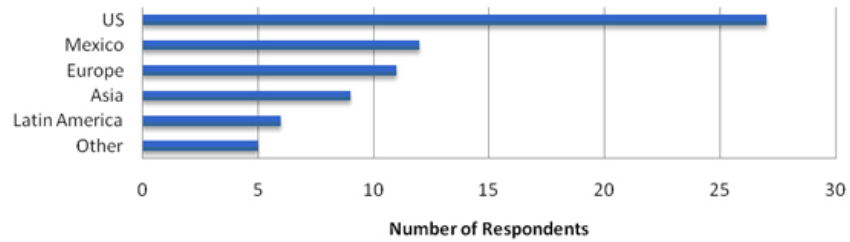


It is interesting to note the presence of both Manufacturing and Construction in both "Deterioration of Risk Ranking" and "Improvement of Risk Ranking" categories following the initial survey conducted in 2009. The insolvency statistics available from the OSB at the time of the National Conference were updated to March 2011. Of interest, total number of insolvencies for manufacturing sector rose from an average of 33 per month for the period December 2010 through February 2011 to an average of 53 per month during March, April and May 2011. By comparison, but as interesting, Construction sector averaged 68 per month during December 2010 through February 2011, rising to 73 insolvencies per month during the following three months ended May 2011.

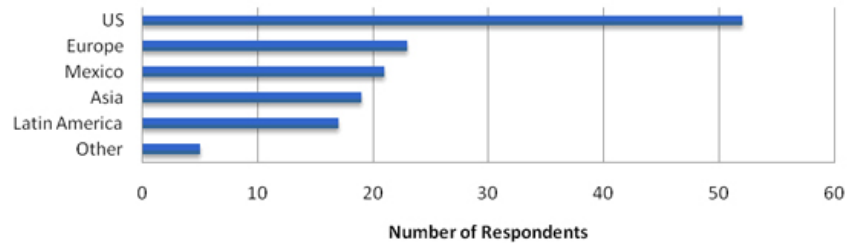
Seventy seven percent of respondents reported having a Credit Policy in place, down 7% from 2009. Sixty four % of respondents who report having a current credit policy in place have not seen the need to amend their credit policy in the past year. While this is an increase of 17% over 2009 this still leaves 36% who found that they have have to amend their credit policies since the 2009 survey.

Seventy five % of the 2011 survey respondents report exporting their products. This is only a slight drop (3%) from the 2009 survey. The following graphs depict, by country, goods and services exported to various markets both in 2009 and 2011.

### Exports in 2009



### Exports in 2011

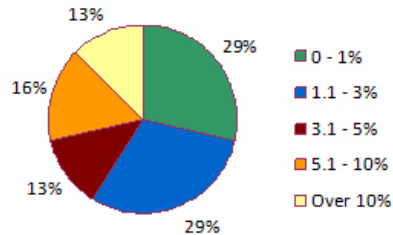


As expected, these graphs show, the vast majority of those who export do so to the US., Of interest is a shift in exports reported in 2011 to Latin America This trend reinforces and confirms similar trends noted in other trade export reports.

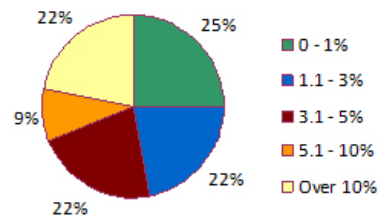
The end of the survey examined some of the negative credit scenarios. The majority (64%) of respondents reported having to take, since the last survey in 2009, some form of defensive credit action against or restricted their selling on open account to less than 10% of their portfolios.

When looking at what percentage of their accounts receivable were in arrears, the results were also promising. In 2011, 59% of the respondents report that the percentage of their arrears fall at or below 3% of their overall credit portfolio. In 2009, 47% of survey respondents reported that the percentage of their arrears were in the category of 0 to up to 3% of their credit portfolio. While substantial headway has been made in the past two years reducing the over 10% arrears, down to 13% of respondents from 22% reporting in 2009, the combined "over 5% plus over 15% past due" categories look much the same in 2011 as 2009.

**% of March 2011  
Receivables 90 days  
past due**



**% of March 2009  
Receivables 90 days  
past due**



**Summary of Workshop Discussions - Industry Roundtable Feedback:**

The second part of this White Paper deals with the results of discussions from the Round Table Workshop held at the 2011 National Conference. Delegates were asked to move to areas throughout the hall, which were indicated by the business sector representing the primary customer base of the delegate. For example, delegates employed in, say the Manufacturing sector, but whose primary customers were of the Construction sector, were asked to move to the "Construction" sector tables, those in Retail selling to Manufacturing customers, asked to move to the Manufacturing tables, and so on. The workshop then, was conducted in order that the delegates could comment on their responses to five general questions concerning the business sector of their primary customers. Those questions were:

1. How has the changing credit environment impacted your sales to this sector?
2. Have you made any changes to your credit policies or credit terms to this sector?
3. Have any of your own suppliers from this sector made any changes since the last conference to their credit policies or terms?
4. Have you changed the way you use third party risk mitigation tools for sales into this sector?
5. Are there any other general issues or concerns that you would like to discuss?

Of the business sectors reviewed at the workshop, the largest was the Construction sector. Each sector was asked to discuss the five questions above and we report that not all business sector tables reported on their flip charts answers to all five questions but there was considerable discussion by all groups in all sectors. The following is a recap of information transcribed from the flip charts utilized at the workshop along with short narrative recaps taken from the sector spokespersons.

**Construction:**

1. How has the changing credit environment impacted sales?

Overall sales are down and engineered building projects have added to the downturn. However this group did seem to have a feeling of cautious optimism. Concrete sales are up in 2011 over 2010. There was an oversupply in the Residential construction sector of single-family unit condominiums in during 2008 and 2009 causing some slow down in 2009 to 2010. Banks were holding back financial liquidity to the construction sector and were somewhat slow to release cash to suppliers. Private developers are disappearing. There has been evidence of pressure on sales forces due to a pressure to reduce Sales and General Administrative costs. Confidence is cautiously returning to the sector. However, some suppliers, particularly in Ontario are still waiting to pay in the supply chain until they themselves receive payment. Larger companies along the supply chain are enforcing unilateral terms of sale and holdbacks giving them an unfair advantage over their smaller competitors. As much of the Construction sector business is price driven, increased margins attract new business and decreased margins drive suppliers to markets in other provinces. Some have also just merely seen that they have "too many eggs in one basket" and are developing strategies to expand and diversify to other geographic areas and other sector customers.

2. Have you made any changes to your credit policies / terms?

There is seen a need to more tightly enforce the current policies and some in this group confess that they are taking on more risk than in the past. Additionally, as long as the customer continues to pay on time the credit managers are forgiving "over limits" conditions as a trade off for prompt payments except for larger accounts where there is seen a need to tighten credit limits. The need to review financial statements from almost all existing and prospective customers has developed over the past couple of years as normal practice. Registration of liens are on the rise with tighter control over collections. Suppliers are conducting far deeper investigations into the credit-worthiness of customers in this sector including drilling down to the review of business conditions, including investigations on the financial health of ultimate receivers of goods and services from the prospective Construction credit applicant. While in the past, security documentation had been taken from Construction customers without perfecting, more suppliers to Construction customers are now perfecting their security interests up front and there is a move toward more direct contact with prospective customers' banks for banking information as a part of routine credit investigations. There is a rise in obtaining more third party guarantees.

3. Have your suppliers changed any of their policies / terms?

United States suppliers have been tightening their terms of sale. Reduced manpower in the supplier side of the Construction sector has negatively impacted relationships with suppliers. There has been a move to engage senior management in the collection of past due accounts with a focus of remediation and maintaining relationships. There is a move up and down the supply chain line to try to negotiate longer credit terms to sixty days or beyond. We see up and down the supply chain the constant negotiation for changing (lengthening) of credit and payment terms. Holdbacks are an issue and are used as a creative tool for retention of cash.

4. Have you changed the way you use third party risk mitigation tools? Implications of implementing third party risk mitigation tools, while being contemplated seem not yet to be required in many cases. That said, there is an increase of requesting deposits, and even pre-payments for custom jobs. Use of pre-authorized payments are on the rise but not acceptable to larger companies. Some have introduced credit card programs. Suppliers into the Construction sector are sensitized to the cost of obtaining third party mitigation tools. However some have introduced factoring receivables as a tool to reduce risk / improve cash flow and others have introduced the need to get labor and construction bonds.

5. Are there any other issues or concerns?

The first item expressed as a major concern of those selling into the Construction sector was dealing with ongoing requests of customers to extend credit terms of sale. There is an increased burden on the credit department suppliers to the Construction sector to step up the frequency of credit reviews and employ deeper investigations on new applicants. A closer review of supply contracts is also underway to ensure that the terms and conditions within those contracts, as they relate to credit management, bear a closer "resemblance of reality". The term "credit on credit" was introduced by this group meaning that there seems to be a chain reaction of dependence on the subcontract being paid before the contract can be paid by the subcontractor. The existing or potential to "offload administration" to third world countries is of real concern to getting the flow of payment and information pertaining to payments. Postal disruption is also of concern from time to time.

#### **Wholesale/ Retail**

1. How has the changing credit environment impacted sales?

The closure of several auto dealerships over the past few years has negatively impacted this sector. However there is evidence of the industry starting to rebound. Tighter credit controls by credit insurers has resulted in decreased sales. A reduction in advertising budgets in Sales and General Administration costs has had a negative impact on sales. Some customers in this sector are unilaterally changing (lengthening) terms of payment. Others are asking for discount for prompt payment. Others who are given discounts for prompt payment are abusing the discounted credit terms by paying the discounted value after the discounted payment due date.

2. Have you made any changes to your credit policies / terms?

There is evidence of closer collaboration between Credit and business development departments. The use of pre-approved payment plans and payments by credit cards has been introduced to sales into this sector. While credit terms for open account have not changed there has been a movement toward the taking of additional security including an increase of personal guarantees. More suppliers selling into this market report an increased use of formal Credit Application forms and tightening of credit policies.

3. Have your suppliers changed any of their policies / terms?

Some suppliers in this sector are setting their own terms contrary to industry norms.

4. Have you changed the way you use third party risk mitigation tools?

Credit insurers are reported to be playing a more active role and suppliers are in many cases leaving decisions regarding creditworthiness of buyers to the insurers.

5. Are there any other issues or concerns? Three major concerns to those supplying the Retail sector are the increased use of consumer credit cards, overall rising levels of consumer debt and unstable housing prices. However signs of positive change within the Wholesale sector point to reducing monthly days sales outstanding by virtue of direct billing to individual wholesale companies instead of through third party management companies.

### **Agriculture**

1. How has the changing credit environment impacted sales?

Banks have a reduced appetite for extending credit to Hog markets therefore financing is falling to the supplier, which is not seen by the suppliers as their core competency. Due to weather conditions over the past couple of years grain production is off. Suppliers then are becoming more inclined to stop orders sooner, as few as 30 days delinquency, down from the former norm of 60 days. This has contributed to a loss of loyalty in general within the sector. There has been a marked increase of third party financing especially on crop inputs. Sales, overall are down over the past two years, due to a decrease in the number of producers and to a general decline of general crop production. Two bright lights in the Agriculture sector are the Meat industry and the Biofuel industry.

2. Have you made any changes to your credit policies / terms?

There has been a move toward offering discounts in exchange for shorter credit terms. Many are looking at cost savings and using more tools for credit reviews and taking additional security such as personal guarantees. Information sharing between suppliers is on the rise. Deeper financial reviews are being conducted on existing and new customers. As a result of downsizing of many credit departments across Canada there has been an increased use of collection agencies to help, as part of credit policy steps, to effect collections. Automation of credit interchange information between suppliers and from credit reporting agencies and of internal monitoring of customer activity has become more efficient than in the past.

3. Have your suppliers changed any of their policies / terms?

Suppliers within the Agriculture sector are imposing tighter collection cycles and employing more efficient payment methods such as electronic funds transfers and electronic data interchange. Credit reviews have become more sophisticated with much more information required by suppliers than that which had been requested in the past in order to complete an in-depth credit review.

4. Have you changed the way you use third party risk mitigation tools?

Credit managers representing firms selling into the Agriculture sector are exploring and using more tools to protect themselves from loss. They have seen an increased taking of security devices and purchase of credit insurance. The insurance carriers are more heavily involved with credit decisions on the quality of the buyers right down at the transaction level rather than the traditional portfolio level. Some suppliers are even having the buyers pay for the cost of the credit insurance. The use of commercial credit cards is also on the rise.

5. Are there any other issues or concerns?

There is general concern over the stability of the Hog market. Weather is also a major concern to those selling into the Agriculture sector. The industry is becoming more mature with less hobby farms and more farms forming large corporations making it difficult for the smaller independent farmer to survive. Producers are watching their cash flows and are unilaterally stretching payment terms to their suppliers. Costs of inputs such as oil products are on the rise all of which cause an increase of overall operating costs for those in the Sector sometimes making it harder to collect on a current basis. Credit managers selling into this sector have to keep bumping up credit limits due to increased pricing.

### **Mining and Oil & Gas Extraction**

1. How has the changing credit environment impacted sales?

Large or "Senior" Oil and Gas producer companies are unilaterally deciding terms of payment to their suppliers. These Senior producers are bureaucratic and making personal contact with their personnel to extract payment is difficult. There is often no live person to talk to about issues. Slow payments create a domino effect meaning that small to medium sized companies in this sector are forced to provide extended credit terms amongst themselves and those that were paying in 60 days before are now taking 90 or more days to pay.

2. Have you made any changes to your credit policies / terms?

There is a need to more tightly enforce authorized payment terms.

3. Have your suppliers changed any of their policies / terms?

There is a general understanding that Suppliers are also paying their own suppliers later than normal authorized credit terms.

4. Have you changed the way you use third party risk mitigation tools?

The use of third party security devices such as bank letters of credit, security deposits and pre-payments is becoming more standard. Credit Insurance is employed in this market at both the portfolio level and transactional "one-off" level.

5. Are there any other issues or concerns?

Suppliers report there is a need to educate their own customers on the credit risks they in turn are taking on their own customers.

### **Transportation**

1. How has the changing credit environment impacted sales?

Surcharges on fuel prices are a cause for requiring to increase credit limits. Physical product volumes remain steady but revenues are increasing causing sales to rise, increasing the credit risk of the customer.

2. Have you made any changes to your credit policies / terms?

There is a need to obtain more credit information, financial statements etc on customers. Credit terms are tightening and the use of preauthorized debits from customers has provided better cash flow to the suppliers. Suppliers still have to review credit limits for fuel more than once per year. Credit terms have to be tightened to all commercial carriers including bus operators. There has been seen an increase of the number of liens on service industry in this sector. Sales are reported on the rise in 2011 over prior years and credit managers selling into this sector report having to be more diligent with collection follow-ups and work more closely with sales force. Improved status of the credit departments with operations and sales departments as sales force have become part of setting corporate targets of various key performance indicators, such as days sales outstanding. The inclusion of General Security Agreements has become a standard part of the Credit Application form.

3. Have your suppliers changed any of their policies / terms?

Yes there is a move toward suppliers wishing to invoke shorter credit terms.

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