MEDIA RELEASE

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Tuesday, 29 March 2011

Business to business lending declines as payment terms deteriorate

Business to business lending has declined following a spike during the Global Financial Crisis (GFC) as deteriorating payment terms make executives nervous about extending credit to their customers. The trend is likely to act as a drag on Australia's economic performance and present as a considerable headwind for the global recovery according to an analysis of trade credit trends by Dun & Bradstreet.

Dun & Bradstreet is the world's leading provider of commercial credit data with information on more than 170 million companies worldwide. The trade credit analysis is the first of its kind ever released in Australia.

The Dun & Bradstreet data reveals that during the height of the global crisis the amount of trade credit extended rose dramatically as firms' increased their reliance on suppliers as a source of finance to sustain their purchases in the absence of bank lending. Suppliers agreed to this increased amount of trade credit fearful of losing customers or even ultimately sending those customers to the wall.

During the 2008 financial year the amount of outstanding trade credit in Australia exceeded $190 billion. This was followed in the 2009 financial year with total outstanding trade credit exceeding $166 billion.

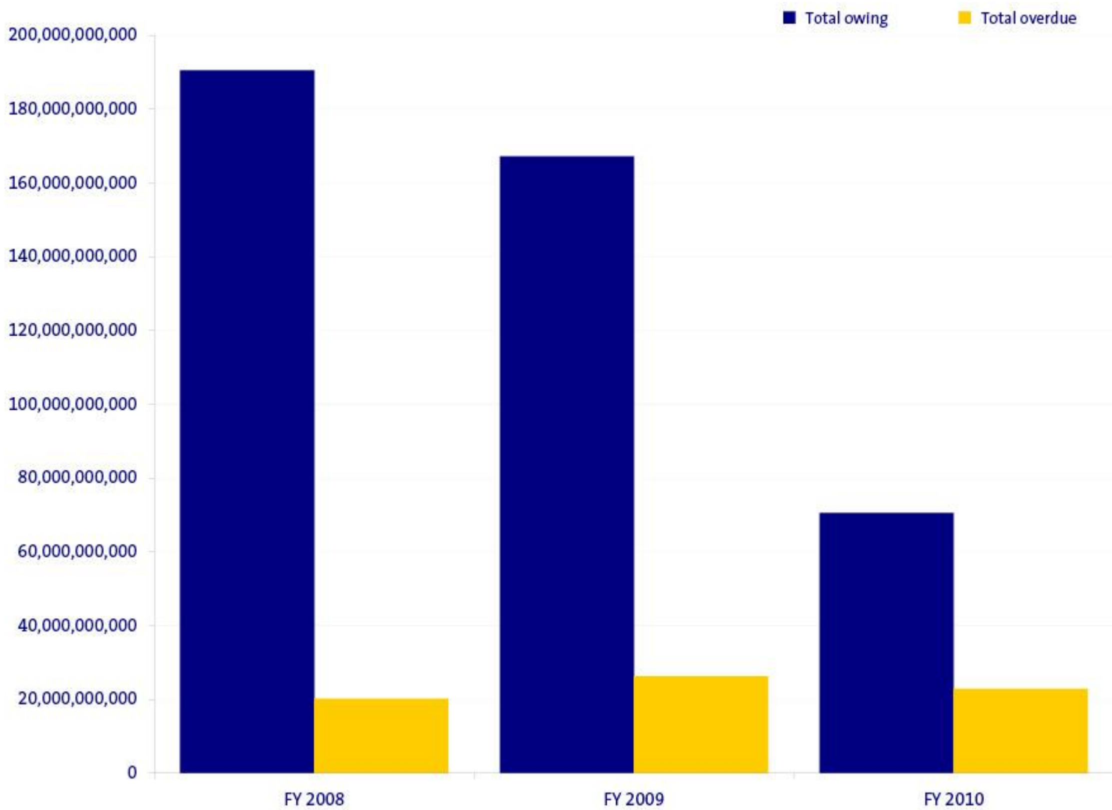
For the most part creditors were rewarded with improved payment terms during the crisis as creditors sought to pay suppliers on time and keep credit lines open. At the peak of the GFC business to business payment terms in Australia actually improved, declining to around 50 days; their best level in more than seven years. These improved payment terms afforded creditors the opportunity to lend more often, lubricating business activity in Australia.

However, as the GFC receded payment terms began to deteriorate. Average payment terms began to creep out to 55 days and the amount delinquent began to rise. The Dun & Bradstreet analysis reveals that the average amount of trade credit overdue jumped to 30 percent after an average of just 12 percent in the preceding two years during the GFC. Most recently, in the December quarter of 2010 the number of firms that were severely delinquent in their trade credit payments (90+ days due) jumped 7 percent.

As a result the overall amount of trade credit extended declined dramatically as creditors adjusted their lending habits to the new risk environment. In the 2010 financial year the amount of outstanding trade credit dropped to below $70 billion, which was less than half the outstanding amount at the height of the crisis.

The new data has important implications for the business outlook given the role of trade credit as the largest source of short term finance for firms and its link to business health. Independent research in the United States has identified Dun & Bradstreet's trade payment data as the most important variable in predicting firm failure; an outcome confirmed in Australia by the 23 percent jump in business failures during 2010 that correlated with the rise of trade payment delinquency.

Additional research from the US reveals that firms with access to trade credit during the GFC experienced a smaller decline in sales than firms that did not. In the case of exporters the research found that they had less access to trade credit on average than domestically focused firms during the GFC, a result that had a disproportionately larger impact on international trade trends than other types of credit.



Total owing compared to total overdue FY 2008 – 2010 (Australia)

However, other countries are suffering a worse deterioration of trade credit terms than Australia. In the United Kingdom, a country struggling with economic recovery, more than 75 percent of trade credit payments were late in the fourth quarter of 2010. For most major economies in Europe more than 60 percent of payments were late. One exception to this rule was Germany, a country that is growing strongly, where more than 60 percent of payments were made on time.

In the case of the United States, Dun & Bradstreet advises exporters to prepare for payment terms that exceed thirty days and may run as high as 90 to 120 days when allowing for conversion and transfer risk.

China and India, which while growing strongly are exposed to risks of overheating and high inflation, are both experiencing payment terms of up to 90 days with a further 60 days delay due to conversion and transfer risk. The fear for exporters here is that high rates of inflation will erode the value of invoices when eventually paid.

Dun & Bradstreet CEO Christine Christian believes the data provides insight into why the tightening of bank credit during the GFC was not as disastrous for firms as many feared at the time.

"Trade credit acted as a viable substitute for many firms during the GFC as bank credit became harder to source", said Ms Christian.

"This allowed firms to continue trading even without the use of standard credit lines they had come to rely upon for management of their day to day operations. This willingness by suppliers to extend trade credit was rewarded with improved payment terms that in turn facilitated more lending.

"However, this part of the equation is no longer apparent and the deterioration in payment terms throughout 2010 has resulted in a decline in the amount of trade credit extended. Consequently, cash flows have been negatively impacted and the outcome is apparent in the rise in business failures and the increased risk profile of many firms.

"For executives the message is clear. A focus on the fundamentals of credit risk and cash flow is critical regardless of the stage of the economic cycle."

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Media notes

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