Atradius
Managing risk, enabling trade

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Australia: Brace for an insolvency surge. Why strong credit management is paramount

Atradius Payment Practices Barometer

Mark Hoppe
Managing Director for Oceania commented on the report

Covid-19 response and future credit management measures

"B2B liquidity support has helped many businesses keep a strong grip on working capital management during the pandemic.

However as the customer credit risk environment becomes more challenging over the coming months, businesses will need to put strategic credit management measures in place to protect their books from the increased risk of customer bankruptcies."

From March 2020, the Australian Government introduced quarantine measures to limit and control the spread of Covid-19. On the whole, this approach has been successful at containing the virus and the country has enacted localised snap lockdowns. While minimising the need for lockdowns will have benefited businesses, Australia has not been immune to the global economic downturn. To support the economy, the Government last year increased the debt threshold for companies to declare bankruptcy and implemented substantial fiscal support packages.

These interventions helped cushion the impact of the mild recession that hit the country and the first signs of economic rebound were already visible in the second half of last year. However, from January 1, 2021, the Government scaled back some of the fiscal support measures including the removal of temporary bankruptcy thresholds. It is likely that there will be an increase in insolvencies during the course of 2021. This will include the bankruptcy-delayed businesses that, in a 'normal year' and without the fiscal interventions, would have filed for insolvency anyway, as well as businesses squeezed out by the downturn in the economy.

Using our Payment Practices Barometer survey, we focused on the B2B trade of the essential industries of agri-food, chemicals/pharma and construction to gain insight into how businesses have reacted to the changing economic conditions. Interestingly, the survey results show that businesses in Australia appear to have a strong grip on working capital management.

The majority of businesses actively employ internal credit management processes while trying to minimise external financing. This can be seen by the number of businesses choosing to delay payments to their own suppliers in a bid to safeguard their liquidity levels. Currently this business-to-business liquidity support has been working.

However as the customer credit risk environment becomes more challenging over the coming months, this picture may well change and businesses will need to continue putting strategic measures in place, such as credit insurance, to protect their books from the increased risk of customer bankruptcies.

Key takeaways

Strong credit risk management paramount as bankruptcy safeguards removed

The Australian Government removed the temporary insolvency and bankruptcy safeguards and returned to normal procedures on 1 January 2021. Struggling businesses that may have been protected from insolvency due to these interventions last year are now more vulnerable to collapse. To minimise risk, businesses should tighten their credit management processes to protect themselves from potential customer insolvency. Care should be taken to look at whole supply chains to avoid any potential domino effects, where one insolvency leads to others in the chain.

Insolvencies are likely to increase this year

Among our survey respondents an average 5% of receivables were recently written off. Such losses can threaten the viability of a business. Strong credit management practices can help businesses minimise risk. As the insolvency environment is expected to deteriorate further during the course of 2021, businesses could benefit from taking a proactive approach to minimising the risks of payment defaults.

The greater the value of receivables tied up in trade credit, the higher the risk

Significant numbers of businesses in Australia lengthened payment terms last year, 25% of businesses reported increases in Days Sales Outstanding (DSO), and 40% delayed payment to suppliers in a bid to support their own liquidity. Taken together, this points to a significant proportion of working capital tied up in trade credit. The greater this value, the higher the impact of payment defaults. All businesses are at risk, although SMEs are often the least equipped to manage defaults as they tend to have smaller cash reserves.

Pay attention to late-payers, they are most likely to become never-payers

Our survey findings reveal that an average of 54% of B2B credit sales resulted in late payments. The longer a debt remains unpaid, the more likely it is to become a write-off. Many businesses in Australia offer discounts for early settlement of invoices and many employ credit insurance to both protect accounts receivable and encourage customers to be seen as ‘good payers’ to preserve their credit ratings.

Survey results for Australia

Use of trade credit continues during pandemic

In the year following the start of the pandemic, trade credit was used as an important part of the supply chain of the agri-food, chemical/pharma and construction industries. Most of these essential industries reported no significant change to either the amount of their credit sales, or their payment terms. More than half of the businesses polled (55%) told us they offered trade credit to B2B customers almost as often as they did before the pandemic. What's more, the agri-food industry reported an increase in the use of trade credit. Over four in ten of the businesses polled (42%) reported accepting credit requests far more frequently than they did before the pandemic.

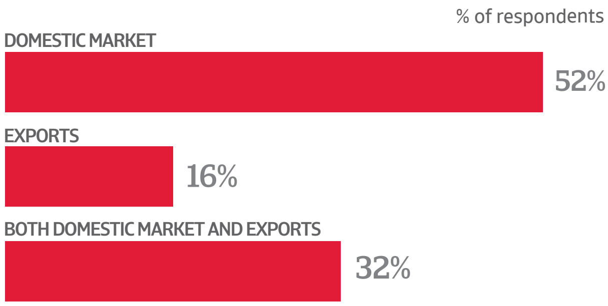
Businesses spend more on managing trade debt

Three in five of the businesses polled (60%) incurred increased debt management administrative costs. Over four in ten (43%) reported strengthening credit control procedures, including credit quality assessments, to screen out potential defaulters prior to making credit decisions. Most of the businesses polled (on average seven in ten) gather credit information from their customers' financial statements, use bank references and favour customers' internal sources. To minimise the impact of customer credit risk on the business, more than three in five of the

Australia: how do you expect your business performance to change over the coming months?

IMPROVE	NO CHANGE	DETERIORATE
35%	59%	6%

From which of the below do you expect the improvement in your business performance will be more likely to come?



Sample: all interviewed companies
Source: Atradius Payment Practices Barometer - June 2021

53%

of the businesses polled in Australia believe that selling on credit to B2B customers will be more common over the coming months as a short-term financing tool for customers.

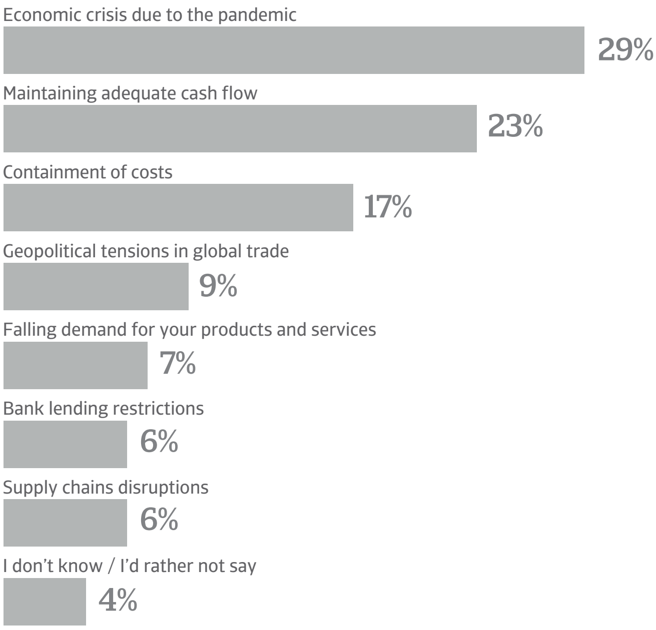
businesses polled (66%) offer discounts as an incentive for early payment of invoices. Almost the same percentage request cash payments, spread credit risk, or ask for letters of credit. A significant proportion of the businesses surveyed actively employ trade credit insurance (75%).

DSO holds steady year-on-year

Regardless of the set of credit management tools and techniques chosen, the strong focus on trade debt management helped keep days sales outstanding (DSO) under control for most businesses (70%) who reported no year-on-year change. 25% of businesses reported an increase in DSO, with only 3% recording a decrease. 40% of businesses told us they delayed payment to their suppliers to support their own liquidity.

Australia: top 5 greatest challenges to business profitability in 2021

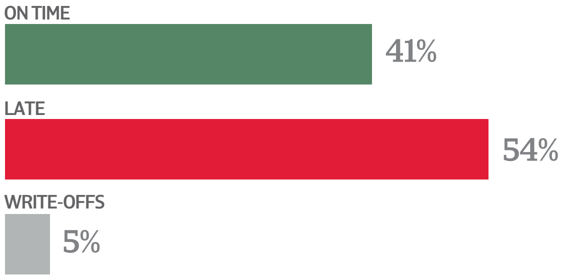
% of respondents



Sample: all interviewed companies
Source: Atradius Payment Practices Barometer - June 2021

Australia: on average, within what time frame do your B2B customers pay their invoices?

% of respondents



Sample: all interviewed companies
Source: Atradius Payment Practices Barometer - June 2021

Average payment terms largely in line with last year

More than three in five of the businesses polled (66%) said they did not change their payment terms in the year since the pandemic began, although nearly one third extended terms by up to two weeks. SMEs told us they offered longer payment terms to grow sales, whereas larger businesses reported using terms to encourage repeat business. Many respondents extended longer credit periods to help cushion customers from financial distress during the economic squeeze and 74% told us they frequently adjusted payment terms to reflect their customers' credit risk profile.

2021 already showing signs of an insolvency surge

Early signs of a surge in insolvency cases are evident. Businesses reported an average of 54% of B2B invoices overdue (compared to 21% in the pre-pandemic year) and 5% written off as uncollectable (compared to the 2% average of pre-pandemic year). Significant numbers are seeking short-term financing from external sources, with 60% resorting to factoring (largely observed in the SME segment) and 58% securitisation. 42% of the businesses polled told us they spent more on financing than in previous years.

Business concerns over the economic crisis remain

Almost one third of the businesses polled (30%) expressed concern about economic conditions over the coming months. A higher percentage of businesses expect increases in DSO (36%) and nearly a quarter (24%) anticipate issues with maintaining adequate cash flow. On a more positive note, just over half of the businesses polled (52%, particularly among large manufacturers) expect growth to be driven by the domestic market. Looking ahead, 55% of businesses told us they plan to manage credit risk internally through techniques such discounts for early payment of invoices (44%). Conversely the same percentage of respondents told us they will invest in credit insurance over the coming months.

Overview of payment practices in Australia By industry

AGRI-FOOD

Improvements made to efficiency of invoice collection

On average, 53% of the total value of the invoices issued in the agri-food industry is currently overdue, compared to 45% last year. However, respondents reported making an effort to collect on large debts, halving the amount of long-term (over 90 days) overdue invoices to an average of 8% (down from last year's 15%). DSO now averages 40 days, one week shorter than last year. Write offs decreased to 6%, down from 10% last year.

Businesses increasingly use credit insurance

Almost a quarter of businesses in the agri-food sector have recently adopted credit insurance (71% compared 47% last year). However, 75% of survey respondents told us they retained credit risk in-house, an increase on last year's 59%. In addition 48% of respondents frequently adjusted credit terms in line with customer credit risk profiles, offered discounts for early payment and spent more on chasing late payments.

Safeguarding of liquidity levels central to industry's credit risk management

Nearly one third of respondents consider maintaining adequate liquidity levels to be the greatest challenge to business profitability over the coming months. This concern stems chiefly from pandemic uncertainty and its effects on the global economy and international trade. This may explain why nearly half of the respondents believe the domestic economy will drive improvements in their business performance (sales and profits) rather than export trade. Against this backdrop, trading on credit will play a bigger role in their trade relationships, as a way to allow customers longer time to pay invoices. To minimise the impact of customer credit risk on the business, half of survey respondents (55%) anticipate resorting to self-insurance and increasing efficiency in collection of overdue invoices over the coming months.

CONSTRUCTION

Write-offs three times higher than last year

Write-offs in the construction industry grew by three times year-on-year (now 6% of all credit sales), although at 54%, the average total value of overdue invoices is not significantly different from last year. Long-term outstanding receivables (those more than 90 days overdue) average 10% (compared to 13% last year).

On average, it takes the industry one week longer than last year to settle overdue invoices and, overall, DSO is twice as long as last year (averaging 49 days). These findings point to a pressure on the liquidity levels of the Australian construction industry. In response, businesses tend to increase their overdue collection efforts (as reported by 52% on respondents) and take longer to pay their own suppliers (reported by 48% of respondents compared to 25% last year).

Increased focus on customer credit risk management

Far more respondents in the construction industry (80%) told us they opted for in-house retention and management of customer credit risk than last year (62%).

The most frequently used risk management techniques are the adjustment of credit terms to reflect different risk profiles and requests for letters of credit. Outsourcing customer credit risk management to insurers is also far more frequent among survey respondents in the industry than one year ago (70% compared to last year's 60%).

Industry more concerned over DSO increase then last year

The construction industry told us the administrative costs most commonly incurred when offering trade credit include the resources spent on collecting overdue payments, as well as the costs related to external financing to keep their day-to-day operations going.

To keep these costs under control, 57% of respondents alike avoid offering credit, avoid concentrations of credit risk, or request letters of credit. Despite such measures, 40% of the industry respondents expect DSO levels to increase over the next year, up from 30% one year ago. That said, 68% anticipate business performance (sales and profits) to improve over the next 12 months due to a positive outlook for the domestic economy.

CHEMICALS

Half of the total value of long-term overdue invoices is written off

An average of 57% of the total value of the chemicals industry invoices is overdue, 8% is more than 90 days overdue and 4% of these have been written off. On average, it took chemicals businesses three weeks past the due date to settle overdue invoices. These late payments are reflected in the DSO.

This averages 35 days and although has remained stable for 75% of respondents, it has increased for 22%. In addition to late payments, this increase may be in part due to a more liberal approach to payment terms over the past 12 months.

Trade credit insurance is the leading source of risk management

86% of chemicals industry respondents employ trade credit insurance as their preferred risk management tool. However, a significant percentage also told us that they manage credit risk in-house (82%). This involved allocating resources to collecting on late invoices and strengthening internal credit management procedures.

However, half of the respondents resorting to self-insurance, told us they needed to access external financing to fund their day-to-day business operations, and also delayed payments to their suppliers to retain liquidity as long as possible.

Pandemic poses greatest threat to future profitability

Nearly half of the survey respondents from the Australian chemicals industry told us they consider the uncertain outlook surrounding the end of the pandemic to be the greatest challenge to their business profitability over the next months.

However, 30% believe their business performance will improve over the same time frame, mainly due to the consolidation of the domestic economic rebound, as well as healthier export flows. Only 2% of respondents anticipate a deterioration of their business performance, while the remainder expect their performance to continue unchanged.

Offering trade credit will continue to be an established business practice among respondents. In particular, most (67%) believe that the businesses that most successfully adapted to the pandemic challenges, will more often accept trade credit requests from their customers going forward. To mitigate the impact of customer credit risk associated with the increased extension of credit over the coming months, most industry respondents said they will use trade credit insurance, while 65% will opt for retaining and managing customer credit risk in-house. This will chiefly involve adjusting payment terms to account for differences in the credit risk profile of the customers, as well as offering discounts for early payment of invoices to improve cash flow.

Survey design for Australia

Survey objectives

Atradius conducts annual reviews of international corporate payment practices through a survey called the 'Atradius Payment Practices Barometer'. In this report focusing on Australia, which is part of the 2021 edition of the Atradius Payment Practices Barometer, companies from Australia have been surveyed. Due to a change in research methodology for this survey, some year-on-year comparisons are not feasible for some of the results. Using a questionnaire, CSA Research conducted 202 interviews in total. All interviews were conducted exclusively for Atradius.

Survey scope

- **Basic population:** companies from Australia were surveyed. The appropriate contacts for accounts receivable management were interviewed.
- **Sample design:** the Strategic Sampling Plan enables us to perform an analysis of country data crossed by sector and company size. It also allows us to compare data referring to a specific sector crossed by each of the economies surveyed.
- **Selection process:** companies were selected and contacted by use of an international internet panel. A screening for the appropriate contact and for quota control was conducted at the beginning of the interview.
- **Sample:** N=202 people were interviewed in total. A quota was maintained according to three classes of company size.
- **Interview:** Computer Assisted Web Interviews (CAWI) of approximately 15 minutes duration. Interview period: Q2 2021.

Sample overview – Total interviews = 202

Economy	Interviews	%
Australia	202	100
Business sector (Australia)	Interviews	%
Manufacturing	102	51
Wholesale	22	11
Retail trade/Distribution	24	12
Services	54	27
Business size (Australia)		
Small enterprises	36	18
Medium-sized enterprises	38	19
Large enterprises	128	64

It may occur that the results are a percent more or less than 100%. This is the consequence of rounding off the results. Rather than adjusting the outcome so that it totalled 100%, we have chosen to leave the individual results as they were to allow for the most accurate representation possible.

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