COVID-19 pandemic – effects on the accounts receivable management

COVID-19 is leading to economic consequences worldwide that are much more far-reaching than the 2009 financial crisis. This is particularly characterized by the unemployment figures in the US, which rose by 22 million people within four weeks between March and April 2020. Many economic institutes in Germany are forecasting a four to five percent shrinking gross domestic product for 2020. In the first quarter of 2020, the metal and electrical industry saw a 14 percent year-on-year decline in orders, while the automotive industry saw a 26 percent drop in orders. China's economic output slumped by 6.8 percent in the first quarter. For the export-dependent German economy, it remains to be seen how the US and the European countries that were particularly hard hit by the pandemic will develop.

Measures in Germany

In Germany, various measures are currently cushioning the economic consequences. The most important of these is the possibility of applying for short-time work compensation for at least ten percent of the workforce. In the maximum case, it is possible to use short-time allowance to relieve employees completely from their work for the short-time working period, and the employees' costs are covered with a discount.

Various credit offers by the Federal Government via the Kreditanstalt für Wiederaufbau (KFW) are also intended to help provide liquidity for companies so they can meet their payment obligations. A prerequisite is that the companies must have been in a financially stable situation at the end of 2019. In some cases, the state will then assume up to 100 percent of the risk.

Individual entrepreneurs, the hotel and catering industry receive non-repayable grants on application, which are intended to partially compensate for loss of revenue.

Tenants and also companies also have the option of postponing their rental payments for their apartments and branches. Social security contributions can be deferred.

In addition, the Federal Government guarantees the credit insurers the assumption of compensation payments of up to 30 billion Euros for 2020, in return the insurers cede 65% of their premiums to the Federal Government. This measure is intended to ensure that cover commitments in trade credit insurance are not cancelled, which would have the consequence of further reducing trade volumes and tearing up value chains.

Finally, the obligation to file for insolvency was suspended until 30 September 2020. In addition, there are now many companies that ask their suppliers for a deferral of payment, and in some cases the credit insurers have granted this in the case of insured credit lines.

Developments for accounts receivable management

All of this leads to the expectation of various developments for accounts receivable management. With a few exceptions, the restaurant and hotel sector generally only has low equity ratios. Since sales in this sector cannot be made up and the hygiene measures (spacing rules) mean that capacities cannot be fully utilised even in the long term, there is a particularly high risk of insolvency here. The same applies to the entire tourism industry. For this reason, short payment terms with reduced credit lines will be appropriate in this area.

The textile industry and textile retail trade are also severely affected. The latter in particular is already suffering from declining sales due to online trading. Here too, debtors must be closely monitored. The aviation industry will shrink and suppliers will also be affected.

Parts of the mechanical engineering and automotive supply industries were already struggling with declining sales in 2019. They are now coming under further pressure. It remains to be seen how investment activity will develop overall in the second half of the year. It is to be expected that the construction and construction supply industry, which is currently still feeling few effects, will also experience a slowdown in the long term.

In some cases, payments are deferred, which leads to an additional payment burden for companies in the fourth quarter at the latest. With regard to personnel, it must be critically considered that even when the economy restarts, it cannot be ruled out that overall economic output will settle at a lower level and that redundancies may therefore also be necessary for which severance payments must be taken into account. Improved incoming orders will lead to increased material procurement with an increase in payment obligations to suppliers. Repayment of the loans taken out will only be necessary after two years, so that in the event of financial strains the obligation is limited to payment of interest.

Finally, it can be expected that the number of insolvency applications will increase significantly in the fourth quarter. At the same time, many companies will certainly try to manage their insolvency themselves. The aim will be to free themselves from accumulated debts, not only those resulting from additional borrowing, but also from trade payables.

Professional credit risk management necessary

Against this background, a well-positioned credit risk management system is very important for companies. Solutions are needed which offer permanent monitoring of customers in order to detect changes in payment behaviour immediately and enable companies to be informed at all times, also by means of external information. In addition, the evaluation of external payment experiences, information obtained from payment experience pools, will become increasingly important. This information can also be processed automatically with the help of IT solutions. Simulation or break-even calculations based on annual financial statements appear to be particularly relevant, as they can be used to analyse what scope companies have to absorb slumps in sales or to ensure solvency even in the case of expanded credit volumes. Interim financial analyses can also provide clarity in the short-term area. Here too, special tools can efficiently support these tasks. The measures on the customer side also apply to suppliers. Failing suppliers can put even their own company at risk, in the worst case by causing their own production to fail.

Finally, there is the question of how to deal with the customer request for deferred payment. As long as credit-insured limits are in place and the credit insurance goes along with them, this is less risky. Due to the situation described above, however, the liquidity situation will not necessarily improve after the crisis. For this reason, payment deferrals should be examined closely, non-negotiated payment arrears should be followed up consistently with dunning procedures and attempts should be made to make payments. It would be bad if these were to be included in an insolvency estate.

For some companies, especially small and medium-sized enterprises, the effort to obtain liquidity will lead to factoring offers being used. Similarly, purchasing factoring/reverse factoring will be used more frequently for short payment terms on the purchasing side. For factoring companies, this means that efficient business processing is particularly important. To achieve this, the business processes from the factoring client to the factoring company and from there to the risk protection - mostly for credit insurance - must be highly automated. Factoring companies that are well positioned here will be the winners in their markets.

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