

CapitalOne Trade Credit

Improve Cash Flow & Reduce Credit Risk

The LBM Leader's Guide



The past few years have been a rollercoaster for the lumber and building materials (LBM) industry, with home building and renovation surging alongside skyrocketing lumber prices, supply chain issues, and pandemic-related challenges.



This experience has taught us two big lessons.

First, that the future is unpredictable so mitigating risk whenever possible is a smart move. Second, those businesses with the strongest cash flow are in the driver's seat. In this guide, we'll look at how a strong trade credit program can reduce risk and give your company the cash flow it needs to stay ahead of the game.

Two ways your trade credit program can expose your business to risk or hinder growth:

- 1 You can overextend yourself, resulting in account limits beyond the customer's needs, a high level of bad debt, and unpredictable cash flow.
- 2 Conversely, you can be too conservative, leaving potential business on the table.

By contrast, managing your program effectively offers three critical benefits:



Fast, predictable cash flow



Reduced risk



Better customer service

The challenges of managing an effective trade credit program

If you own or run an LBM business, chances are you wear a lot of hats. But, it's unlikely that you entered this industry to be a banker. Nonetheless, your business depends on building relationships and that typically includes extending trade credit.

Here are just a few of the common challenges LBM businesses face when managing a trade credit program:



Limited resources

Chances are, your business has a limited number of people managing credit, including approvals and servicing. They may not have the tools and resources to perform due diligence or properly monitor accounts, especially if your business is growing quickly.

Lack of oversight

Given that lack of resources, credit rules can quickly go off the rails. It's all too easy to override a credit decision or line limit without proper controls in place — and contractors will take advantage of any leniency they can.

Cash flow constraints

Without a payment portal, it can be easy for customers to fall behind on payments, leading to unpredictable cash flow. At the same time, without modern A/R tools, your team may find it difficult to track past-due payments, streamline collections processes to reduce the work burden, and optimize time-to-cash.

Fraud risk

LBM businesses running their own trade credit program likely don't have the systems in place to protect themselves from today's rampant fraudulent activity.

What about credit cards?

Many dealers accept credit cards, which can be a useful addition to your payment options. However, credit cards are not a substitute for a well-crafted trade credit program. In fact, they can disadvantage both you and your customers when used that way.

For dealers

Using credit cards as a substitute for trade credit takes control out of your hands. You have no visibility into your customers' buying capacity nor can you offer terms that could encourage ongoing purchases. In addition, many dealers keep the credit card numbers of "term" customers on file, which can lead to card-not-present transaction fees when charging those cards. Storing this data is also risky: Payment Card Industry Data Security Standard (PCI-DSS) violations can result in fines of up to \$500,000 per incident for security breaches.

For customers

Customers who must pay by credit card in lieu of trade credit may not be able to purchase everything they need from their dealers due to daily transaction limits or their overall credit limit on a particular card. Customers also are limited by their card's specific interest-free period (typically 25 days), which may not be enough time to pay the outstanding balance to avoid interest. With a good trade credit program, you can offer extended terms that better suit your customers' buying needs.



The basics of a solid trade credit program

Given these challenges, it's fair to ask: What does a strong credit program look like? How can it be an advantage for your business, not a liability? Your credit program should help you gain market share and loyalty while producing cash in an effective, predictable way so you can make good mid- and long-term decisions.



Here are the ingredients of a healthy trade credit program:

- **Sustainability**
- **Efficiency**
- **Account servicing**
- **Collections**
- **Governance**



Sustainability

A sustainable credit program should provide a consistently positive impact in terms of sales growth, market growth, and market share. It should reward the loyalty of current customers while supporting new business, and provide steady, predictable cash flow.

Your trade credit program should right-size each line of credit to match each customer's business and ability to repay on time. It should also leverage technology, including automation and self-service payment portals, to make it easier for your employees to get their work done and your customers to do business with you.



Efficiency

It's critical to have well-established processes that are carried out consistently to get the most out of your credit program and reduce risk. These processes include:

Decisioning

What are your tools and processes for handling credit checks and decisions?

Objectivity

When offering credit, you have interests that may compete with risk reduction, including long-term customer relationships and the desire to grow your business. Adding a layer of objectivity to credit decisions via a third-party partner can help reduce credit risks, late payments, and non-payments, as well as uncomfortable decisions.

Security

You need a secure way to send, receive, and process credit information and transactions. Technology solutions can remove this responsibility from your staff, while providing peace of mind and better security.

Payment processing

Paying with checks is expensive and unwieldy, and it lengthens the payment-to-cash cycle. Self-service payment portals make life easier for customers, reduce manual back-office processes, create better digital records, and allow for new business volume without burdening staff.



Account servicing

When it comes to account servicing, you need clear policies for credit line increases and a one-stop solution for trade credit line information. If someone hits their limit, who can approve an increase? What factors are involved in a credit decision? Who is maintaining regular credit checks on existing customers? Talk to your staff about any roadblocks to completing tasks like these. Can they easily access credit line limits, authorized users, and payment information when helping customers?





Collections

Debt collection is an unpleasant but necessary component of trade credit. Evaluate how you are currently handling late payment notifications. If the process is manual, consider how much time your staff is spending on this work. If you outsource collections, taking measures to reduce upfront risk in the decisioning process and to improve account monitoring may lower outstanding debt levels and limit the need for collections services.



Governance

You should be actively monitoring customer credit lines to keep risk under control, which takes staff time and effort. Critical steps for ensuring proper governance include:

- Reviewing customer credit lines at least twice a year.
- Keeping an eye on your highest-level credit customers to make sure their businesses are doing well.
- Consistently ensuring credit lines are right-sized for customer needs.
- Running an aging report on a regular basis to view payment histories.
- Identifying credit lines that haven't been used in more than a year to secure accounts and avoid fraud.
- Monitoring transactions for fraudulent activity.

5 KPIs to track



- 1 DSO (Days Sales Outstanding)**
What is the average time from invoice to payment?
- 2 Utilized Credit**
How much of the credit you make available to your customers is being spent?
- 3 Credit Sales**
What portion of your total sales are paid via credit?
- 4 Cash Sales**
Are there customers that are paying cash but could benefit from having credit with your business?
- 5 Cost of Credit**
What is your credit program costing your bottom line?

Why cash flow matters

Cash flow is a critical component of any business. For LBM companies, it can be even more challenging. You must balance the need to provide customers trade credit with the need to also ensure you have the goods they rely upon in stock — creating a gap between your cash outlay and cash receipts. Maximizing your cash footprint means increasing your flexibility, sustainability, and even the value of your company to potential buyers.



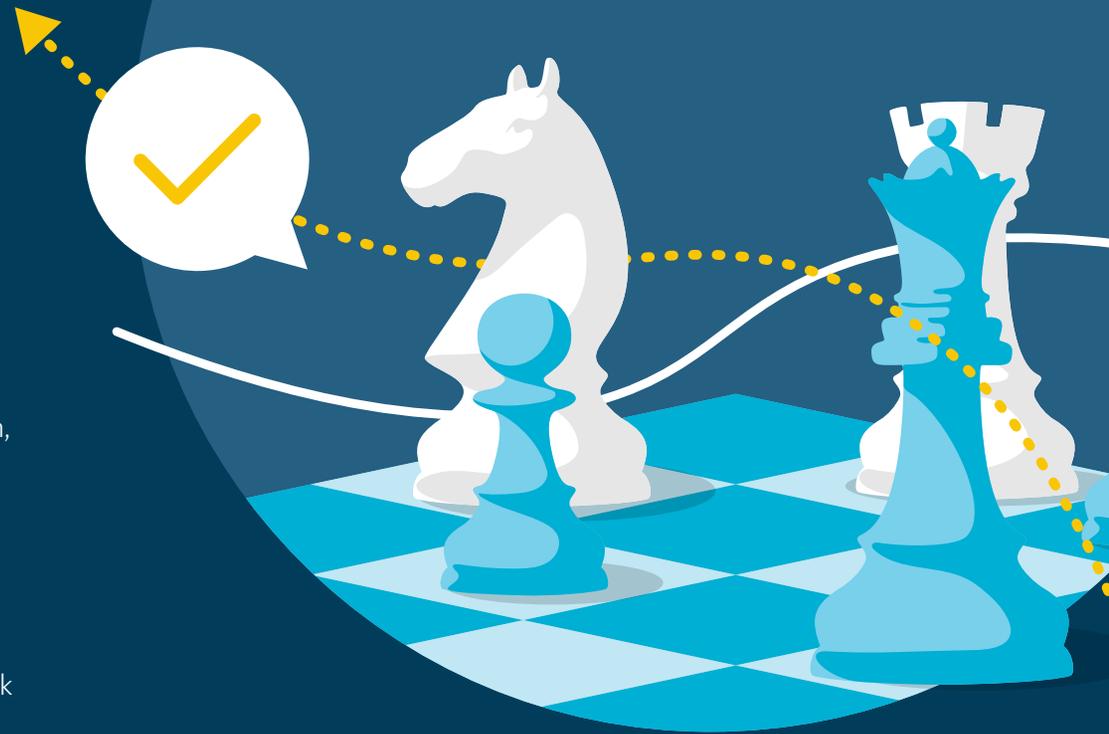
Here are six benefits of positive cash flow

- 1 Staying current with vendors.** Maintaining a current A/R portfolio creates more value for potential asset-based lines of credit usage.
- 2 Capital investment.** Cash allows you to invest in inventory, equipment, technology, real estate, and staff on your own terms.
- 3 Security and resiliency.** There's no telling what may happen tomorrow, so having additional cash on hand can insulate your business from potential risks like weather, pandemics, supply chain issues, economic slowdowns, or other disruptions and disasters.
- 4 Cost savings.** Reliable cash flow helps your business avoid unnecessary expenses like late fees and finance charges, as well as maintain a good credit rating for better terms.
- 5 Strong supplier relationships.** When you regularly pay on time, you may be able to earn cash and prompt-payment discounts from your own vendors.
- 6 Bottom-line benefits.** Having reliable cash flow allows you to keep your business well-stocked and purchase inventory when market prices are favorable.

Position your business for growth with better trade credit management

All healthy businesses are engaged in growth, whether it's growing margins, clients, markets, or operations. And to sustain that growth, every move matters. Improperly managing trade credit can tie up the resources you need to grow your business, while creating unnecessary risk.

After all, if your cash flow, staff, and technology can't keep up with growth, your business won't be able to meet and exceed its goals. Properly investing in your credit program can help turn it from a risk factor into a growth driver.



Smart moves to optimize your trade credit program

Build a strategic vision for how you want your credit program to support your business. As you gain more customers and offer more lines of credit, establish procedures to ensure you're protecting your business from risk, not adding to it.

Be consistent in your vision, making sure that your trade credit program and policies not only tie into quantitative goals, but also culturally with your customers and staff.

Draw a line. Have a clear limit as to how much risk you're willing to be exposed to for growth.

Stay vigilant with regular credit and business intelligence monitoring. Make sure your business is staying on track with your ideal risk levels and procedures.

Find a strategic partner to fill in the gaps of your business expertise. As stated earlier, you got into the LBM business, not banking. The right trade credit partner can provide the expertise, risk reduction, and technology that will make your business stronger and more resilient.

Choose a partner to create a customized trade credit program

Working with a partner like Capital One Trade Credit allows you to grow your business while maintaining your ideal level of trade credit risk. It can help you increase cash flow, improve your customers' experience, and let you focus on growing your business. Here are just some of the benefits you can expect when working with a best-in-class trade credit partner:



Improve cash flow

Make business decisions with certainty, knowing that you'll be paid predictably on a monthly or semi-monthly basis.



Reduce risk

Mitigate risk from nonpayment and fraud, while retaining full sales control with recourse options. Capital One Trade Credit performs all the necessary due diligence to make credit decisions and continually monitors accounts.



Focus on your core business

When your partner manages credit lines, billing, payments, collections, and customer service, your teams can focus on building your business.



Improve the customer experience

Offering a payment portal allows customers to easily make and schedule digital payments, download invoices and statements, and set preferences.



Grow your business

Win and retain customers with instant decisioning, extended terms, larger credit lines, and rewards options.

Simplify & Optimize Your Trade Credit Program



An effective trade credit program can improve cash flow and fuel growth, but it can be a tall order if you have limited resources to maintain it. Capital One Trade Credit offers a seamless end-to-end solution customized for the unique needs of every business. You can decide on the terms, billing, and servicing that work best for your customers, and then choose funding and risk protection that work best for your business.

To learn more about partnering with Capital One Trade Credit, visit capitalone.com/trade-credit