Jacob Barron

Accurate CMI Readings Show Worth of Credit Department Insight

News outlets heavily covered the National Bureau of Economic Research's (NBER's) announcements of when the recession began and when it mercifully ended. December 2007 was the official start date, giving a green light to negative GDP growth, increased investor anxiety and swift political action. Three months prior to the recession's official start, a sizeable contingent of credit managers sat down at their computers and participated in one of a series of surveys conducted by the National Association of Credit Management (NACM).

The survey was used to calculate the Credit Managers' Index (CMI), NACM's own economic indicator that first starting taking the market's pulse in January 2003. In the CMI, any reading above 50 suggests economic growth, while anything below 50 indicates a contracting economy. The CMI's first reading showed a growing economy, but only modestly. Years later, when the September 2007 CMI was released, the forecast was a bit more negative.

Since its inception, the CMI has been an immensely powerful and startlingly accurate economic predictor.

This was three months before the official start of the recession. Following a significant 1.3% drop in July 2007 and another -0.2% in August, September's reading edged up 0.3% to 54.3, but an uneasiness had set in. Comments received by credit professionals in the manufacturing sector noted they "had more companies just closing their doors and walking way [with] no assets to recover" and that "orders are being canceled or modified after the initial order," illustrating the jittery, changing nature of their customers. Comments from the service sector by and large focused on the housing market mid-collapse.

October's reading of 54.1 showed yet another decline. NACM members in the abrasives industry reported "seeing some domestic slow down" and one from the newspaper industry said that "certain local industries continue to experience severe financial crisis, citing cash flow problems, reduced sales and inability to get financing." November continued the downward trend, falling 0.2%.

In December 2007, the recession began, although savvy observers armed with the CMI already knew it was going to happen.

A Powerful Tool

Since its inception, the CMI has been a startlingly accurate economic predictor, proving its worth most notably during the recession. In the case of the Purchasing Managers' Index (PMI), which NACM Economic Advisor and Managing Director of Armada Corporate Intelligence Chris Kuehl, PhD frequently refers to in the CMI reports, it depicted an economy flirting with recession in the run-up to the downturn, but seemed to have trouble committing. The overall PMI reading tiptoed around 50, recording 50.4, 49.9 and 50.7 in September, October and November of 2007, respectively. It then dipped to 48.7 in December 2007, before hopping back up to 50.5 in January 2008, and eventually crashed to the 30s late in that year and in early 2009. During this period, the CMI mirrored the PMI on occasion, but altogether showed a remarkable sensitivity to the intricacies of the recession, resisting the month-to-month swings that seemed to characterize the PMI. For credit professionals looking for the expected economic trend of the next few months, they needed to look no further than the CMI.

Bad times aren't the only thing that the CMI can predict. Eighteen months after plunging into negative growth, in June 2009, the economy emerged—albeit less than triumphantly—from the recession and into positive growth territory. As early as February 2009, however, the CMI indicated that the market was slowly stabilizing. While the index didn't break the 50-point threshold until later that year in October, its slow trickle upward signaled that the recession would hit bottom soon, and that very tentative, much awaited growth was on its way, and it was.

"The PMI is a much more immediate snapshot," said Kuehl. "Its strength is that it will tell you where the economy is today, but there isn't much in the PMI that talks about what's next." Kuehl noted that other indices try to measure what's expected to happen by asking respondents what they intend to do in the next several months. The problem, however, is that intentions don't always pan out, and often change for many of these participants, which affects how easy it is to generalize from the index in question. "There are other indices that talk about intent and plans, but as soon as you start getting into that kind of conjecture you kind of weaken the data," he noted. "For example, the purchasing manager doesn't know what they're going to do in three months. They'll say 'I think I'm going to do this.'"

On the other hand, the CMI survey asks about more concrete factors, but is still indicative of what's coming in future quarters. "When responding to the CMI question, 'Do you have more credit applications?' there isn't a lot of room for interpretation or conjecture there," said Kuehl. "The more you get into the future with the PMI, the more subjective it becomes. The real data doesn't reflect what the purchasing manager thought they would do."

The Nature of Credit Management

Part of what allows the CMI to predict economic developments is that it surveys credit professionals, whose responsibilities really deal with what's going to happen next. "I think it's the nature of credit management," said Kuehl, when asked why the CMI is proving to be so accurate. "Credit managers are as concerned about the condition of their clients 15, 30, 60 and 90 days from now as they are today. The tendency is to think ahead."

Many of the questions asked of CMI participants are fairly basic, but a closer look reveals that they all suggest something that hasn't happened yet, but will in the coming weeks and months. "You're getting responses that have to do with credit applications and the status of accounts, and most of that stuff is oriented to the future," Kuehl added. "As you collect data, you're almost forcing people to be predictive and the information that you get, particularly the things like number of credit applications received and credit applications denied, are things designed to indicate a future occurrence." If someone applies for new credit, Kuehl noted, "they're planning to do something," which most likely involves spending, which in turn helps the economy in general. On the other hand, if someone has their application rejected, "that's a future plan that has to be altered," meaning the cancellation of originally planned spending or some other negative change. Altogether, these items take advantage of the forward-looking nature of credit management to accurately and intuitively suggest what the economy will see in the months to come.

Many credit professionals already participate in the monthly CMI survey, but more are always welcome as the benefits stretch far beyond the continuing education units earned by taking part on a regular basis. "The most compelling thing for people who are getting into the survey to realize is that the more participation we get, the stronger it becomes," said Kuehl. "Where that becomes relevant is to get to a point where we have enough numbers to do regional breakouts, and then we can get to the point of sector breakouts."

The future of the CMI, as participation increases, will lead to the necessary numbers that can be easily used to project how things are—not just nationally, but regionally and locally, and within one's own industry. "The first part would be regional breakouts," said Kuehl. "Say 'here's an East Coast version, here's a West Coast version,' since there's really no such thing as a national economy. If we ended up with statistically significant numbers that let us break them down even further, that's what we'd have."

Additionally, as more people participate, and the CMI continues to effectively predict the nation's business climate, it raises the profile of the respondents themselves, as well as their chosen career. "I think the PMI did wonders for convincing executives that their purchasing managers play a huge role," said Kuehl. "It elevated the supply chain manager and other jobs to a new level. The CMI can do the same thing." Recognition of the worth of credit management has already reached some portions of the business world, especially in the wake of a recession driven by poorly managed risk. "There's already recognition from the CFO's office about how important credit management is," Kuehl noted. "But when the rest of the organization sees that it's our credit managers that are predicting the economy, it makes it easier to present to top-level people."

To learn more about the CMI, or to become a participant, visit NACM's website at www.nacm.org and click on Credit Managers' Index in the Resources area. •

Jacob Barron, NACM staff writer, can be reached at jakeb@nacm.org.