

The Good Credit Reference

Topic: Insider Information/Trading

Characters: Kathy Ryan, Trade Credit Officer, Diversified Consolidated Corporation
Scott Bradley, Treasurer, North Manufacturing
Mike Walman, Credit Managers, Basic Products

Kathy Ryan, a credit officer at Diversified Consolidated Corporation (DCC), had heard rumors that North Manufacturing was in deep trouble. She is responsible for credits to North of approximately \$1 million. North always pays on time and is current on outstanding payables to DCC. North, in fact, uses DCC as a credit reference with other suppliers. Nevertheless, Kathy decided a visit to North was in order.

Kathy Ryan and Scott Bradley, North's treasurer, had developed a good working relationship and went to lunch during Kathy's visit. After several drinks, Scott Bradley said: "Kathy, we're fried. I have to tell you, our financial statements aren't fraudulent, but they don't paint the full picture. Not only are we not doing well, but we've been talking to bankruptcy attorneys. If things don't turn around soon, we may file before the end of next quarter. We plan to continue paying DCC promptly because we need all the trade credit we can get. In fact, supplier credit is giving us a chance to come back. Without it, we'd be under right now; with it, we might just squeak by. Frankly, if there is any way you can encourage your competition to supply us--do it. I've told Purchasing to place a large order with Basic Products instead of DCC. If Basic gives us credit, we can pay DCC in full before we file. If we make it through this, DCC will get our business back, but I don't want your career to suffer because of our problems now."

Kathy was shaken by Scott's comments. She knew that if North's credits went bad she would lose her annual bonus--25 percent of her compensation--and probably any chance for promotion. At worst, she could be fired.

Shortly after her visit with Scott Bradley, she received a call from her friend in the Credit Department at Basic Products, Mike Walman. Suppliers often share credit information on common customers, so it was not surprising that Mike called. DCC's policy is to provide what they refer to as the "prompt payment history" for the customer. This includes recent high credit balances, any past-due balance, and how promptly customer payments had been received.

After Kathy provided North's prompt payment history--which in fact had been good--Mike was enthusiastic. "I'm glad to hear that," he said. "We just got a huge order to supply them through the end of the year. There are a lot of rumors floating around, but if you're getting paid promptly on that much, I guess it's OK." Kathy broke in at that moment.

"Can you hold the line, Mike? There's someone at my door." She put Mike on hold, her mind racing. She could suggest that Mike look into other public information sources or contact other suppliers about credit histories with North. That would be within acceptable company practice and almost certainly would send up a red flag for Mike. But who else could supply enough credit to North for DCC to get its money out?

She couldn't keep Mike on hold forever, she pressed the flashing button on her telephone--
"Mike?..."

Author: Scott B. Moore, Assistant Professor of Finance, John Carroll University

Co-author: Edward D. Curren, Manager, Credit and Trade Finance Team, Union Carbide
Company, Inc.