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Accounts Receivable Insurance Mechanisms Available to the Book Industry In Europe

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CREDIT RISKS AND CREDIT RISK MITIGATION

Accounts receivable can account for up to 50 percent of the assets of some businesses, and as such represents a significant investment of working capital.

According to data compiled by the Credit Research Foundation (CRF) in the U.S., there is a 93.8 percent probability of collecting receivables one month after the due date[1]. That probability falls to 85.2 percent when the receivables are two months past due and to only 26.6 percent after 12 months. This problem is exacerbated by the fact that the real net value of receivables is further reduced by the working capital that must be borrowed to fund them.

Receivables are the second most liquid asset on a company's balance sheet after cash, and protecting them is no less important than protecting inventory, equipment and property. This is especially important where 80 percent or more of sales are made to 20 percent or less of customers. Managing issues of debtor concentration because of industry consolidation has become a challenge as merger activity can suddenly change debtors' risk profiles. The Canadian book publishing and distribution industry has not escaped consolidation, and the fact that receivables make up a significant portion of the balance sheet of many Canadian presses warrants a proactive position towards credit risk mitigation.

There are several ways of mitigating accounts receivable risks, chief among them credit insurance, letters of credit, factoring and joint ventures with finance companies in order to remove receivables from the balance sheet. Factoring, joint ventures and accounts receivable are briefly examined here.

FACTORING

Factoring is a type of financial service whereby businesses sell or transfer their receivables to a factoring company for immediate cash payment at a discount (invoice discounting). Buyers are notified that their debts have been sold to a factor and are instructed to pay the factor directly. The advantage of factoring is that sellers get their receivables up front, instead of having to wait for customers or insurers to pay at a later date. This frees up precious capital that is used to finance continued expansion. Factoring may be a solution for smaller, credit constrained companies in situations where insurance is less attractive for cost and administrative (handling) reasons. Factoring is obviously not a solution for businesses that value their relationships with those customers who purchase from them on a frequent basis. Aside from invoice discounting, Canadian factoring companies can offer customer credit guarantees, accounts receivable management services and customer credit intelligence services. Since factoring is based on specific invoices, it would be difficult to adopt by the Canadian book industry because of the common practice of returning books.

[1] Comizio, Tob, *Getting the most bang for the buck*, AFP Exchange, Bethesda, Fall 2000.

JOINT VENTURES

Joint ventures are another way of turning receivables into cash flow. They can provide risk mitigation, but not at the expense of customer relationships. Basically, a joint venture works this way: the business with accounts receivable enters into a business partnership with a financial services firm to create a separate company—the joint venture—that oversees and jointly manages the credit management and collection processes. The business with the accounts receivable becomes a profit partner in the joint venture and contributes equity based on a contractual percentage of the net receivables that it sells to the venture. The finance company provides capital and a state of the art collection system. The joint venture enables the company to move most or all of its receivables off its balance sheet. Let's say, for example, that a book publishing company seeks to convert $200,000 worth of accounts receivable into cash. The joint venture company takes $200,000 off the publisher's balance sheet in return for an investment of say, 7.5 percent of the receivables from each partner. The publishing company and the finance company therefore contribute 7.5 percent of $200,000, or $15,000 each and the publisher receives $185,000 from the joint venture. The equity contribution for both partners is the same, however the recommended ownership split in the joint venture is at least 51 percent. This enables the joint venture to operate on a balance sheet separate from the publisher, yet gives the publisher an equal voice in the election of the board of governors and other decisions under the control of the joint venture. Disclosure in a joint venture arrangement involving a book industry association that represents member publishers and booksellers could be problematic however. Balance sheet confidentiality would have to be preserved so that financial information on any one member would not be available for all others to access. A neutral, third party administrator could best handle this.

ACCOUNTS RECEIVABLE INSURANCE

Accounts receivable insurance protects businesses against losses that result from non-payment of receivables because of the insolvency of buyers, creditor protection arrangements and protracted default (slow pay). Such commercial risks can be covered on both domestic and foreign accounts receivable. Political risk coverage is also available on foreign accounts receivable, providing protection against risks such as expropriation, nationalization, confiscation and political events over which exporters have no control.

Accounts receivable insurance can be provided on a whole turnover basis, meaning that coverage applies to all eligible business transacted by a policyholder within an agreed period. This situation is usually associated with firms that have few customers making up most of their accounts receivables. Coverage can also be secured on individual invoices or on groups of invoices or customers, as well as against catastrophic losses only, over and above the bad debt provision.

Rates are usually a percentage of insured sales and the use of large deductibles and retentions over the medium term can significantly lower premiums. Rates and the availability of coverage are always better before a particular trade sector has experienced bad debt loss. Underwriters will try to control risks through vetting of credit limits as opposed to policy structure and price as is the case for most other forms of insurance. However expensive premiums as a proportion of profit margin on sales may seem to be, the cost of accounts receivable insurance is more than offset by the margins on sales that would not have been made had there not been accounts receivable insurance in place.

Rates vary depending on which sales are covered (whole turnover, certain invoices or groups of invoices or customers, etc.). Rates also vary depending on where insurers attach (start providing coverage), in other words, on the size of the deductible or self-insured retention. Premiums can also obviously vary from one month to the next for the same policyholders depending on the volume of insured sales at risk.

Increasingly, businesses are looking for a more extensive risk sharing relationship with insurers who typically assess their customers' ability to manage risk and then only offer coverage for losses above a reasonable expected level. Accounts receivable insurance is rarely sold without a loss prevention product and as such it represents a means of obtaining proper control over credit exposures. In addition to providing accounts receivable insurance coverage, most credit insurers provide credit management services such as the management of receivables, debt recovery and the continuous monitoring of the creditworthiness of customers and prospective customers in Canada and the world over.

Accounts receivable insurance can also help companies obtain funding because insuring the receivables ledger is seen as added security by lenders. This is especially true for exporters, for whom foreign receivables are generally excluded from the pool of eligible capital. By naming the lender as a loss payee on an export credit and political risk insurance policy, insured borrowers can get access to greater working capital financing to run their businesses. Another advantage of accounts receivable insurance is that it provides an opportunity for reducing bad debt reserves, which, unlike insurance premiums, are not tax deductible.

To sum up, purchasing accounts receivable insurance offers many advantages, the most obvious of which is risk transfer. Accounts receivable insurance coverage improves receivables-based financing and it comes with valuable risk management services the net effect of which is to enhance any organization's overall credit management function.

There are some drawbacks. Policy administration and claims procedures are complicated with claims being paid on a conditional basis depending on policy administration performance. Most accounts receivable coverage is usually associated with excessive paperwork.

In Europe, the process of preparing an insurance policy can take up to a year before the credit insurer and the insured actually finalize their contract. This goes to show how much more important proper loss control is than rates for insurers.

THE GERMAN MODEL

Buchhäendler-Abrechnungs-Gesellschaft mbH (BAG) is a payment clearinghouse serving approximately 2,000 book publishers and 4,300 booksellers in Germany and abroad. Participants in the BAG payment clearing system have to be members of *Verein für buchhändlerischen Abrechnungsverkehr* (The Book Traders' Payment Clearing Association), which owns 90 percent of BAG. All publishers and booksellers are eligible to become members and participate in the BAG payment clearing system, however participants have to comply with BAG's rules of operation, which are based on good faith. BAG has existed since 1922. The system rests on mutual confidence between publishers and booksellers, and contentious debit or credit note entries cannot be processed. Publishers are not obliged to clear through BAG in those instances where a bookseller does not appear to be reliable. Prepayment is the usual condition in these instances.

BAG in no way influences the relationship between publishers and booksellers, nor does it assume booksellers' debts or indemnify publishers for amounts they are owed, however it does intervene on behalf of publishers to attempt collection of any receivables due.

Here's how the system works: BAG issues a collective statement 24 times a year, namely on the 2^{nd} and 17^{th} day of each month. This 15-day cycle establishes the dates on which BAG receives payments from booksellers. For example, booksellers have to pay BAG on the 2^{nd} day of each month for those items that come due between the 17^{th} day of the month and the 1^{st} day of the following month. Publishers are urged to send their lists no later than 30 days after the date of invoice, but not before booksellers have received their order and the invoice. BAG remits amounts owed to publishers four days after it has received payments from booksellers. Publishers are therefore paid on the 6^{th} and 21^{st} day of each month.

BAG remits total amounts due to publishers on those due dates whether booksellers have paid BAG within the specified time frame or not. Subsequent statements sent by BAG to booksellers who have not remitted their last payment on the due date come with a notice of debt reminding them of the overdue situation. At the same time, those publishers who are owed money receive notice of the overdue payment. At that point, publishers may decide to extend any further credit or ask for prepayment of future orders.

In those instances where, in the third period following the payment due date, BAG has been unsuccessful at collecting receivables, the unpaid items are re-debited to publishers who are then in a position to take legal steps in order to recover amounts owed. This does not mean that re-debited items should be considered to be written off, as it seems that publishers are able to recover amounts owed to them although with some delay. The system works. For example, in 1994, of about 7 million invoices and credit notes worth in excess of 1.5 million DM, only .21 percent of receivables had to be re-debited to publishers. Who would want to do business with a bookseller that does not participate in BAG? Aside from obvious savings of time and on the costs of handling for publishers and booksellers alike, the BAG clearinghouse offers other advantages. Booksellers can batch many different items under a single payment to BAG.

Publishers can be paid on time and plan their finances more accurately. They can obtain timely information about the financial status of their customers and they can also save on collection efforts. Finally, they can manage delivery to BAG member booksellers more quickly, without pro-forma invoices.

THE FRENCH MODEL: *LA CENTRALE DE L'ÉDITION DU LIVRE* AND COFACE—PROTECTING FRENCH BOOK PUBLISHERS' ACCOUNTS RECEIVABLE RISKS

The organization

La Centrale de l'édition du livre was created in France in 1974 as a *Groupement d'intérêt écconomique* (GIE)—an economic interest group whose role is to support member book publishers in their export activities through credit and transport insurance. A GIE is a unique legal entity halfway between a corporation and an association, but with the flexibility of associations. As such, *Centrale de l'édition* is a for profit organization, however its goal is to generate profits for its members, not for itself. If, after a fiscal year, there is a surplus after reserves have been set, this surplus is redistributed to members in the same proportion that their billings bear to the total billings of the group. Any deficit could be deferred to another period or assumed by members in the same proportion as in the case of a surplus. In case of dissolution of *Centrale de l'édition*, the net proceeds of the liquidation of any assets would be allocated to members in the same proportion that their billings bear to the total billings of the group. GIEs receive some funding from the French Department of Culture and Communications, which aims to help small and medium entreprises in the book publishing industry among others. For example, GIEs in the book publishing industry, including *Centrale de l'édition*, received close to 8 million Euros in funding in 2003, a little over half of which went towards subsidizing transport costs for exporters so as to achieve price parity with books that are available in France. Spain also has a large export market, and the prospect of protecting Spanish book publishers has been contemplated, however nothing has come of it. *Centrale de l'édition* is the only European organization that provides credit insurance for book industry members. Although membership is voluntary, nearly everyone—some 45 members accounting for up to 90 percent of the book publishing industry's sales—participates. Although 45 publishers may seem like a small number of publishers, this includes giants such as Vivendi, Hachette, Gallimard, Flammarion and others who include many small, owned publishing houses on their insurance program. Everyone exposed to credit risks is covered—except authors. Also, although there have been many requests for Centrale *de l'édition* to provide accounts receivable insurance protection for the domestic market of late, coverage applies strictly to exports sales at this time and it does not appear that *Centrale de l'édition* will provide credit insurance for the domestic market anytime in the near future. Accounts receivable coverage provided by *Centrale de l'édition* is nonetheless worth scrutinizing because it can provide a model, in some respects, for Canadian publishers and distributors to set up their own accounts receivable insurance program.

Coverage

Up until a year and a half ago, *Centrale de l'édition* was co-reinsured by *La Compagnie Française d'Assurance Crédit à l'Exportation* (COFACE) and *Société Française d'Assurance Crédit* (Sfac)—now Euler, however COFACE is presently the sole insurance provider for *Centrale de l'édition*.

Centrale de l'édition's mandate is to negotiate transport and accounts receivable insurance coverage for its members. It secures a global or overall amount of credit insurance, then allocates it to individual members based on their respective credit exposures. The aggregation of individual members' respective credit exposures represents the global insurance amount available to *Centrale de l'édition* and COFACE authorizes the maximum amount of credit—the aggregation of individual exposures—that may be extended.

If a receivable is not paid for within the stipulated time limit, the indemnification process is triggered, and the financial guarantee—the exposure representing the amount of sales to a publisher's customer—may eventually be withdrawn. Coverage is ongoing since the amount of credit insurance available to individual publishers is reinstated when amounts owed by customers are paid. Individual amounts of insurance can be adjusted either upwards or downwards based on individual publishers' projected sales (credit exposure).

Coverage applies to those risks usually associated with export exposures including political risk and natural disasters for sales to approximately 4,000 booksellers throughout the world. *Centrale de l'édition* monitors the amounts of insured credit on these customers and sees to it that terms of payment are adhered to. Keeping permanent watch on foreign buyers enables *Centrale de l'édition* to assess the political and economic environment these businesses operate in. Publishers are immediately informed by *Centrale de l'édition* of changes that may affect their customers. *Centrale de l'édition* regularly communicates with overseas customers and possesses credit information on each one of them. This information is updated on a regular basis. In case of dispute or late payment, *Centrale l'édition* can intervene, in consultation with the insurer and other parties with a vested interest, to negotiate an authorized postponement of the debt repayment date. This procedure prevents the automatic cancellation of the insured credit limit while enabling buyers to settle their debts according to their means.
Members may also entrust *Centrale de l'édition* with the task of collecting unpaid balances. In order to obtain these services, members have to forward monthly sales and accounts receivable figures along with a payment of .17 percent of net sales declared. The monthly figures are collected along with and added to other members' figures and all members may access financial information on foreign buyers.

Member publishers may decide to insure all their sales in all countries, only their sales in certain groups of countries, or only their sales in certain countries within groups of countries. They transmit their account activity via electronic data interchange failing which *Centrale l'édition* charges a fee of 1.52 Euros per line for manual data entry.
The General Assembly of *Centrale de l'édition* may decide to not include coverage for publishers who have not transmitted their account activity for a period equal to the duration of the policy period.

Centrale de l'édition has to notify the insurer, with the approval of all members concerned, of any claim for the debt of a customer that exceeds 1,500 Euros—*Centrale de l'édition's* deductible, which is actually a self-insured retention (all publishers combined). *Centrale de l'édition* has to manage claims and indemnify publishers according to the rules of the insurer for all claims up to and including that amount. Beyond that amount, *Centrale de l'édition* continues to manage the claim, but only after it has consulted with the insurer, which may grant permission or take over the claims handling process. The insurer may also take over collection procedures and indemnifies *Centrale de l'édition* for sums up to 90 percent of the total amount insured beyond the 1,500 Euro retention.

Policy limits

The amount of credit insured for any customer of a book publisher is managed globally, that is to say that it is managed for all those publishers who sell to the same customer. For illustrative purposes, say a book distributor purchases from three different publishers. If publisher A invoices the distributor for 400 Euros, publisher B invoices the distributor for 75 Euros and publisher C invoices the same distributor for 925 Euros, then the total amount of insured credit that has to be managed globally by *Centrale de l'édition* for the distributor is 1,400 Euros. This is a floating insurance limit in a manner of speaking because it is adjusted according to amounts outstanding that are reported monthly by the publishers. The amounts of credit insured are reinstated once customers pay the amounts owed to publishers. Since coverage—the amount of credit insurance coverage available for any one customer is managed globally; others can use any underutilization of a publisher's insured amount of credit extended. For example, should publisher B be owed 150 Euros, it will be able to recover that amount from *Centrale de l'édition* since 1,400 Euros are available for the group and the other publishers have not claimed. The following example illustrates a situation where three publishers file a claim. The total sum insured on a book distributor's risk of payment default is 20,000 Euros. *Centrale de l'édition* allocates this sum according to the three publishers' needs and the following claims ensue:

Insurance: Publisher X: 10,000 Euros Publisher Y: 5,000 Euros Publisher Z: 5,000 Euros

Claims: Publisher X: 15,000 Euros Publisher Y: 3,000 Euros Publisher Z: 1,500 Euros

Publisher X will be indemnified for 15,000 Euros since Publisher Y and Publisher Z have unused amounts of coverage amounting to 5,500 Euros, 5,000 of which can be allocated to Publisher X.

The indemnification process

It can take up to nine months for COFACE to be advised of a situation that could lead to a claim. If a publisher has not been paid six months after an invoice has been sent to a customer, *Centrale de l'édition* sends the publisher what it refers to as an Info-flash. This is a note that highlights the amounts outstanding preceding a period called *Pre-manquement*—a pre-default situation of the debtor occurring after seven months. The Info-flash note also requests publishers to notify *Centrale de l'édition* in writing if its involvement is required. If it is, *Centrale de l'édition* intervenes, on behalf of publishers, by sending debtors faxes and emails, and by phoning them and meeting with them in person in critical cases. Requests for postponement of the debt repayment date by debtors have to be submitted to *Centrale de l'édition* which checks to see if those amounts owing as measured against insured credit available at the proposed repayment date could place the debtor in a default situation for that period. COFACE must be advised of any such repayment arrangements failing which there would be no indemnification should a debtor not respect the terms of the repayment arrangement.

The debtor is considered to be in default at the end of the eighth month if at that time the unpaid balance exceeds 15 percent of the amount of insurance available for all publishers provided by the reinsurer. At that time, all publishers who sell to a debtor in default are advised and the insurance on that customer is withdrawn for all invoices going forward. COFACE is advised (*Déclaration*) after the ninth month. If at that time a payment is made by the debtor, the debtor is no longer considered to be in default, however any new invoices would not be insured should the debt lead to a claim. If the debt is paid, insurance on all new invoices is reinstated. If the debt is not settled, a claimant is eligible for indemnification after a two month waiting period (from the time COFACE has received the last notice of unpaid invoices) if the global amount owing is less than or equal to 2,300 Euros, and after a 5 month waiting period if the global amount owing is greater than that sum.

If a publishing house decides not to declare to the insurer a debt owed by one of its customers, *Centrale de l'édition* asks that publishing house to confirm its decision in writing advising it that it is not entitled to indemnification should the debt not be paid.

Once a debt has been declared to the insurer, correspondence with customers (debtors) and arrangements with them regarding terms of repayment may not be made without the insurer's authorization. Any payment made by a customer after a debt has been declared has to be reported to the insurer who will apply such payment to the very first debt incurred as opposed to the invoice number to which the payment refers.

For COFACE to insure any association or other group, a credit risk management system approved by them has to be in place. This is certainly the case for *Centrale de l'édition*. It should be noted that publishers have to wait one full year before they can become members enjoying credit insurance coverage. This period of adjustment gives new publishers the time that is required for them to familiarize themselves with the business and financial rules of *Centrale de l'édition du livre*. Registration of a new customer with *Centrale de l'édition* can be processed within 48 hours and is required to obtain information about its activities and reputation. When a new customer account is opened at *Centrale de l'édition*, invoices are programmed to enable them flow within the parameters set from an Info-flash response to a declaration of default to COFACE.

Book returns are not an issue and pure consignment sales are not covered on the master policy issued to *Centrale de l'édition* since the invoices for actual sales made, and upon which premiums are based, are the true measure of the exposure. Exceptions can be made for insuring them separately for certain publishers, although this is difficult to manage. Most publishers who request coverage for consignment sales either secure individual coverage from Sfac or do without insurance altogether. It should be noted that as far as consignment sales are concerned, coverage provided by both COFACE and Sfac is limited to apply to the bankruptcy of an insured member's customers.

Fees paid by members of *Centrale de l'édition* are applied towards the costs of managing this system. Although under such coverage individual certificates of insurance can be issued to individual members, the master policy is issued to *Centrale de l'édition du livre*, which alone is considered to be the insured. The major question for insuring such groups in North America as far as COFACE and other credit insurers is concerned is whether laws here would permit them to insure a group, such as *Centrale de l'édition*, which does not itself have trade receivables. Fees paid by members to an insured association would not be considered as receivables for rating purposes.

La Centrale de l'édition du livre's accounts receivable insurance policy is not available for scrutiny and rates are confidential.

Summary

- *Centrale de l'édition du livre* provides the only existing accounts receivable insurance model for the book industry in Europe.
- Coverage applies to export sales only, not the domestic accounts receivable exposures.
- Book returns are not an issue with the export market and accounts receivable insurance premiums are based on firm/final sales.
- *Centrale de l'édition* is a for-profit organization. It is self-insured and COFACE provides reinsurance coverage for the larger, unexpected losses only.
- The accounts receivable exposure on pure consignment sales is difficult to manage for *Centrale de l'édition*. Members at risk seek coverage elsewhere which applies only in case of bankruptcy of their customers.
- It takes up to one year for new members to get coverage
- Members at risk may have to wait for up to 15 months before they are indemnified for larger losses.

COMMON FEATURES OF BOTH EUROPEAN MODELS

- Both European organizations were created for the purpose of managing the accounts receivable risks of publishers and book distributors.
- Both organizations involve publishers and booksellers to make the system work.
- Both organizations have existed for over 25 years and both are successful.

- Virtually every book industry firm exposed to accounts receivable risks is a member of BAG in Germany or of *Centrale de l'édition* in France.
- Both organizations provide members with timely information on the financial status of their customers and both feature a well-honed collection system.
- Under both systems, everyone at risk is protected—except authors.
- Both organizations offer worthwhile features that could be incorporated into a Canadian-made risk management and insurance model.

REDUCING BOOK RETURNS

Print on demand

Many supply chain solutions have limited shelf lives, however some are worth looking into for reducing returns in the Canadian book distribution chain. Print on demand (POD) is just in time inventory management (JIT) for publishers: it can enable them to use the latest technology in digital printing and imaging to print some types of books on demand and in the right quantities instead of printing a run of thousands and pushing them through the book chain then seeing many of them come back up through the system. With POD, distributors no longer need to stock hundreds of copies from hundreds of authors in anticipation of possible orders from bookshops. While the cost of producing books using POD technology are not yet as low as those used for producing the mass market paperback, it is anticipated that significant savings in distribution and storage will soon make POD competitive for producing pocket books. Obviously, POD technology cannot replace methods used to produce many books—coffee table books for example, however a big advantage of this technology is that publishers' lists of out-of-print titles can be made available on demand. With POD, books are never out of print because they are stored digitally and can be printed whenever ordered.

Retail space currently used for storage will eventually accommodate POD equipment. Three POD machines only require about 100 square feet of floor space, and proponents of POD predict that in-house retail POD will come when the price of equipment comes down and that consumers will eventually be able to order and almost immediately obtain a book from the menu of books provided by the publishers' lists.

The Nielsen BookScan system

Another method, the Nielsen BookScan point-of-sale data collection system, can also enable Canadian publishers and booksellers to better manage inventory and returns. Under this system, sales data is collected weekly from retailers' electronic point of sales systems to produce information on over 140,000 different titles sold at over 6,000 retail outlets in the UK alone. Through this continuous monitoring of retail book sales, publishers can obtain crucial sales information by title, author, category, etc. The BookScan system enables publishers to track cultural trends in book buying and to make more time-accurate decisions regarding the types of books to publish. They can also obtain timely sales information that can help them decide which books to reprint.

Those publishers who cater to niche markets can obtain information that is broken down into specific market segments. This system also enables booksellers to track sales data over time, allowing them to identify changes in consumer purchasing patterns and to identify those categories where sales are above or below the market average—all of it very valuable information that can help reduce unproductive book returns.

The issue of book returns in the Canadian book industry is central to risk management and risk reduction for Canadian book publishers and distributors. More efficient ordering makes for less returns and reduced costs. This, combined with improved cash flow, should make accounts receivable exposures more attractive for potential insurers.

While POD and systems such as BookScan are not a panacea, they can help reduce book returns and accounts receivable risks, however they won't eliminate them altogether as publishers depend on book returns as a means of ensuring shelf space for as many of their titles as possible. Book returns will remain a way of doing business and any accounts receivable insurance model proposed for the book industry would still have to address the issue of book returns.

ADJUSTABLE PREMIUMS

Premiums for accounts receivables insurance are based on sales—the amount of credit at risk. But how can premiums be accurately determined on sales that have not really taken place because of book returns? An insurance model for the domestic book industry does not exist, but the basic mechanics of such as model are proposed here. Accounts receivable insurance premiums should also be "on consignment" for what some refer to as consignment sales (credits on future orders) in the Canadian book industry. Premiums should reflect the accounts receivable exposure. In other words they should reflect only those sales that were actually made. Premiums could therefore be adjusted at the end of an adjustment period—each quarter in this case—with an additional premium or a return premium (more likely a premium credit). At the end of each quarter, the anticipated sales that were declared for that quarter can be compared to actual sales for that same quarter and the premium adjusted accordingly. Actual sales are arrived at by subtracting credits granted for returns from the sales that were made in the same period. A minimum premium could apply depending on an agreed upon percentage of returns made.

Accurate premiums could be charged for ongoing (revolving) credit in this fashion. A simple, uniform system would have to be adopted by all book industry members at risk to track and record sales and returns for the purpose of determining actual sales per quarter. Accurate planning of purchases and fewer book returns would not only serve to decrease accounts receivable risks, but would also make for more accurate sales forecasts upon which premiums are set.

A draft model for a premium adjustment mechanism would have to be based on industry cash flow statistics. Payment terms and returns obviously vary in the book chain, however book stores will generally keep books for 90 days. In Quebec for example, bookstores using the *système de l'office* are required by law (Bill 51) to keep books for 90 days and for 120 days in the case of titles from Quebec authors. According to a study carried out by La *Société de développement des entreprises culturelles du Québec* (SODEC) in 2000, 74.9 percent of new titles are sold within 90 days[2]. The trick for bookstores is to return books without mortgaging the future sales potential of the 25 percent of unsold new titles. A quarterly premium adjustment for the preceding quarter should suit the book industry because it would lend itself to proper planning and would ensure more accurate determination of actual sales made.

A good credit risk management system is central to any insurance initiative undertaken by book publishers and distributors, and the Canadian book industry should be thinking in terms of risk management instead of a cure-all insurance product. Accounts receivable insurance policies are typically tailor-made and coverage is provided in tandem with a sound loss prevention program. Insurers cannot serve up an inexpensive off-the-shelf insurance policy that will solve all the problems. Insurance—a form of risk financing—is only one aspect, albeit an important one, of an effective risk management program, and accounts receivable insurance in particular cannot be provided without there being a proper risk management system in place. There is no other option than to seek tailor-made coverage that truly addresses the needs of book publishers. Insurers would not have it any other way.

SELF-INSURANCE

Private credit insurers' willingness to insure and their conditions of coverage may reflect the fact that they are going after market share, and there is a very large market indeed to go after in North America. Unlike Europe, where the domestic accounts receivable market is very mature, the market is just opening up in North America. The risk exists however that some insureds could find themselves without coverage should some insurers decide to pull out when losses due to deteriorating economic conditions start yielding unfavorable loss ratios for them. Potential conditions such as these make sound long-term planning for the book industry somewhat uncertain. This is why prudent planning dictates that the book industry take the long view and doesn't leave itself exposed to the insurance cycle which is characterized by times of decreasing cost, increasing coverage and rising capacity, then by times of increasing cost, decreasing coverage and lack of availability. The book industry could implement its own loss control procedures and self-insurance mechanism. This would not only make it less dependent on the insurance market, but it would also provide significant tax advantages and direct access to reinsurers or to excess insurers who would participate only in the catastrophic layer of coverage leaving it less vulnerable because insurers could be more easily replaced in the catastrophic layers of coverage.

Self-insurance could make the book industry less vulnerable to the insurance cycle, however this cannot be achieved overnight. The first step towards self-insurance is thinking in terms of an industry insurance program—providing risk management and accounts receivable insurance coverage for the book industry as a whole. While the Canadian book industry does not represent a homogeneous group of potential insureds—a prime requirement for providing coverage for any group on a program

[2] Ménard, Marc, *Les chiffres des mots*, *portrait économique du livre au Québec*, Société de développement des entreprises culturelles du Québec, Collection Culture et économie, SODEC, Montreal, 2001.

basis—an insurance program would make all participants in the chain subject to the same loss control procedures, and this would not be lost on potential insurers.

A book industry association or organization could implement and manage a loss control program and seek coverage for its members in excess of a self-insured retention (SIR). An SIR differs from a deductible in that when a deductible applies insurers handle claims whereas when an SIR applies, the insured performs all he functions normally undertaken by insurance companies for losses within the SIR including the funding, adjustment, and payment of claims. It should be noted that with an SIR, loss adjustment expenses are the responsibility of the insured and that, as in the case of *Centrale de l'édition*, a risk management program and claims handling procedure must be approved by the insurer who reserves the right to become involved in those cases where it feels a claim may involve it. The SIR could be managed for the industry association by a hired risk management specialist, by a specialty firm, or by the specialized department of a credit insurance company.

An SIR would provide publishers with experience to handle their own claims and enable them to evolve to an alternative risk transfer mechanism such as an association captive, which is an insurance company formed for the purpose of providing insurance coverage to its group or association of owners. Over the longer term, self-insurance in the form of an association captive would provide:

- Significant tax advantages
- Investment income earnings on premiums collected
- Less vulnerability to the insurance cycle
- Direct access to the excess insurance and reinsurance markets
- The ability to obtain broader coverage
- Greater control over the handling and settlement of claims
- Greater stability in the cost of insurance

NEXT STEPS

- Survey the members of book industry associations to identify their key concerns and priorities, the type of risk management system they would like to adopt and the type of structure that would best suit their needs for managing an accounts receivable risk management system.
- Examine the mandates of existing book industry associations and define the type of industry organization that already exists, or that could be created or modified to manage such a risk management system.

- Define the role and mandate of the proposed organization that would eventually work with book industry members at risk and handle risk management.

- Examine existing book industry models for mitigating accounts receivables exposures, compare the relative merits of each as they apply to the Canadian book industry, and propose a Canadian model to book industry associations.

- Identify the risk management procedures that need to be in place for insurers to consider providing accounts receivable coverage for the Canadian book industry.

- Devise a state-of-the-art credit risk management system with book industry members and for all book industry members at risk.

- Devise a system for also protecting authors at risk.

- Explore the possibilities for establishing a self-insurance mechanism serving the Canadian book industry and the requirements for doing so.

- Devise a premium determination method that would accurately reflect accounts receivable exposures, that would be practical to use for self-insurance purposes and that would be acceptable to excess insurers or reinsurers.

- Determine the best method for providing bridge financing to those industry members who can’t afford to wait up to 15 months to be indemnified.