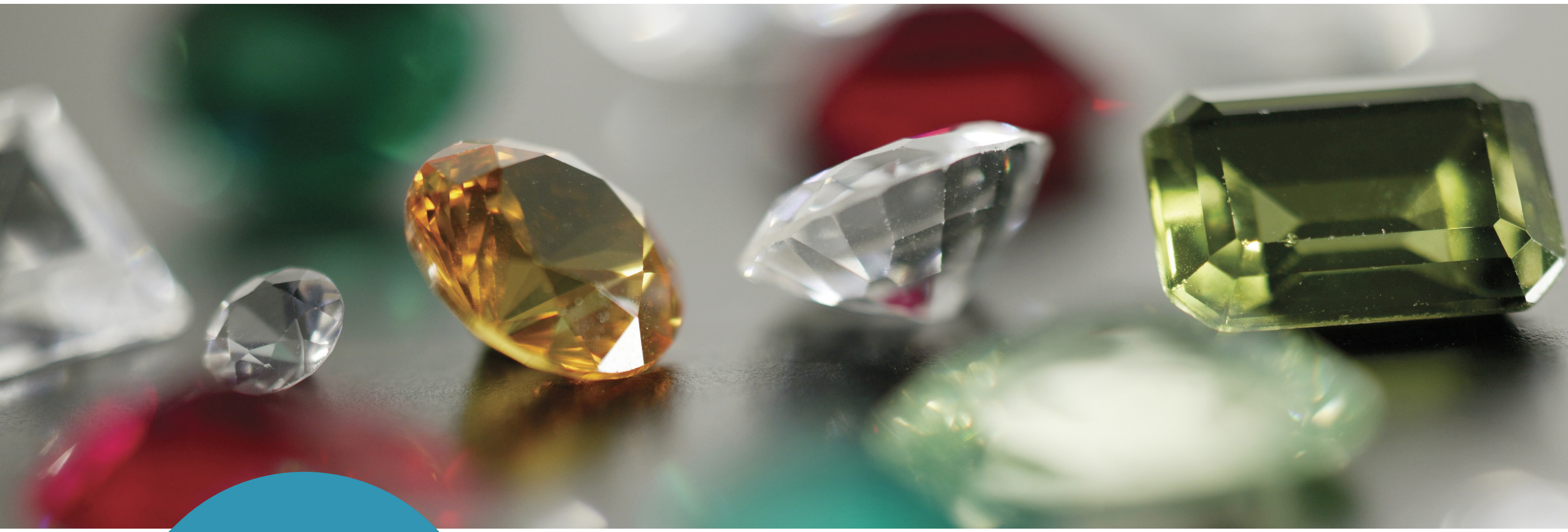
CAPITAL & RISK MANAGEMENT

The Hidden Gems:

Mining Maximum Insight from Your Dun & Bradstreet Credit Reports



BY BOB PORRECA,
SENIOR CHANNEL DIRECTOR,
DUN & BRADSTREET
GLOBAL PRODUCT SOLUTIONS

The insight in a credit report isn't always obvious, but it is plentiful. At Dun & Bradstreet we have been collecting credit information for 170+ years, and what we provide in our reports is deeper than ever. This paper helps you uncover it all.

The modern-day explosion in data and insight has presented new challenges to understanding and interpreting credit reports. At the same time, we often struggle to do more with less bandwidth. At the end of the day, we have to be more efficient with the resources we have and the data we use to make our decisions, whether we're talking with a new customer or an existing one.

Either way, credit reports are a critical component of making important decisions. So it's important to take the mystery out of these reports and find a methodology for mining the value from their less commonly utilized parts. By doing this, we begin to enhance our ability to understand the data that in some cases may seem to tell us different stories. In addition, a few tips and tools will enable you to bring everything together when making tough credit decisions.

Here we address two primary themes. First, we'll examine the different aspects of data in a typical Dun & Bradstreet credit report, exploring how to actually use it. This includes how to find the right business, identifying high-risk and special-event triggers. Next, we'll explore how D&B scores make sense of your data and provide insight around prospects and customers.

FINDING THE RIGHT BUSINESS

Locating the right business is a critical step to ensure you are viewing the right data on the right company. This is a basic step, particularly for the user who is familiar with the Dun & Bradstreet company search process. Type in the name of the company you're seeking and the state in which they are located, click the search button and voilà, you have a match list.

As far as your search results go, the most relevant ones will top your list, similar to what you might find doing a Google search. Results will be ranked from top to bottom, best to worst. To pick the right company from these results, it's important to understand what types of locations are included in the D&B database. For instance, a headquarters constitutes a business location with branches or divisions reporting up to it. The HQ is legally responsible for those branches and divisions.

Likewise, a branch is basically a secondary location of a business. It has no legal responsibility for debts, in spite of the fact that some debts may be paid from that branch location. Finally, we have the single location, where the business has no branches or subsidiaries reporting up to it. By giving you location types, you can better choose the right result on which to run your credit report. And if you choose a branch location, you will have the option to receive the headquarters report as well. You will always want to choose the headquarters report, as it would be the one legally responsible for paying the bills.

The Location Search and Executive Search options are also important components of finding the correct D&B credit report. Regarding a Location Search, you're basically trying to answer such questions as, "Is this a real company? What is the location type? Do other businesses operate nearby or at the same address? Is this an apartment building, yet the business lists more than 100 employees there?" On the other hand, with the Executive Search function you can look up a business principal's name. This is helpful when you see the name linked to the business you are looking for or potentially other businesses that she owns or is an officer in.

For instance, let's say I start with a company search for Dell and the results don't yield a close enough match to my liking. Then I try a location search for an address in Round Rock, Texas and suddenly I get six other businesses that look very similar to Dell. How do I know if they're related to the Dell profile I'm searching for? More often than not, by utilizing the Location Search function, you'll find additional businesses to the one you originally explored, or you will find the one you want because the name you entered might have been abbreviated or a trade name.

The Executive Search function works in much the same way. I type in the name of an executive and the results yield all businesses that executive is associated with. So if I can't find the exact company I'm looking for, perhaps there are three other businesses owned by the same executive on which I can still get credit reports. So even if you can't find the one you are looking for, you can still get a lot of insight into how that principal runs her businesses by viewing the reports on these affiliated concerns. The Location and Executive Search functions provide valuable insight that you might not otherwise have discovered.

What if you can't find the business you're looking for? A number of reasons may explain why a business fails to show up in your search results. It could be a mom-and-pop shop whose owners rely on personal credit cards. It could be a brand new business. Perhaps you used the incorrect name or abbreviation. If you've exhausted all options — including Location and Executive Searches — then you may order an investigation. It's just one more underutilized component of a Dun & Bradstreet credit report that users can leverage. The data submitted through this tool is verified and validated for the business you seek.

HIGH-RISK TRIGGERS AND SPECIAL EVENTS

In addition to finding the right business and before you delve into the details of the report, you need to assess potential high risk triggers and/or special events. Do you have an overly eager owner? Why is he or she so anxious to get credit? Did your credit department receive an unsolicited order requesting large dollar amounts that requires sameday approval? Does the prospect have a questionable start date? Are they telling you they've been in business for 15 years, yet no Internet history can be found on the business? No website to be found, no Dun & Bradstreet information, no trace of the business…all these issues should send up a red flag.

You might be surprised just how much information comes from Dun & Bradstreet customers, thanks to mechanisms within the products that enable them to provide it.

Another good example is the ostentatious business name. For instance, Triple A Global Services. It sounds great, but what do they really do? It almost sounds too good to be true. And from a trade reference perspective, be wary that you see all PO boxes or residential addresses by pulling reports on those references to ensure they all make sense. Trade payments that are too good to be true for prospects of a certain size or time in business should be a warning sign. The first stop in a credit report for most users should be to identify special events to make a quick decision whether to proceed or not. Other issues also warrant attention, such as bankruptcy notifications, burglary, embezzlement, partnership changes, fires, natural disasters, legal changes, discontinued operations and criminal proceedings. These are just some issues that may not seem so obvious. When you're looking at company name changes, ownership changes or merger and acquisition activity, you have to understand if this implies change in who is legally responsible for paying the bills.

Everything in the special event section of a Dun & Bradstreet report could be an indicator of potential risk. A name change could be trying to mask something. A change in ownership or control requires deeper understanding of who you might be doing business with. Perhaps the entity was recently acquired by another company. What does the new legal structure look like? Does a separate legal entity still exist which owes you money, or has that debt been transferred to the acquiring company?

It's critical to understand exactly who you're doing business with and these high-risk triggers and special events provide a useful tool in gaining that understanding. It's also important to understand where this information comes from. Bankruptcy courts publish multiple cases every day, and D&B has 100% coverage on all national bankruptcy litigation by electronically linking to all major metropolitan courts and 3,800 courthouses and other locations. D&B's FirstRain news service also funnels news directly into D&B reports and products. And information that comes directly from the customer can be a powerful tool.

You might be surprised just how much information comes from Dun & Bradstreet customers, thanks to mechanisms within the products that enable them to provide it. In addition, we rely on sources like the US Postal Service, utility services, the Securities and Exchange Commission for public companies and secretaries of state to verify company information.

HISTORICAL, OPERATIONAL, CORPORATE LINKAGE INFORMATION

Too often, when I watch people read and use credit reports, they go right for the D&B Scores, Payments and Public Records sections. But for me, I like to start with who owns the business, how long has the business been around, were there any changes in management, what background do the owners have in this line of business and how big and strong is the Corporate Family that they belong to. I also like to understand basics around how big are they, how many and what types of locations do they have, who their customers are, how many they have, and are they a seasonal business. So before you go to the "nuts and bolts," let's get grounded with some basics.

D&B's ownership and historical information is collected through the Secretary of State, direct investigations, trusted news services and the SEC at least once a year. Included in this data is the business type and legal structure, such as whether it's a sole proprietorship, partnership, or corporation. You'll see when the company opened its doors for business, when it got bought out and current ownership makeup such as who owns the business or capital stock. Furthermore, this section will show any related or affiliated businesses that the company is tied to. And updates such as past criminal proceedings and business failure will also appear in this historical section.

Also part of the historical information, the Google Maps functionality is an often underutilized part of the Dun & Bradstreet credit report. So, if a business tells you it has a 10,000-square-foot warehouse and all you see is an empty lot on the corresponding Google Map, that should send up a red flag. In addition, users get a unique view into the ownership and management changes of a company since the date it first began operations. Each time a management or ownership change occurs, the report receives a new present control date. Anytime a change of control happens in a business, it's like it becomes a brand new business. If a company started in 1900 but underwent a control change two years ago, quite frankly it's a 2-year-old business.

> Anytime a change of control happens in a business, it's like it becomes a brand new business. If a company started in 1900 but underwent a control change two years ago, quite frankly it's a two-year-old business.

Dun & Bradstreet's operational data includes information such as the business line, standard industrial classification code, terms of sale, number of employees, facilities and locations of branches and subsidiaries. In this section we answer key questions such as whether you have relationships with other companies or branches in that business' family. You can also assess whether its sales align with the number of employees it states on its books. Other important questions, such as whether it's a seasonal business or slow payer in the off-season, can also be answered by exploring the operational information. Sometimes this historical and operational information can be overlooked, but it's nonetheless very important.

Corporate linkage is yet another critical but underutilized part of the Dun & Bradstreet credit report. This is really the "who owns who" view of the business world. There are two scenarios you should look for when looking at corporate linkage. First, is there a Parent/Subsidiary relationship where a parent company owns more than half the capital stock of a subsidiary. In this case, both companies are separate legal entities, even though the parent owns a majority of the shares of the subsidiary. If you're doing business with the subsidiary, the parent has no legal obligation to help it pay its bills. Second, is there a Headquarters/Branch relationship where a company that is headquartered in one location has a relationship with a branch office in a different location. Like the parent in the first scenario, branch locations are not legally responsible for paying their invoices. In that case, we need to understand the total exposure we have at the headquarters level and clarify that the headquarters is indeed the legal entity we're doing business with.

ABOUT THE AUTHOR

Robert (Bob) Porreca is as Senior Channel Director with Dun & Bradstreet's Global Product Solutions organization. Mr. Porreca has 32 years of experience in information management and credit risk management at Dun & Bradstreet. Over the years, he has held a series of leadership positions in data management, data strategy and product development for credit risk. Mr. Porreca was the driving force behind the company's global initiative to create D&B's proprietary DUNSRight Data Quality process, the process D&B uses to produce quality information. He holds two patents for Product Development. In his current role, Bob is responsible for supporting D&B's sales teams and customers as a D&B product and best practices expert on credit risk management. Recognized as an industry thought leader, Mr. Porreca is a frequent speaker at industry events and webinars on the credit risk management.

So when you look at this information, you must first assess the total exposure at a family level. In the parent-subsidiary example, we assess whether we might be dealing with several companies that are all part of the same corporate family. The same applies to the headquarters-branch relationship, where you do business with multiple branch locations. You should understand the total exposure you have at the headquarters level, because that knowledge can help you re-evaluate credit limits. There are cases where a customer's credit limits fall out of compliance because you didn't understand that you had multiple limits to companies or branches within the same corporate family. This insight also enables prioritization of collections.

Some situations don't come under the umbrella of what D&B terms corporate linkage. These include joint ventures and franchise-dealer relationships. A joint venture is comprised of two separate companies coming together for a common cause but maintaining joint ownership. And a franchise is typically a company owned and operated individually, much like a Ford car dealership or a McDonald's restaurant. It pays a fee to the franchise company to use the name and leverage other benefits, but no legal relationship exists between the franchise owner and the Ford or McDonald's companies in this example.

So remember, ownership, longevity, experience as well as size, and customer base data can be critical in getting a high level perspective on the business and its owners, before delving into the Scores, Payment and Public Records.

PUBLIC RECORDS AND TRADE PAYMENTS

When I think of credit, I harken back to the old sieves of credit: character and capacity. We talk about the capacity of a business when we get into its trade payments and begin to understand its capacity to pay bills. And we talk about character when we examine the company's public records. Tax liens may indicate difficulty to pay. Judgments may present large outstanding obligations. Suits may also impact credibility.

Some larger businesses may face either frivolous or bona-fide litigation, but the suit may not be a problem if the company is financially secure. In the case of a bankruptcy, what did the reorganization look like? Was it 10 cents on the dollar or 90 cents on the dollar? This gives you a sense of how quickly a company can bounce back. And a large volume of UCC filings may indicate something worth exploring in your investigations.

Trade payments are the most critical piece of information the credit professional can have. D&B has more than 10,000 trade participants providing accounts receivable information each month. This trade is expansive and diverse, since we collect data from more than 700 different lines of business. Some 99.5% of all trade in our database comes from companies and independent third parties. We disallow self-references as well as trade from inside the corporate family.

In D&B's trade payments data, each trade line represents a unique account from a single supplier. That supplier could appear many times in the detail trade history. Each trade line could include up to 12 data points or monthly aging inputs. Each line represents the summary view of how that account has been paid over the past year. Each time a new trade tape is processed, the prior tape is overlaid. Account updates from the same supplier are overwritten rather than compounded, giving you the most recent information.

Trade payment habits by industry and size is an often overlooked area within this part of the D&B credit report. It provides a summary of all payments by industry. You can also view a company's payment habits by dollar amount extended. How it pays its largest and smallest invoices can be valuable information. Distinctions such as these help you assess how you might be paid at a much more granular level, compared to how others might be paid.

Over the years, customers would tell us we didn't focus enough on small businesses, such as how they pay their business credit cards, loans, leases, and lines of credit. Today, D&B's Small Business Risk Insight (SBRI) provides this powerful banking information. This includes a lease score, a cards score, a loan score, and additional data in liens. You can also identify charge-offs. As a result, you gain a clear picture of how they pay their financial institutions. If your prospect or customer is paying a bank slowly, it's probably having problems—one indication worse things could come.

DUN & BRADSTREET SCORES

For years, credit professionals have relied on the raw data in a credit report to make decisions. How they pay, any derogatory public records, size, age, history, special events... all the data we have spoken about. But in today's world of needing to do more with less, the credit function has turned to predictive scoring to make faster more consistent decisions.

Many D&B customers still don't understand how scores are created, what they mean, and how to use them. Our scores basically examine all the raw data discussed previously, in order to help you make sense of that information quickly and efficiently. Different scores mean different things, but they can all help inform your credit decision process. A score isn't meant to replace the need to look at the raw data; it simply supplements and makes sense of that raw data.

Once you understand the scores, they become very powerful and easy-to-use tools. For instance, take the new Viability Rating. The Viability Rating is comprised of two predictive components: the first is known as the viability score, a scaled score that predicts the probability a company will no longer be in business in the next 12 months. This includes whether it closes its doors voluntarily or involuntarily. The second predictive component, the portfolio comparison, assesses the viability of a company compared to similar segments within the same type of business. By segments, I mean how much data we actually have on that particular business. This includes financial statements and trade experiences.

A third component of the Viability Rating is the data depth indicator. For years, D&B customers have sought a quick assessment of how much data D&B has on any one business. The higher the score, the richer the data used to create these scores. And a fourth component of the rating is the company profile, which shows the age and size of a company.

D&B's data depth indicator gives you a quick snapshot of the level of information on hand for a company. An "A" score, for instance, may suggest we have a financial statement, whereas a "G" score might mean we have basic firmographic information. Obviously, the more data you have, the better the score will predict. The data-depth indicator includes high-risk indicators that will override basic scores if we encounter a problem such as a bankruptcy or potential fraud. And in addition to the data depth indicator, the company profile section includes ratings and scales measuring the business' age and size.

So how do we predict whether a business will still have its doors open in the next 12 months? It starts with demographic data: sales, number of employees, year started, years under current management, industry vertical, facilities, and business history. These are all the very same issues we examined in the raw data. The legacy and detailed trade data, public records, and other financial information will certainly signal a company's cash flow and its ability to keep its doors open.

Different scores mean different things, but they can all help inform your credit decision process. A score isn't meant to replace the need to look at the raw data; it simply supplements and makes sense of that raw data.

Once data arrives in the D&B database, we quickly assess whether it relates to an existing business in the database or whether it relates to a new business. Through sophisticated matching engines, this process occurs rapidly. These matching engines also allow us to identify activity signals across the marketplace, such as adding a phone number, retaining an attorney, sending a package. This is all information that may not necessarily show up in the trade payments area. Yet when you pick up these signals, they play a significant role when you don't have much information on a new business. In essence, these signals provide key predictive indicators that can be used to your advantage.

Another important score is the Delinquency Score, also known as the Commercial Credit Score. This predicts the likelihood a company will pay its bills in a severely delinquent manner—90 days or later. The Delinquency Score contains three scales. The first is a class scale, from 1 to 5. One is good, 5 is bad. A second granular scale runs from 1 to 100, where 1 represents the highest probability of severe delinquency and 100 represents the lowest. A third scale goes even more granular, from 101 to 670. The point is all three scales basically predict the same thing—likelihood of severely delinquent payments—but at varying degrees of granularity depending on your business needs.

The power of the Delinquency Score is we can see when a certain-sized company operating in a certain industry pays a certain way. We take this information to formulate characteristics that enable us to see similarly sized businesses in similar industries and geographies, and understand on average how they will pay their bills.

When you factor in specific data like trade and public records, you gain a clear picture of how the company will behave in the future. By combining micro factors (how a company behaves) with macro factors (e.g., industry and geographical pressures), you end up with unique predictive insight.

To illustrate this point, suppose you have a company with scores indicating high likelihood of payment delinquency and high probability of closing its doors in the next 12 months. And suppose you have information that both of those scores are actually improving. That might change your decision to extend credit because a score is not static in time. It's critically important to assess these scores in the context of the direction they're heading.

Our third score is the Financial Stress Score, also known as the failure score. This predicts the likelihood a company will cease operations, declare bankruptcy, or simply go out of business without paying its creditors. When reviewing this score on a company, your D&B report will include commentary indicating why the firm was assigned that particular score.

The national failure rate is less than half of 1%. It's very difficult to predict failure because it can result from unforeseen circumstances, such as a natural disaster. Typically, only 1% of the average customer portfolio will have a severely high financial stress class.

While 1% doesn't look like a lot, it's still twice the national average. It's worth asking, "What if this is my largest account?" If your only concern is how a company pays, then you're probably missing the bigger picture.

In addition to our three scores, the Paydex provides a historical snapshot of how businesses have paid their bills. This dynamic score changes as new payments hit the database. In order to generate a Paydex, we need at least three experiences from two unique suppliers. Think of the Paydex as a numerical summary of a company's past payment performance. Just like our three predictive scores, we have to look at the trends. In this case, the Paydex offers a 12- and 24-month payment trend. Historical context is important to determine whether seasonality or other trends affect payment performance.

Ideally, you will examine all these scores and data elements in conjunction with each other to quickly arrive at a credit decision. What constitutes an easy "yes"? What is a clear "no"? If you're not sure, it's probably time for a deeper dive. By approaching these underutilized areas in the D&B credit report in a systematic, consistent way, you can make smarter, faster decisions.

dun & bradstreet

103 JFK Parkway
Short Hills, NJ 07078