

CREDIT PROVIDING

Supply Risks

Suppliers – Raw Materials:

To manufacture a new product or to run a new service it is necessary to buy various consumables. Some of them are got at once, for example a new factory or new machinery. Others, like raw materials, have to be bought while the product is being produced.

In a company, purchases are often the most important item in the Profit and Loss statement (P&L), any situation that may affect the suitable supply of raw materials at a reasonable price is a crucial factor that may deteriorate financial results.

Inventories are an investment for the company, which means costs and risks due to loss of value, damage, etc. For these reasons, the inventories must be agile and they must have a fast turnover, it applies for raw materials as well as for products in process or finished. As it is not always possible, it is important to know why the company must keep these

Discrimination Variables for Suppliers / Raw Materials

Raw materials market: monopoly or competitive market

Dependence on one or few suppliers

Capacity of negotiation with the supplier

Source of raw materials (delivery risks)

Factors that may affect the raw materials price (price control, international price, etc)

Substitute raw materials (quality and price)

Coordination between sales rate and production rate

inventories and if it is possible to reduce them.

Market of raw materials and characteristics of their suppliers are important data because the production of the company may be stopped at any time because of lack of supplies.

In short, the successful close of the assets conversion cycle depends, first of all, on the raw materials acquisition. The analysis must be focused on identifying possible risks in acquiring raw materials at reasonable prices, problems in delivery, level of dependence on suppliers, evolution of consumables prices and the feasibility of transferring more costs of raw materials to the customers.

Plant, Equipment and Technology

It is important to identify all independent facilities of the company, indicating if they are of its own, rented or in leasing; the place where they are located; extension of land, etc.; in order to know possibilities of expansion of the company, the tentative value of fixed assets and their depreciation techniques.

Many companies have faced crisis because they allowed an unbalance between their production capacity and their market share. This situation leads to important losses because fixed expenses are not amortized.

Knowing the production capacity and the current level of occupancy will enable knowing growth possibilities of the company and the profitability level of its fixed assets. If the company works at its maximum capacity, it will need important additional investments in order to keep its growth trend. If the occupancy level is low, it indicates a poor production, such a way, the company has idle assets, and this means they are expensive.

It is also important to assess the manufacturing process, its estimated duration, capacity of manufacturing and rate of occupancy, as well as technology used compared to the competitors' and to the development rate required. Obsolete facilities (plant, machinery and equipment) show lack of competitiveness, which means high operating costs and a heavy load for the company.

Another important aspect is insurance: policies, conditions and coverage. It is important due to consequences that a wrong policy could have for the company. The following are the most common insurance coverage:

- Fire, theft
- Terrorism, vandalism or ill-disposed actions
- Machinery breakage
- Inflammable or dangerous materials

- Loss of damage (own or third parties)
- Loss of profits

Discrimination Variables for Production and Technology

- Quality of plant and equipment
- Status of facilities and machinery (modern or obsolete)
- Installed and used capacity.
- Level of technological competitiveness
- Environmental regulations
- Technical and financial resources allocated for research and development of new products or betterment of the existing ones.
- Investments and improvement of quality, energy savings, etc.
- Labor agreements (unions, benefits for employees, etc.)

Environment, industrial residues, ecological factors, etc., are also factors to be considered because sometimes law applies serious penalties in case of breaking rules.

Assessment of management / partners

Functional processes as well as financial management are done by people, consequently, it can be said that the human factor impregnates every activity in the company. The human factor will mark the corporate culture, the way it is managed, the corporate goals, the risk exposure, the capacity to assume changes in the business and the whole company style.

The quality of the top management is a factor that always has to be assessed in a deep way. If there is no certainty that the company is driven in the right way, it is better not to assume the risk.

Influence of top management and of other important staff will be felt in all aspects related to the operation of the company, including the financial one, and success or failure will depend on this feeling. The leader of the company will determine the level of efficiency the company needs. If the owner or the manager of the company is

known as an efficient and honorable person who prudently manages his/her businesses, it is likely that he/she gets loans when needed.

When analyzing this area, the financial capacity of shareholders and the management skills of leaders must be included. Financial capacity that allows giving economic support to the company when it is required, and management skills to successfully run a business.

It is very important to know the capital composition, who owns the shares, who are the main shareholders, their financial potential, to determine if they are able to easily increase the capital of the company when needed, if the capital is concentrated or distributed, composition of the Board of Directors, the top management and the key positions of the company.

References

An important aspect when analyzing a risk is to investigate in most of the available sources the performance of the company and the references that third parties can give about it.

In all references it must be considered the level of dependence on the company the person who gives the reference has. Moreover, it is better that all references are written.

The most common sources of references are:

- REPORTS FROM CUSTOMERS

This report may be very useful because it shows the external image, the price policy and the historical evolution of the company. It also may show a wider vision of the company about its commercial image, quality of products, evolution and the positioning in the economic environment where the company develops their activities.

From information given by customers about the company many aspects can be related, but from all of them, the following are the most remarkable and important:

Discrimination variables:

- Quality of the product, technology and historical evolution
- Image of the company in the sector
- Market share perceived
- Seriousness in terms of pricing and delivery of supplies

- How often the company renews its products or includes new ones
- Differentiation factors
- How serious the company is about fulfillment of commitments related to supplies, it includes quality, weight and terms for collection.
 - REPORTS FROM SUPPLIERS

It is also important to know the image that suppliers have about the company. That image is important due to the supplier is who provides raw materials and therefore it can condition the company's continuity.

Among aspects that may be analyzed, we will remark the following:

Discrimination variables:

- Payment method
- Customer's antiquity
- Maximum amount or risk limit given
- Average payment terms given
- Kind of legal document of payment or credit required
- Number of non-fulfillment in the last three years
- Credit evolution in the last three years
- REPORTS FROM COMPETITORS

Usually, competitors know the evolution of companies in the sector, as well as quality and competitiveness of products, as well as administrative and leading characteristics of the company's partners, for this reason, the report is an important source of information.

For these references, as well as for the others, the information received must be carefully managed because it may involve a commercial risk.

- REPORTS FROM RISK DATABASES

This report is one of the most important sources of information to determine the payment behavior of a company. Many sources are available, with good technological support and good historical files that provide an integral vision in which they include information from different financial entities, the ratings of financial management a

customer has in each one, information of different products and/or services such as current account, credit cards and rating of services of the Real Sector.

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