

# Credit Central — or Not?

**As companies strive to cut costs and automate their credit functions, centralized operations increasingly are the norm. When does another approach make sense? And if change is inevitable, what's the best way to prepare?**

By William Atkinson

**T**alk to most credit experts these days, and they'll tell you that a centralized credit structure is the only way to go. Indeed, in a recent study by the Credit Research Foundation, entitled "Future Trends in Business Credit & Receivable Management," 66% of respondents reported having a centralized credit operation. Looking ahead three to five years, they say they expect more firms to follow suit.

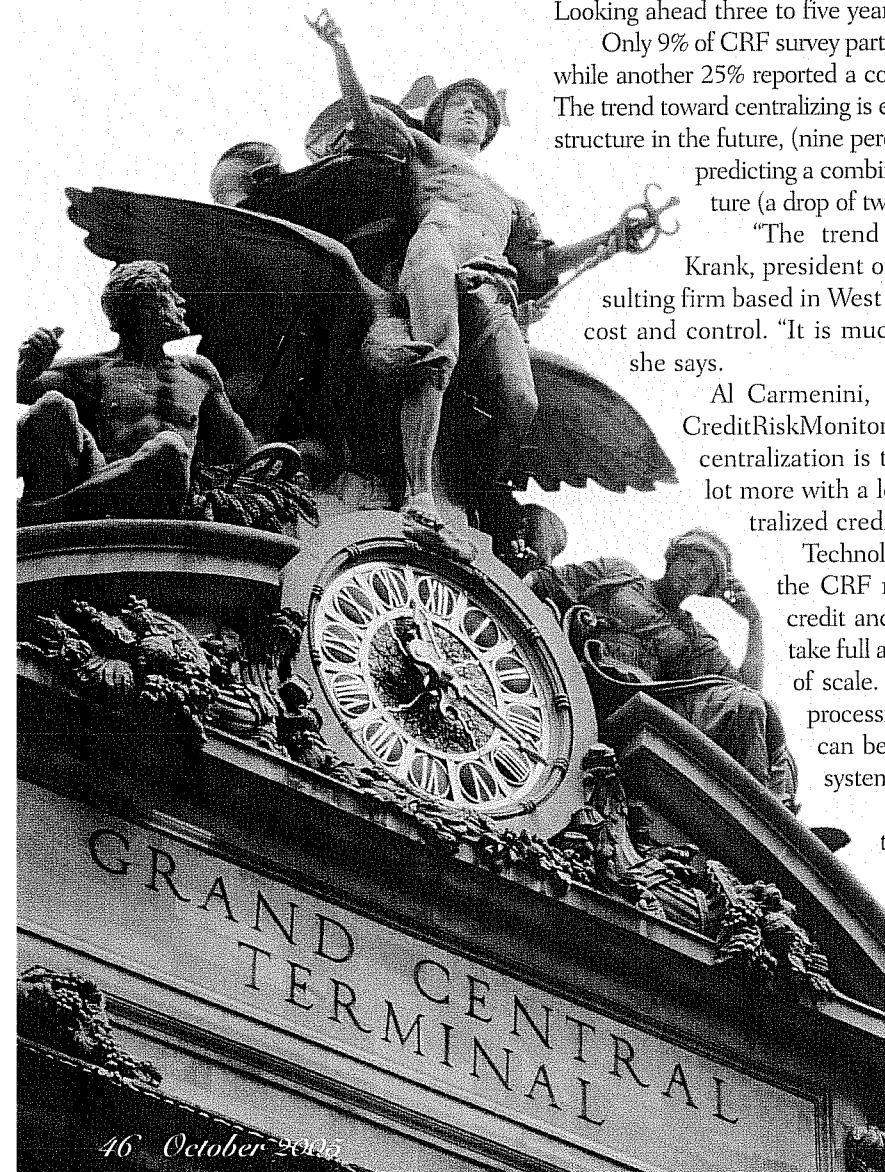
Only 9% of CRF survey participants reported having a decentralized structure now, while another 25% reported a combination of centralized and decentralized functions. The trend toward centralizing is expected to increase, with 75% foreseeing a centralized structure in the future, (nine percentage points higher than the present situation), 19% predicting a combination and 7% expecting to have a decentralized structure (a drop of two percentage points for each).

"The trend is definitely toward centralizing," says Pamela Krank, president of The Credit Department, a credit/collections consulting firm based in West St. Paul, Minn. The two most common reasons are cost and control. "It is much less expensive to have a centralized operation," she says.

Al Carmenini, senior vice president, product development, for CreditRiskMonitor in Valley Cottage, N.Y., concurs. "One reason for centralization is that CFOs are wanting credit departments to do a lot more with a lot less," he says. "One way to do this is with a centralized credit function."

Technology is facilitating the centralization trend. According to the CRF report, as technology improves and takes over more credit and collections functions, a centralized department can take full advantage of the benefits it offers, including economies of scale. "Technological systems are capable of gathering and processing data from around the world," the report notes, "and can be managed from a central location more easily than a system that relies on human capital."

The second reason for centralizing the credit function is to gain better control — to ensure uniformity of credit and collections practices, as well as objectivity in decision-making. Today regulatory concerns are also a factor. "Companies are concerned about SOX compliance," Krank says, referring to the Sarbanes-Oxley Act of 2002, which tightens the rules about financial accountability and disclo-



sure for publicly traded firms. "SOX requires that you have consistent criteria [for granting credit]," she says. Auditors want to know what percentage of a firm's portfolio is at high risk and how those accounts are being monitored.

Carmenini expresses similar concerns. "One challenge with decentralization is getting a clear picture of what's going on," he points out. "I have seen situations in decentralized structures where sales were being booked that weren't even real sales, and receivables were being overstated. In simple terms, people were 'cooking the books.'"

Another point in favor of centralization, Carmenini says: It allows firms to attract better talent. Regional departments with three people on staff don't offer ambitious staff members much of a career track. In a centralized department with 50 employees, the opportunities for advancement are greater.

### **Globalization Challenge**

While companies that sell only in the United States need to determine whether centralization or decentralization works best, companies that operate globally are faced with a more complex challenge. The general wisdom seems to suggest that, for international credit to operate at maximum efficiency, domestic operations should be centralized but offshore operations should be decentralized into regional centers.

According to the CRF survey, almost two-thirds of respondents thought their domestic structure would become more centralized due to globalization. That is, in order to manage a strong global operation, their firm would need to have a consistent, centralized domestic structure. "As companies expand to other countries, they look for ways to set up the credit function," says Carmenini. "They find it easier to model them after a centralized U.S. operation than a decentralized model, because the former provides consistency."

While some companies attempt to

operate both domestic and international credit operations out of one centralized domestic location, other firms prefer to set up regional offices for their international credit and collections. Respondents to the CRF survey cited several reasons for adapting such a model:

- 82% cited language barriers. Few U.S. workers speak foreign languages fluently. While many people in other countries do speak English, most are more comfortable transacting business in their own language. Having credit/collections staff in foreign countries able to talk to customers in their native tongue creates a stronger, more effective relationship.
- 81% cited responsiveness to customers. They believe it is easier to respond to customer issues locally.
- 75% cited cultural issues. Different practices are used to conduct business in different countries. Local staff presumably would be more aware of and sensitive to those considerations.
- Another reason: Decentralized global operations can mean lower labor costs.
- Telecommunications is another factor, both in terms of cost – lower for local rather than international calls – as well as convenience in contacting customers across multiple time zones.

### **Decentralized Approach**

Still, there are situations where a decentralized structure provides better results. However, in adapting that approach, it is important to know why a decentralized structure is preferable. "If your main reason for decentralization is to stay close to customers, this may not be a good enough reason," says Krank. "With today's advances in communications technology, there is no need for companies to have a decentralized structure simply in order to stay close to customers. You can do this just as well with a centralized function."

Some companies prefer a decentralized structure so credit and collections staff maintain close relationships with the sales force. "In fact, in some companies," Krank says, "the credit department

is embedded in the sales function."

Decentralization can also make sense for a company with business units that don't mesh with each other, such as subsidiaries that sell into completely different markets, Krank points out.

### **Greater Control**

For some small companies with half a dozen or so locations around the country, decentralization may make sense, says Thomas Tulenko, president of Decision Dynamics Inc., Chester, N.J. Tulenko works primarily with Fortune 1000 companies, most of whom are moving toward centralization. "In a small company though," he says, "each location may have one person who handles credit, collections, customer service, and also fills stock in the warehouse in their spare time."

Other companies prefer to maintain a decentralized structure because high-level executives, such as vice presidents in different geographic regions, prefer to retain control over the credit/collections function in their area. "They not only want to maintain control over sales to customers," he explains, "but they want to control who their customers are going to be, and they do this by controlling credit."

One company that finds genuine value in maintaining a decentralized structure is XTRA Lease LLC, a St. Louis, Mo.-based semi-trailer renting and leasing company with approximately 90 locations in the U.S. and Canada. John Pomilio, vice president, says decentralization fosters what the company's chief executive calls a "street corner" strategy, where managers and employees know their customers personally. "The people who work in our branch and regional offices are there to 'touch' our customers," he says. "We have done a number of customer surveys over the years, and they continually show that our personal approach is what keeps us ahead of our competitors."

Regional control over credit and collections is also important because

compensation for managers at each location consists of a base salary plus additional pay determined by the region or branch's profitability.

To deal with the challenges of several locations, XTRA Lease has established comprehensive written policies and guidelines. The company also provides ongoing support and monitoring to ensure the policies are being followed, as well as other tools to assist in meeting company goals. "For example, we provide credit managers with validated scoring models, which allow them to spend their time dealing with exceptions," explains Pomilio. The automated scoring gives credit managers the time to focus on larger deals with more significant risk. "This is where their real value lies," Pomilio says.

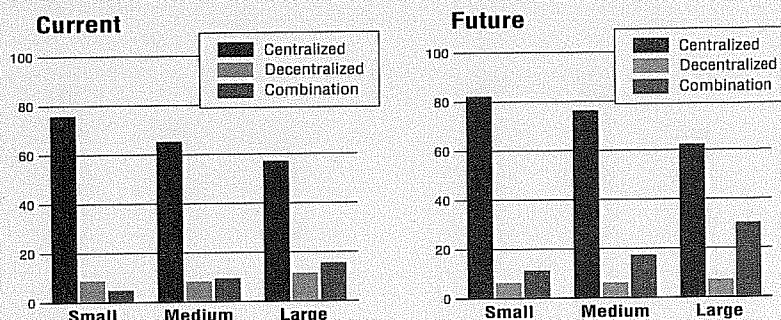
### Combination Approach

While most companies are already centralized or moving in that direction, and others prefer to remain completely decentralized, some choose to employ a combination of the two. Minneapolis-based Apogee Enterprises, with its seven subsidiaries, is a case in point. Apogee manufactures a wide range of glass and glass coating technologies, including architectural products, automotive replacement glass and large-scale optical technologies. Because the subsidiaries sell to such varied industries, much of the firm's credit function is decentralized. Each subsidiary creates its own credit and collections policies and procedures, as long as they fit within the overall Apogee business plan.

Yet Apogee's credit function also has a centralized aspect: a shared services committee for credit, chaired by Jerry Drake, CCE, financial services manager for two of the subsidiaries — Viracon and Viracon/Curvlite in Owatonna, Minn. "Our committee, which is composed of the credit managers of the seven subsidiaries, has quarterly meetings to share best practices," he says. Apogee also has a centralized D&B contract that is shared by all the

## Credit Operations

Although many firms in the Credit Research Foundation survey report already having a centralized credit function, the more accounts a firm has, the less likely it is to be centralized now. Only 57% of the large firms report being centralized compared to more than three-fourths of the small firms. Still, more than 62% of the large firms expect to have a centralized credit operation and another 30% a combination of centralized and decentralized operations within the next three to five years.



Note: In the CRF survey, a small credit department is defined as one with 499 accounts or less; a medium one, 500-9,999 accounts; and a large one, 10,000 accounts or more.

Source: Credit Research Foundation's "Future Trends in Business Credit and Receivable Management"

credit managers.

Companies that are centralized are likely to remain that way, and indications are that more companies will be joining them. (See the graphs above.) But shifting to a centralized function requires thoughtful planning. Experts make the following recommendations.

1. Know why the firm wants to make the change. "The main reason should be to improve performance, Tulenko says. "Cost savings should be a secondary reason. If you aren't able to improve performance, you won't be able to reduce costs."
2. Be sure the company has the necessary resident expertise, Tulenko says. Make sure the company has the know-how to improve performance, including managers and supervisors qualified to manage larger operations.
3. Create a plan. Before becoming a consultant, Carmenini was a credit executive, responsible for merging the credit functions of approximately 75 companies his employers acquired over the years. "You need a formal plan that covers people and systems," he says.

"For example, in terms of technology, you need a common platform that has the scalability to handle the volume of business you will be doing."

4. Plan the changeover in stages. Some overlap is needed, Carmenini says, so the decentralized system remains in place while the centralized system is being set up.

5. Don't expect to be able to reduce staff right away. It may take a year to reduce staff by 50%, Carmenini says.

6. During the transition, don't lose track of delinquent accounts. "If delinquent customers sense a disconnect," Carmenini says, "it will make it even more difficult to collect these accounts."

7. Maintain a personal touch. "If you centralize, you can assign one individual to specific accounts, so the customer will be talking to the same person all the time, just as was the case in a decentralized structure," Tulenko says.

Clearly there is no one-size-fits-all best practice for organizing the credit function, but many firms have already adopted a centralized approach and more appear likely to in the future. ■