

**Credit-Reporting Agencies:
Their Historical Roots, Current Status, and Role in Market Development
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I. Introduction

The problem of asymmetrical information. In a perfectly efficient market, the interest rate on a loan would always reflect the risk profile of the borrower: good borrowers would have no problem obtaining loans at low interest rates, while bad ones would be charged higher rates or denied loans altogether. So why, in the real world, do lenders sometimes deny loans to good borrowers or force them to pay the same interest rate as bad ones?

According to the theoretical literature, the answer lies in the problem of asymmetrical information: borrowers know much more than lenders about their own ability and willingness to repay.¹ The asymmetry may work to the advantage of bad borrowers, but it is in the interest of lenders and good borrowers to overcome the problem. Reasons for why lenders would want to do so are obvious, but good borrowers also benefit because public knowledge of their good payment histories leads to better access to lower-priced loans, especially in an environment where there are several competing lenders. Society benefits, too: good borrowers would not be inadvertently penalized (which might lead them to abandon their good behavior) and bad ones would be given an incentive to improve, or could even be accommodated at a higher interest rate. In turn, the higher confidence among lenders would result in greater credit availability for everyone, a situation that enhances economic growth.

Various information-sharing devices have evolved to meet the problem of asymmetrical information; some, such as merchants' groups, are nearly as old as credit itself. Today they have become institutionalized in the form of banks, credit-reporting and credit-rating agencies, bureaus, and trade associations -- powerful organizations that vitally affect how credit is allocated. Yet, aside from banks, the academic literature has rarely focused on these institutions and their effects on economic growth and market development. Moreover, the literature has tended to assume a scenario wherein borrowers deal with one lender at a time rather than with multiple lenders. This is a

¹ Joseph E. Stiglitz and Andrew Weiss, "Credit Rationing in Markets with Imperfect Information," *The American Economic Review* 71, no. 3 (June 1981): 393-410.

serious omission because the latter is common in trade and consumer credit, where a business or an individual can be in debt to several creditors simultaneously.²

Fortunately, research has begun to focus on these other types of credit, where information sharing among multiple lenders is especially valuable. The research suggests that information sharing reduces loan interest and default rates and can have disciplinary effects because they encourage borrowers to try harder to meet obligations. Credit-reporting agencies and bureaus can therefore fill a dual role as both information clearinghouses and enforcers of contracts. With these mechanisms at their disposal, creditors become more willing to extend credit. Barron and Staten argue that the heavy use of credit bureau information in the U.S. "has made a wide range of credit products available to millions of households who would have been turned down as too risky just a generation ago." By extension, they believe that the increased willingness of foreigners to lend to Latin American consumers is due to advances in the region's credit-reporting system.³

Evidence of the effectiveness of information sharing has begun to accumulate. Using macroeconomic data, Jappelli and Pagano found that countries with higher levels of formal information sharing have greater levels of bank lending relative to GNP; conversely, the risk of default was higher in countries with lower levels of formal information sharing.⁴ Jappelli and Pagano focused on bank lending and made no distinction between business and consumer credit. Other studies, however, have established that information sharing is effective in these kinds of lending as well. Using Dun & Bradstreet data, Kallberg and Udell found that the information collected by credit-reporting agencies, particularly debtors' payment histories, had "substantially greater predictive power" than the standard financial ratios calculated from information contained in balance sheets.⁵ These findings mirror the research on consumer credit, where one study of bank card applications found that lenders who relied only on application data fared worse than if they used information provided by credit bureaus. Higher levels of credit bureau detail, including information on individuals' positive and negative payment histories, substantially increased predictive power: up to 52 percent greater than when

² Jarl G. Kallberg and Gregory F. Udell, "The Value of Private Sector Credit Information Sharing: The U.S. Case," The World Bank, forthcoming, pp. 6-8.

³ John M. Barron and Michael Staten, "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience," The World Bank, forthcoming, pp. 1, 4, 22.

⁴ Cited in Kallberg and Udell, "The Value of Private Sector Credit Information Sharing," p. 3.

⁵ Kallberg and Udell, "The Value of Private Sector Credit Information Sharing," p. 6.

creditors relied exclusively on application data. "In fact," the study noted, "a model incorporating the detailed credit bureau data plus application data actually performed worse than a model based on the detailed credit bureau data alone."⁶

Credit-reporting agencies. Credit-reporting agencies (CRAs) were an early institutional response to the problem of information asymmetry. These pioneering organizations, which originated in the U.S. during the first half of the nineteenth century, greatly enhanced the transmission of information during a time when other information-sharing mechanisms were not yet well developed. By enabling suppliers to access local knowledge about potential customers, including those in distant localities, CRAs facilitated the granting of trade credit and encouraged market transactions over vast distances even before a national transportation system was fully in place.

In addition to their role as information-sharing mechanisms, credit-reporting agencies had an important effect on the business culture of the U.S. In the course of their activities, CRAs transmitted the business values of the large commercial centers to nearly every American community. In so doing, the agencies helped to standardize the criteria for creditworthiness in a country that was large, regionally varied, and heterogeneous. CRAs also helped to legitimize business credit and its practices, thereby preparing the way for the professionalization of credit managers that occurred at the turn of the twentieth century.

Credit-reporting agencies in the U.S. were private-sector initiatives; they developed largely without government involvement, their evolution driven instead by inter-firm competition. Courts, rather than legislatures or policy-setting bodies, established the parameters within which the new industry developed. The press was another safeguard against abuse: public debates about the agencies occurred in newspapers and business journals, and at least two book-length criticisms of CRAs were published prior to 1900.⁷ In this way, public concerns about the new (and for some, potentially menacing) organizations were aired and addressed during the first decades of their development.

Today credit-reporting agencies are an integral part of American business practices. They are, in their own words, "embedded in the systems" that businesses use to

⁶ Barron and Staten, "The Value of Comprehensive Credit Reports." p. 6.

⁷ Thomas F. Meagher, *The Commercial Agency "System" of the United States and Canada Exposed: Is the Secret Inquisition a Curse or a Benefit?* (New York, n.p., 1876); William Y. Chinn, *The Mercantile Agencies Against Commerce* (Chicago: Charles H. Kerr & Co., 1896).

manage their supply chains. As will be discussed in Section IV the cultural assumptions that underlie the American CRAs are rapidly being transferred to other countries, as business credit becomes a more global phenomenon. Like their U.S. counterparts, the CRAs now operating in developing countries are largely private-sector initiatives; in fact, they frequently are established by former employees of international agencies such as Dun & Bradstreet. By examining the U.S. experience with credit-reporting agencies, this paper aims to contribute to the discussion of how institutions can support market development. Following Miller, this paper broadens the concept of credit reporting to encompass not just the agencies themselves but also the legal and regulatory environment in which they operate, including the many complementary organizations that support their work. The term also encompasses the cultural context in which credit transactions and information sharing take place.⁸

II. Definitions

Trade (business) credit. Credit-reporting agencies were an attempt to manage the riskiness of mercantile (now called trade or business) credit. This form of credit is the extension of goods to another business -- for example, from a wholesaler to a retailer -- based on the promise that the receiver of the goods will pay for them at a later date. It is, therefore, a form of unsecured business-to-business lending. In the American colonial era, credit terms stretched to a year or more. They shortened considerably in the intervening time and today generally span from thirty to ninety days depending on the type of goods involved. Interest is generally not charged unless the buyer pays late, and a discount is given for early payment.⁹

Trade credit functions as short-term working capital because it allows businesses to have full use of goods before they are paid for, an important benefit when capital is scarce. In the nineteenth century U.S., it was often the only type of credit available to businesses operating in small towns and rural areas, where bank loans were confined to land and other real estate purchases. No reliable statistics on the volume of trade credit used during that period exists, but the anecdotal evidence suggests that it was present almost every time goods changed hands. When the U.S. became a capital-rich economy towards the end of the nineteenth century, trade credit continued to be important. What

⁸ Margaret Miller, "Credit Reporting Systems Around the Globe: The State of the Art in Public and Private Credit Registries," World Bank, forthcoming, p. 4.

⁹ Roy A. Foulke, *The Sinews of American Commerce* (New York: Dun & Bradstreet, 1941).

had begun as a practical necessity when capital was in short supply became a tool for retaining the loyalty of customers, stimulating sales, and gaining a competitive edge over rivals.

Today trade credit accounts for a significant proportion of working capital; practitioners estimate that accounts receivable constitutes between 20 and 60 percent of many companies' total assets.¹⁰ The Federal Reserve's flow-of-funds data shows that nonfinancial corporate entities had a total of \$1.3 trillion of accounts receivable in the fourth quarter of 1998, almost exactly the same amount as consumer debt outstanding for the same period. Small firms in particular rely on trade credit for a significant portion of their financing because they have less access to public debt and equity markets. Using 1993 data, Berger and Udell found that firms with fewer than 500 employees financed nearly 16 percent of their assets using trade credit. Private sources such as friends and family typically provided 50 percent, while bank financing furnished an additional 19 percent. (They point out, however, that bank financing is secured by owners' assets, whereas trade credit is not. Bank financing can therefore be deemed a kind of internal equity, which makes trade credit the largest source of external financing.)¹¹ So although trade credit gets far less press than government, bank, or consumer credit, it was and continues to be substantial. Moreover, because it constitutes such a large proportion of companies' asset portfolios, the effective management of this kind of credit can contribute to overall economic health.

The dynamics of trade credit differ in important ways from other types of lending. A number of studies have shown, for example, that trade creditors have advantages over bankers in their ability to acquire information about debtors. As Kallberg and Udell suggest, "these advantages may be even greater in the informationally poor environments of formerly centralized economies and lesser developed countries where banks may look to trade creditors for certification of borrower credit quality."¹² In contrast to a banking relationship, the trade relationship is more akin to a partnership wherein contracts are flexible and open to compromise. Trade creditors have historically been willing to postpone payments when debtors are struggling through a tough selling environment, a leeway that does not usually exist in bank or consumer lending. Such flexibility can be

¹⁰ Ian Edmonds, "Winds of Change," *Business Credit*, May 1998, pp. 60, 62.

¹¹ Cited in Kallberg and Udell, "The Value of Private Sector Credit Information Sharing," p. 8, note 12.

¹² Kallberg and Udell, "The Value of Private Sector Credit Information Sharing," pp. 8-9, note 13.

an advantage in helping new businesses to get established, or when the business environment is uncertain.

In the U.S., the distinction between business and consumer credit is clear and precise, whereas credit-reporting agencies and bureaus in developing countries typically do not distinguish between the two. But even in the U.S., the creditworthiness of very small businesses is often closely tied to that of their owners. Hence, creditors frequently access individual (consumer) credit reports for information, and some CRAs provide blended consumer and trade credit scores when a small business uses personal credit for business purposes.¹³

Credit reporting vs. credit rating. This paper employs the term credit reporting rather than credit rating. Although the terms are sometimes used interchangeably, credit-reporting more accurately describes the function of organizations such as Dun & Bradstreet and Experian (formerly TRW, purchased in 1996 by a British conglomerate), which serve business-to-business lenders. There are, as well, credit-reporting agencies - Trans Union, Experian and Equifax being the largest -- which specialize in consumer rather than business credit reports. This paper focuses on the latter type because in the U.S. they preceded consumer credit bureaus by several decades. The term "credit-rating" will be restricted to agencies such as Moody's and S&P, which assess the default risk of fixed-income securities, i.e., bonds and commercial paper issued by companies, municipalities, states, and countries.

A historical connection exists between credit reporting and credit rating. Both have their origins in the U.S., where John Moody published the first bond ratings (of railroad securities) in 1909. Nearly a century's worth of developments in the older credit-reporting industry, which first appeared in New York in the 1830s, helped to lay the groundwork for Moody's new service. (Incidentally, Dun & Bradstreet acquired Moody's in 1962 but sold it in 2000.)¹⁴

Credit bureaus and registries. The term "bureau" is used primarily in the U.S. and Canada; elsewhere, the term "registry" is also used.¹⁵ Although "credit bureau" technically refers to any non-profit or for-profit private organization that collects

¹³ Kallberg and Udell, "The Value of Private Sector Credit Information Sharing," p. 3, n. 2; "Experian to Introduce National B2B Direct Marketing Solutions," *Business Wire*, September 13, 2000.

¹⁴ "Evaluating the Bond-Rating Agencies," *Financial Times*, May 27, 1997, p. 2.

¹⁵ Miller, "Credit Reporting Systems Around the Globe," p. 3.

information on individuals and businesses, in the U.S. the term is used almost exclusively in connection with consumer rather than business credit. The Associated Credit Bureaus, Inc. (ACB), founded in 1906, is the trade organization that represents this large industry, which includes companies that "provide fraud prevention and risk management products, credit and mortgage reports, tenant and employment screening services, check fraud and verification services, and collection services." Today almost all U.S. credit bureaus are members of ACB.¹⁶

In the U.S., the history of credit bureaus differs significantly from that of business-to-business credit-reporting agencies. The idea behind the two is similar: to provide information to creditors about potential customers. Credit bureaus, however, developed much later and, unlike business credit-reporting agencies, were first structured as local non-profit associations and cooperatives. These usually took the form of merchants' groups, including some run by local chambers of commerce. The fragmented nature of consumer credit reporting changed beginning in the 1950s, when a number of new companies attempted to achieve scale efficiencies by buying up the local operations. For example, TRW entered the field by buying the Michigan Merchants' Credit Association. Eventually the Big Three consumer credit-reporting agencies -- TRW, Trans Union, and Equifax -- integrated many of the regional operations and standardized their products in order to provide a uniform, nationwide service.¹⁷ The pace of consolidation has accelerated during the past fifteen years, when the number of independent bureaus fell from approximately 2,000 to only around 400. These remaining independents sell information to the Big Three; so, in effect, they are also part of the national network.¹⁸

Credit reporting is most advanced in the United States, the country with the most comprehensive credit files on the largest percentage of its citizens and businesses. However, other countries are taking steps to catch up. Globalization, technological innovation, the liberalization of markets, and the inadequacies evident in their financial sectors have spurred the governments of many developing countries to set up public credit registries or encourage the establishment of private ones -- sometimes both. Public credit registries, which obtain most of their information from banks rather than

¹⁶ "Who We Are," Associated Credit Bureaus, Inc. Web-site, acb.cyberserv.com.

¹⁷ Daniel B. Klein, "Credit Information Reporting: Why Free Speech is Vital to Social Accountability and Consumer Opportunity," available in <http://lsb.scu.edu/faculty/creditreporting.html>. Klein is associate professor of economics at the University of California, Santa Clara, and is the editor of *Reputation: Studies in the Voluntary Elicitation of Good Conduct*.

¹⁸ Miller, "Credit Reporting Systems Around the Globe," p. 8.

businesses, are not a new phenomenon; they first appeared in Germany in 1934 and in other European countries during subsequent decades. What is new is the pace at which these are being established worldwide, a phenomenon documented by a recent World Bank survey.¹⁹

III. History

Industry groups vs. third-party-providers. Good information is a necessary element in credit relationships, especially when potential trading partners do not know each other personally. Prior to the establishments of credit-reporting agencies, information about individuals' creditworthiness flowed through networks and merchants' groups, of which the mutual protection society was among the most effective. One early example (formed to exchange information on consumer rather than business credit) was Britain's Society of Mutual Communication for the Protection of Trade, founded in 1801 to safeguard the carriage trade in London's West End. At its peak, the society had around 2,000 members who agreed to share information about their customers with one another.

Industry groups of this kind had a relatively late start in the U.S., where they did not appear until the end of the nineteenth century. As in the earlier British organization, information-sharing in these groups was restricted to members, and there was little or no attempt to profit from the services provided.²⁰ Today, industry groups flourish as important mechanisms for information sharing; they do not compete with credit-reporting agencies so much as provide overlapping and complementary services. Some industry groups are run independently while others operate under the auspices of larger trade groups such as the National Association of Credit Managers. Some are affiliated with credit-reporting agencies; Dun & Bradstreet, for example, sponsors several such forums. Interchange groups must be monitored by an outside party to ensure that the information complies with antitrust regulations.

The credit-reporting agency, in contrast, was a third-party provider of information, and it departed from the industry group model in a number of ways. The most obvious was that CRAs made information available not just to members but to anyone willing to pay the subscription price; that is, the agencies were profit-seeking ventures that turned

¹⁹ Miller, "Credit Reporting Systems Around the Globe." The report finds that public registries are more likely to evolve in countries with a legal system based on Napoleonic code, where creditors receive less protection.

²⁰ Greig, C. McNeil. *The Growth of Credit Information: A History of UAPT-Infolink plc.* (Oxford, U.K.: Blackwell Publishers, 1992).

information into a commodity that could be appraised, bought, and sold. The other major difference was that CRAs attempted to gather information on a wide array of businesses, not just those that were of interest to a particular industry group. Because competition among CRAs was robust in the early years, broad coverage came to be seen as a competitive advantage, and agencies often instructed their local correspondents to report on even the smallest businesses in their locality. In this way, peripheral establishments were brought under the agencies' purview. (One of the unexpected and welcome features of these early credit reports, especially for social historians, is the large variety of businesses they cover, including ones owned by women, ethnic minorities, and African-Americans).²¹

Credit-reporting agencies were the products of the dynamic and highly mobile American society, wherein stable and effective industry groups did not easily develop. Not surprisingly, the early CRAs tended to argue for a business environment that was open, dynamic, and transparent -- precisely the kind of environment that benefited them. The agencies' arguments happened to dovetail with the rhetoric of fairness and opportunity that characterized American politics during the 1820s to the 1850s, when modern American ideas about democracy first took shape.²² Moreover, competition drove the agencies to greater inclusiveness, as ambitious agency managers strove to demonstrate that they could provide subscribers with more thorough coverage than their competitors. Coverage soon included even the smallest businesses owned by women, African-Americans, Jews, and other minorities.

Credit-reporting agencies, in other words, *helped to entrench the very conditions that gave rise to them, and which made their work possible*. It might be argued that the strong embeddedness of these values in U.S. business culture resulted in part from the CRAs' early appearance and success there. If so, credit-reporting agencies provide a vivid example of how organizations can transmit and embed particular business values within the larger society.

²¹ Recent studies of female, African-American, and ethnic business owners that have made extensive use of nineteenth-century credit reports include Wendy Gamber, *The Female Economy: The Millinery and Dressmaking Trades, 1860-1930* (Urbana, Ill.: University of Illinois Press, 1997); Juliet E.K. Walker, *The History of Black Business in America: Capitalism, Race, Entrepreneurship* (New York: Macmillan Library Reference USA, 1998); and Elliott Ashkenazi, *The Business of Jews in Louisiana, 1840-1875* (Tuscaloosa: University of Alabama Press, 1988).

²² See Harry L. Watson, *Liberty and Power: The Politics of Jacksonian America* (New York: Hill and Wang, 1990).

Early U.S. agencies. Credit-reporting agencies emerged first in the U.S. because the country's strong commercial orientation, combined with the comparative absence of entrenched interests, was highly conducive to institutional experimentation. It is worth emphasizing again that the U.S. experience was unique, in that business credit reporting appeared there much earlier than did consumer credit reporting. As will be discussed later, this is today generally not the case in developing countries, where agencies and bureaus do not strictly separate the two types of credit.

Until the early nineteenth century, the small scale of trade in the U.S. allowed businesses to rely on letters of recommendation for information on creditworthiness. Recommenders were usually local or distant suppliers with whom an individual had previously done business or, less frequently, respectable members of his or her community, such as lawyers and bankers. Some large mercantile houses such as Baring Brothers of the U.K. hired local agents to conduct credit investigations of their U.S. customers, but this was a costly arrangement and was confined to the very largest firms. By the second decade of the nineteenth century, the expansion of the country and the accompanying increase in the volume of trade rendered letters of recommendation inadequate and (it was generally felt) unreliable. Wholesalers, in particular, needed a better way to assess the creditworthiness of a growing number of potential and existing customers, many of whom operated "country stores" in distant states and territories.²³

Perhaps because of the country's vast geographic scale and the high mobility of its population, mutual protection societies and other industry groups did not evolve as an effective response to business credit risk. In fact, robust and long-lasting organizations of this type did not appear even in places such as New York City, Chicago, and New Orleans, where one might have expected to find them. In the 1820s a group of New York wholesalers formed a society and hired a credit investigator, but the arrangement did not last; the first successful national wholesalers' group, the Credit Clearing House, was established only in 1888.²⁴

Instead, during the 1830s enterprising individuals invented a new type of organization, the credit-reporting agency. Arguably, the new CRAs were better suited to

²³ Ralph W. Hidy, "Credit Rating Before Dun and Bradstreet," *Bulletin of the Business Historical Society* 13 (December 1939): 84-88; Lewis E. Atherton, "The Problem of Credit-Rating in the Antebellum South," *Journal of Southern History* 12 (November 1946): 534-556.

²⁴ Peter P. Wahlstad, *Credit and the Credit Man* (New York: Alexander Hamilton Institute, 1917), p. 125; E.M. Skinner, "Essentials in Credit Management," *Credits, Collections & Finance: Organizing the Work, Correct Policies and Methods; Five Credit and Collection Systems* (Chicago: A.W. Shaw Co., 1914), pp. 16-17; B.H. Blanton, *Credits: Its Principles and Practices* (New York: Ronald Press Co., 1915), pp. 99-100; William A. Prendergast, *Credit and Its Uses* (New York: D. Appleton -- Century Co., Inc., 1906), p. 203.

the peculiar needs of American society, where creditors needed a means to obtain information on individuals whose business experiences frequently were dispersed over a wide territory. CRAs achieved scale and scope efficiencies by setting up a centralized agency that coordinated the flow of information within a large territory, an arrangement that one scholar has aptly described as a "hub and spoke" system.²⁵ At the time, merchants' societies could only be local in nature and were therefore less effective in meeting these requirements than CRAs, whose branch structures proved better at alerting creditors about debtors who had run into trouble, tracing individuals who moved from state to state, and identifying new or inexperienced individuals who might potentially become good customers. As Barron and Staten have pointed out, information sharing is most useful in large markets with high borrower mobility and heterogeneity, a situation that perfectly describes the U.S. during this period.²⁶

Most of the early agencies' records have not survived, so some of the details concerning their evolution can only be a matter of conjecture. Fortunately, however, those of the R.G. Dun Co. (established in 1841 as the Mercantile Agency and the forerunner of today's Dun & Bradstreet) have been preserved, and they constitute the single largest source of historical information on this otherwise hidden industry.²⁷ The Dun records are particularly useful given the firm's unusual position; after the Civil War this firm along with the Bradstreet Co. and perhaps one or two others came to dominate the field of credit reporting. (R.G. Dun and the Bradstreet Co. merged in 1933.) The Dun records allow historians to trace the changes in the type of business that used CRAs, changes that mirrored the country's evolution from a mercantile to a manufacturing economy. In 1870, the agency claimed to have 7,000 subscribers; by the 1880s, it had an estimated 40,000, including the country's largest wholesalers, importers, manufacturers, banks, and insurance companies.²⁸ By 1900, R.G. Dun was reporting on well over one

²⁵ Daniel B. Klein, "Credit Information Reporting," p. 5.

²⁶ Barron and Staten, "The Value of Comprehensive Credit Reports," p. 3.

²⁷ R.G. Dun Historical Collection, Baker Library, Harvard Business School. On the history of credit reporting, and of R.G. Dun in particular, see James D. Norris, *R.G. Dun & Co. 1841-1900: The Development of Credit-Reporting in the Nineteenth Century* (Westport, Conn.: The Greenwood Press, 1978); James H. Madison, "The Evolution of Commercial Credit Reporting Agencies in Nineteenth Century America," *Business History Review* 48 (Summer 1974), 164-186; Bertram Wyatt-Brown, "God and Dun & Bradstreet, 1841-1851," *Business History Review* 40 (Winter 1966), 432-450; Owen Sheffield, "The Mercantile Agency . . . A Private History," 3 vols., Dun & Bradstreet, privately printed, 1965.

²⁸ Norris, *R.G. Dun & Co.*, p. 189 n. 68. On the transformation of the American economy, and especially of the role of distributors, see Glenn Porter and Harold Livesay, *Merchants and Manufacturers: Studies in*

million establishments. (These are net numbers, which do not reflect the significant number of entries that were dropped between each date. So in reality, the agency covered many more businesses than these figures indicate):

Number of entries in R.G. Dun Reference volumes, 1859-1900

Year	Number of Entries
1859	20,268
1870	430,573
1880	764,000
1890	1,176,988
1900	1,285,816

Source: Edward Vose, *Seventy-Five Years of the Mercantile Agency: R. G. Dun & Co., 1841-1916* (New York: R.G. Dun & Co., 1916), p. 98.

Organizational Structures and Problems. Credit-reporting agencies did not, of course, emerge fully formed. They evolved through experimentation and innovation, as entrepreneurs attempted to gain comparative advantages over rival establishments. CRAs responded to four constituencies, all of whom had an impact on the agencies' strategies and structures: their subscribers, who desired accurate and timely information; correspondents, whose interests needed to be aligned with the agencies'; the subjects of the reports, who often resisted the agencies' scrutiny and demanded fair treatment; and the general public, who had to be persuaded of the agencies' usefulness and legitimacy. Like many institutional innovations, CRAs initially prompted suspicion even among groups whose interests they purportedly served.

Four aspects of the agencies' early development are worth exploring: their branch structure, sources of revenue, problems in maintaining control of proprietary information, and the principal-agency problems involving the agencies' correspondents.

Network (branch) structure. This innovative structure was developed in response to the peculiar situation of the U.S., where distances were large and the population highly mobile. In order to provide national coverage, the more ambitious of the early credit-reporting agencies employed a network structure that linked local offices

the Changing Structure of Nineteenth-Century Marketing (Baltimore: Johns Hopkins University Press, 1971).

into an association trading under a common name. (Credit-reporting agencies were, in fact, among the first businesses in the U.S. to be national in scope.) They were run along the lines of a modern-day franchise, where the local offices were partly or wholly owned by individuals or partners. Local offices, referred to as "branches," contributed a share of their profits to the head office in return for access to the network's growing scale advantages, including its ability to provide information on individuals living in other localities. Correspondents typically sent their reports to their local branches, which in turn forwarded them to a head office, usually based in New York City, which then helped to coordinate inter-branch exchanges of information. In the mid-1870s the invention of the typewriter and use of carbon paper allowed the reports to be produced in multiple copies, resulting in much greater efficiencies. Agencies typically offered a range of related services and products, including debt collection and published analyses of local economic conditions, both of which exploited the advantages provided by a network structure.

Revenue sources. Lewis Tappan, founder of the agency that eventually became R.G. Dun & Co., implemented a payment system that was based not on usage, but on the subscriber's annual revenues. The fact that the information's real value was unproven made it somewhat difficult to come up with a fair pricing scheme. Tappan opted for a sliding scale: \$50 per year for firms with up to \$50,000 in revenues, with a maximum of \$300 per year for firms with revenues of more than \$400,000. One-half of the subscription fee was payable in advance, and the balance was due within six months. Renewal was automatic; subscribers who wanted to cancel their service were to notify the firm three months before their subscription lapsed. Basing the price on customers' revenues rather than actual use had at least two benefits: it simplified administration and made the agency's own revenue stream more predictable.²⁹

Subscriptions continued to be D&B's primary source of revenue, a situation that differed from the strategy implemented by the credit-*rating* agencies such as Moody's and S&P. Originally they, too, derived their revenues primarily from subscriptions, but in the 1960s and 1970s credit-rating agencies began charging fees to the issuer of the security -- a situation that, at least on the surface, is fraught with conflict-of-interest problems. (Both Moody's and S&P do, however, publish *gratis* the ratings for large corporations with significant issues.) During the 1970s, Moody's and S&P were criticized for being

²⁹ In 1861, the large department store A.T. Stewart made 10,000 requests for information, for which it paid \$1,500.

slow to respond to bad news about the companies who paid their fees. This kind of conflict-of-interest issue does not exist for credit-reporting agencies. In D&B's case, companies enter the database at the instigation of subscribers rather than of the companies themselves, and D&B must swallow the initial cost of obtaining and adding the new information.³⁰

R.G. Dun, and later Dun & Bradstreet, continued the policy of charging subscribers a relatively hefty fee upfront, which favored larger or more established creditors who could more easily afford the fees. That policy changed only very recently, when D&B was compelled by rivals to offer services on a per-report basis. Today anyone can obtain a D&B or Experian report for a reasonable fee by going online or by calling a toll-free number and paying with a credit card.³¹

Control of information. Two issues lay behind the agencies' problem of maintaining control of their proprietary information: preserving competitive advantage, and the danger that the information would fall into the wrong hands. Keeping control was difficult because pioneers of the new industry enjoyed little legal protection. Competitors freely copied each other's methods, and unscrupulous ones even went so far as stealing and reselling published information. (Occasionally, these were prosecuted and punished.) Indiscreet subscribers shared information with non-subscribers and even told the subjects of the reports what had been said about them. The latter was particularly vexing for the agencies because disgruntled subjects sometimes sued for libel. The agencies experimented with a number of solutions, including issuing their reference books with locks and keys and requiring sensitive information to be transmitted to subscribers orally rather than in writing. These problems were resolved over the course of several decades, as a series of court decisions (discussed in Section V below) eventually broadened the definition of "privileged communication," thus allowing the agencies to conduct their investigations without undue fear of libel suits. Eventually, trademark and copyright laws allowed the agencies to protect their proprietary systems, such as D&B's PAYDEX Score, discussed below.

³⁰ Kallberg and Udell, "The Value of Private Sector Credit Information Sharing," p. 4, note 4; "Evaluating the Bond-Rating Agencies," p. 2; Timothy J. Sinclair, "Reinventing Global Authority: Embedded Knowledge Networks and the New Global Finance," *Environment and Planning C: Government and Policy* 2000 18: 487-502, p. 492.

³¹ "Business-Credit Reports Becoming Affordable," *San Francisco Chronicle*, July 4, 1990, p. C1.

Principal-agency issues. Another serious problem involved securing and retaining competent correspondents and ensuring that they performed their duties in a timely manner. Attorneys were particularly sought-after because they tended to have knowledge of the business owners in their communities. Along with bankers, newspaper editors, and postmasters, attorneys were frequently asked by outsiders to provide local information. Surviving records reveal that attorneys received many requests for copies of state laws, as well as information on local businesses, court schedules, local economic and agricultural conditions, and public works projects. For the agencies, therefore, recruiting local attorneys as correspondents was the natural and obvious solution.

The challenge for the agencies was to align the correspondents' interests with their own. Fortunately for them, nineteenth-century attorneys were jacks-of-all-trades who were attracted by opportunities to expand their business connections. Credit-reporting agencies promised to direct all of their subscribers' debt collection business to the corresponding attorneys, a welcome offer because many small-town law offices relied on suits brought by outside creditors against local debtors. CRAs provided other, unrelated business opportunities such as recommending their correspondents as agents for insurance and steamship companies. The agencies even forwarded requests from firms looking for representatives to sell their stock to the public. Newspaper editors, too, were sometimes recruited; in their case, the CRAs offered to help obtain advertisements and subscriptions in exchange for information on local business owners.

Agencies sent a steady stream of instructions, reminders, and reprimands to ensure that information was collected and sent punctually. Generally, they reminded correspondents that prompt and accurate reports were in their mutual interest, and that quickly alerting the agency when a local debtor was in trouble could result in the correspondent being awarded the debt-collection business. CRAs also made clear that an attorney's reputation for promptness and accuracy (or lack thereof) would travel throughout the agency's network and affect his chances of obtaining additional work. This "reputational mechanism" appears to have worked; a number of agencies flourished by using it. Eventually, some were able to hire full-time resident correspondents, and travelling reporters who made spot-checks to uncover discrepancies and inaccuracies. Most CRAs, however, continued to rely heavily on resident part-timers.

Determining creditworthiness: informal mechanisms. Payment histories, i.e., records of how well a business has met its obligations to various creditors, are among the most important pieces of information collected by credit-reporting agencies today. This kind of information is particularly valuable for small debtors, whose financial statements

are often not carefully audited.³² The early agencies, however, could not systematically collect payment data; at best, they were able to obtain anecdotal information only. To compensate, the agencies used informal but effective mechanisms to predict the likelihood of payment.

Credit analysis today vs. the nineteenth century. In modern times credit scoring models have become available, usually on a proprietary basis, from providers such as Fair, Isaac and Dun & Bradstreet. These techniques enable credit managers to benchmark companies against their peers in order to determine whether a particular account is likely to pay on time, late, or not at all. The models are most useful to businesses that receive large numbers of applications because they allow credit managers to identify the higher risk candidates who can then be separately assessed.

D&B's proprietary measure, called the PAYDEX Score, is one widely used analytical tool. It is a composite statistic that allows creditors to compare their borrowers' record with up to two years' worth of aggregated and weighted data on hundreds of other borrowers in the same industry. The data is provided to D&B on a voluntary basis, mostly by major companies who may also share the data with other credit-reporting agencies; additional data is also gathered by D&B reporters. The PAYDEX Score ranges from 100 ("Anticipate," meaning the payment can be safely anticipated) to 20 (meaning that the borrower has been up to 120 days late in making payments). Obtaining this information is neither easy nor cheap. Not only must D&B expend effort to collect the data; once collected, it must convert numerous diverse reporting formats into a consistent one.³³

Credit scoring was made possible by the willingness of business debtors to share their payment records with credit-reporting agencies, a relatively recent phenomenon. The American creditor of the nineteenth century, in contrast, faced much more serious obstacles to obtaining good financial information on business owners. Not only were payment histories unavailable; financial statements, too, were difficult to obtain, and creditors were reluctant to request them for fear of offending existing or potential customers. Judging individuals, particularly men, primarily on the basis of their "character" rather than on financial statements was a powerful cultural idea that changed

³² Kallberg and Udell, "The Value of Private Sector Credit Information Sharing," p. 22.

³³ D&B, Supplier Evaluation Report Sample, available on www.dnb.com; Kallberg and Udell, "The Value of Private Sector Credit Information Sharing," p. 5 and note 7.

very slowly, and it persevered even into the early twentieth century.³⁴ Moreover, even if creditors succeeded in procuring financial statements, these were not necessarily reliable. Statements were almost never audited, ignorance about bookkeeping was widespread, and there existed no generally accepted accounting practices (GAAP). Financial information was typically limited to an individual's total wealth and liabilities, primarily mortgages; little or no information was provided on a business's revenues, profits, expenses, and cash-flow. Although credit practices and expectations varied among different lines of business, there was no industry data available to use as benchmarks.³⁵

In the following sample report from the 1850s, note the scarcity of precise financial information (here underlined for emphasis):³⁶

Jones, Smith, & Brown
Alfred Jones, John Smith, Wm. Brown, Gen'l Dealers

"J." is about 50 years old, and a merchant at this place for 20 years, during which time he has been doing a good business and has made money, never failed, is of good character, and a shrewd business man. Is now estimated worth about \$25,000, of which \$5,000 is in unincumbered real estate. He does a legitimate business, and never ventures into rash speculations. "S" and "B" are each about 35 years old, and smart business men. "S" had been in business and failed, settled honorably, acted as clerk, for "J." for two or three years, and was admitted a partner some two years since, paying in \$5,000 in cash, principally a gift from his father, who is well off. "B" has been a clerk in the house about four years, and a good and popular one, is just admitted a partner, but does not add any capital. They continue to do a good business, are in good credit, and worthy of it.

Reporters obtained financial information by interviewing the owners, consulting newspapers and county and state tax and property records, or through local gossip.

The above sample underscores how limited was the information about a borrower's liquidity. Jones, the senior partner, is deemed to be worth some \$25,000, of which \$5,000 consisted of "unincumbered real estate." But of what, exactly, did the remaining \$20,000 consist -- cash, securities, merchandise, or personal property? And

³⁴ Judy Hilkey, *Character Is Capital: Success Manuals and Manhood in Gilded Age America* (Chapel Hill: The North Carolina Press, 1997).

³⁵ Firms reporting to D&B provide income statement data much less often than balance sheet data. Kallberg and Udell, "The Value of Private Sector Credit Information Sharing," pp. 19, 23.

³⁶ Elijah W. Morgan, correspondence with American Collecting Agency. Morgan Family Papers, ca. 1830-1900, Box 1, Michigan Historical Collections, Bentley Historical Library, Ann Arbor.

what of the real estate? Was it the owner's home, a property he rented out, a store? The report indicates that one of the junior partners, Smith, paid in \$5,000 in cash when he was admitted into the partnership. But that was a full two years earlier, which means that the financial information -- even if it was duly reported by the correspondent within the last six months -- could be as much as two years out of date.

"Character" as a substitute. In any event, because credit terms could stretch from six to twelve months, a business owner's current liquidity was not as helpful as past behavior. (There was little to be gained from knowing how much cash a business currently had if payments weren't due for another year.)³⁷ Ideally, past behavior would have included an individual's payment record from other suppliers; but, as noted above, interchanges of this kind did not exist until the end of the nineteenth century.

As a proxy for past business behavior, reporters conveyed their assessments in terms of the borrower's "character," a term that at first glance carries much scope for imprecision. One of the most significant features of the early credit reports, however, was the clear pattern of specificity and consistency that they exhibited. Not all character traits were considered to be potentially important. Instead, creditors focused only on those directly linked to borrowers' willingness and ability to pay, which can be summarized as follows:

Important Signals

"Honesty," "Honor"
Punctuality
"Extravagance," "Thrift"
Experience
"Energy"
"Vices" (drinking &
gambling only)
Ethnicity (but not consistent:
sometimes explicitly mentioned,
at other times implied or ignored)

OTHER:
Marital status

Not Important³⁸

Political or social connections
Religious affiliation (except
Jews)
Education
Churchgoing
Marital infidelity, sexual
"deviance" or misbehavior

³⁷ Miller, "Credit Reporting Systems Around the Globe," p. 7.

³⁸ Some reporters mentioned these traits, so they were not completely absent from the reports. However, in general they were not reported.

Age

These traits were actually a shorthand for a specific set of questions.³⁹ For example:

"Honesty," "Honor"

- Has the borrower always made a good faith effort to pay?
- Does the borrower keep creditors informed of the risks faced by his or her business?
- Does the borrower pay ALL suppliers on time? (It was possible to maintain a good record with only one or two suppliers, who were then asked to provide a positive recommendation.)
- If the borrower failed in the past, did he or she deal fairly with all creditors? (One reliable source estimated that some 60 percent of retailers ran into problems in paying their suppliers. Note in the above sample report that a record of failing did not necessarily result in an unfavorable assessment, so long as the borrower made an effort to pay eventually.)

"Extravagance," "Thrift"

- Are the store and its inventory appropriate to the market?
- Are family expenses in line with income? (This was important, as most businesses in the nineteenth century were run as sole proprietorships or partnerships, not as limited-liability corporations.)

"Energy"

- Does the borrower show commitment and willingness to work?
- Is the borrower spreading him/herself too thin on other projects?
- Does the borrower engage in speculation?

"Character" functioned as an effective substitute for information that for cultural and practical reasons was simply not available. Note, moreover, that the rules were relatively simple; there was little need for specialized knowledge or training to understand and apply them. Indeed, it is the folksiness of this method that makes it historically important. Because the method was relatively simple to understand and so

³⁹ These were compiled from a number of contemporary books and articles. See especially Samuel H. Terry, *The Retailer's Manual* (Newark, N.J.: Jennings Bros., 1869).

congenial to larger American values, it spread quickly. Transmission was aided by the CRAs' network structure, which broadcasted the agencies' assumptions and expectations from their base in the large commercial centers to communities throughout the country. Trade creditors, whether operating in New York, Charleston, St. Louis, or San Francisco, shared an understanding about the precise set of traits that constituted creditworthiness. Surviving credit reports show little deviation among the major commercial centers, despite political and social differences among the regions which, in the most extreme and tragic instance, led to civil war.⁴⁰

Obviously, the credit-reporting agency system worked only if business owners acquiesced to the agencies' scrutiny of past behavior, including personal spending habits. Many Americans were profoundly disturbed and offended by what they saw as the agencies' "inquisitorial" system. Yet resistance to the CRAs, although vocal, was nevertheless relatively mild. During the latter decades of the nineteenth century, the initial suspicion gave way to an almost bland acceptance. As the practice spread, the business press affirmed the agencies' usefulness, and courts further advanced acceptance by generally ruling in the agencies' favor.

IV. Current Industry Structure and Characteristics

Dun & Bradstreet's industry dominance. The early industry pioneers who struggled to establish the agencies' legitimacy in the U.S. would have marveled at how tightly CRAs are now woven into the fabric of the country's business establishment. In a recent annual report, D&B itself acknowledged that the public now perceives it to be "conventional," "old fashioned" and "rigid," an unfortunate side effect of being one of the world's most trusted and recognized brand names.⁴¹ Dun & Bradstreet's dominance of this industry has historically been extensive. After the Civil War, an industry shakeout resulted in an oligopoly consisting of R.G. Dun, the Bradstreet Company, and one or two others. When the two largest firms merged in 1933, a monopoly on national credit-reporting appears to have been achieved. Official statistics do not treat credit-reporting agencies as a separate category, so it is difficult to find a total industry figure; there is

⁴⁰ In some cases, the credit-reporting agencies' norms were forcibly imposed. This was the case with immigrant Jews, the only group that managed to form robust business networks which resisted the agencies' demands for transparency. See Rowena Olegario, "That Mysterious People": Jewish Merchants, Transparency, and Community in Mid-Nineteenth Century America," *Business History Review* 73 (Spring 1999): 161-190.

⁴¹ Dun & Bradstreet company Web-site (www.dnb.com); company annual report, 1998, frontispiece.

general consensus, however, that Dun & Bradstreet currently accounts for a large majority of the total industry.⁴²

With annual revenues of some \$2 billion, Dun & Bradstreet is the world's largest provider of business credit information and the largest credit-reporting agency by a wide margin. Its long history and exceptional dominance makes the firm a unique case study of how scale efficiencies can work in the gathering and sharing of information. D&B's most important competitive advantage is its broad coverage of businesses that are neither large nor publicly-owned.⁴³ This is an important service because only some 50,000 to 60,000 of the world's companies are public. In 1998, D&B covered nearly 54 million businesses worldwide (about 26 percent of them in the U.S.), the vast majority privately owned and comparatively tiny. For example, nearly 40 percent of the U.S. companies had only twenty or fewer employees.⁴⁴ In addition to its role as an information-sharing mechanism, D&B also exerts considerable influence as a source of official data. It is a major compiler of statistical information, including failure rates, used by the federal government to formulate policy. Its proprietary numbering system for businesses, called the D-U-N-S Number, is used as a global standard by the United Nations, the federal government, and over fifty industry and trade associations worldwide. The Dun numbering system was used by the federal government until the 1950s, when standard industrial classification (SIC) codes were introduced.

In contrast to what was available to its predecessors, Dun & Bradstreet's data-gathering resources today are extensive. In 1998, a workforce of 1,400 employees contacted some 15 million businesses in the U.S. (mostly to verify addresses and phone numbers) and conducted more thorough interviews of management personnel in an additional 3 million companies. A small minority -- almost 200,000 in the U.S. -- shared their payment and bank information with D&B, and some 6,000 of those supplied accounts receivable data electronically. D&B accesses items on suits, liens and judgments from the federal and state bankruptcy courts. Other sources of information

⁴² Kallberg and Udell, "The Value of Private Sector Credit Information Sharing," p. 14.

⁴³ Some industries, such as construction, remain extremely fragmented. Obtaining good financial information on companies in these industries remains difficult, even for the large agencies.

⁴⁴ D&B delivers its reports in a variety of formats, depending on the need (and budget) of its clients. The different reports and products include: Business Background, Business Information, Comprehensive, Country, Country RiskLine, Credit Check, Desktop Solutions, DUNS Financial Profile, European Credit, Higher Risk Score, Industry Norm, International Business Information, International Risk & Payment Review, Payment Analysis, Predictive Scoring, Public Records Search, and Text Sections. D&B also offers "Automated Decisioning" and "Consultative" products and services. All of these products and services continue to evolve in response to the changing business climate.

include the offices of the states' attorneys general, insurance commissioners, and secretaries of state; over 2,000 daily newspapers, publications, and electronic news services; the U.S. Postal Service; and telephone and other utility companies.

Limits to the CRAs' authority. At first glance, the field of business credit reporting seems to be concentrated in the hands of one powerful entity. The situation is not surprising, as scale advantages are extremely important in this industry. However, D&B's position as the largest of the national agencies was mitigated by competition from smaller local and industry-specific agencies, and the industry groups that had become well-established by the early twentieth century. Today competition has intensified, particularly from Internet startups.

No *regulatory* barriers to entry exist in this industry because no laws or regulations compel trade creditors to first obtain a credit report before engaging in a transaction. This contrasts with the fixed-income securities market, where "state laws and legal precedents restrict the investments of trusts and fiduciaries to investment-grade securities [and some] investors can only legally buy bonds that meet certain criteria imposed by Moody's and S&P," according to the *Financial Times*. As a result, Moody's, S&P, and a small handful of more specialized firms have effectively sewn up the market. While the two biggest players have opened offices in a number of foreign locations, foreign rating agencies have not been successful in penetrating the U.S. because, crucially, the organization that rates the investment must be designated by the Securities and Exchange Commission as a Nationally Recognised Statistical Ratings Organization (NRSRO). The *Financial Times* reports that the "NRSRO designation process is somewhat mysterious and considerably frustrating for non-U.S. ratings agencies. There are no formal criteria for the designation and it is alleged that applications from several non-US rating agencies have been in limbo for several years."⁴⁵ Thanks to such regulatory requirements, Moody's and S&P have acquired what Timothy Sinclair calls "epistemic" authority, an advantage that inhibits competition from new technologies such as the Internet. The judgments of the large established players "are socially valorized" while those of newer entrants "are understood intersubjectively as mere conjecture."⁴⁶ In other words, the very authority that Moody's and S&P have managed to construct in the course of nearly a century, and which is now upheld by powerful bodies such as international banks, the IMF, other transnational organizations, and governments, has

⁴⁵ "Evaluating the Bond-Rating Agencies," p. 2.

⁴⁶ Sinclair, "Reinventing Global Authority," p. 495.

effectively shut out all competition in the credit-rating industry. In contrast, the worldwide credit-reporting industry is rapidly evolving as D&B's position is challenged by Experian and a host of new Internet-only entrants, including Creditworthy, CreditFYI, Creditsafe (UK), eCredit, and businessCredit.

In addition to the checks imposed by competition, D&B itself has always openly acknowledged the limits of its own authority, a stance that is probably motivated by the threat of lawsuits. Despite the much-improved quantitative methods that it makes available today, D&B analysts frequently stress that models must be supplemented by the judgment of the individual creditor, a claim that is accepted by most credit practitioners. (One of these has aptly characterized credit granting as similar to medicine, in that it is an "inexact exact science.")⁴⁷ The authority of credit-reporting agencies is debated constantly and publicly by those who rely on their services; the inaccuracies and inconsistencies of their information are freely discussed by credit professionals in trade publications such as *Business Credit*. Investigative journalists have questioned the accuracy of reports simply by obtaining several different ones on the same company, comparing the information contained in them, and then reporting their findings.⁴⁸ The nature of the credit-reporting agencies' authority is, therefore, more limited than that of Moody's or S&P's. Unlike these agencies, firms such as D&B do not make authoritative judgments about an account; rather, they provide a range of information so that creditors themselves can make the call. "We can provide plenty of background and qualitative information," states a D&B analyst based in the U.K. But it "is up to the managers in the supplier firm to evaluate the data and make a judgment about how the trading relationship should proceed and whether credit should be given."⁴⁹

So although credit-reporting was long dominated by one firm, its authority -- and the authority of credit-reporting agencies generally -- is more contestable than is the case with credit-rating agencies, which "see themselves as 'quasi-regulatory institutions,'" according to Sinclair.⁵⁰ The authority of credit-reporting agencies is checked by

⁴⁷ Joyce R. Ochs and Kenneth L. Parkinson, "Using Credit Screening to Manage Credit Risk," *Business Credit*, March 1998, pp. 22, 24-27; Jeff Brill, "The Importance of Credit Scoring Models in Improving Cash Flow and Collections," *Business Credit*, January 1998, pp. 16-17; Michael G. Ash, "Analyzing Credit Information: What You See Isn't Always What You Get," *Business Credit*, March 1996, pp. 7-8.

⁴⁸ "Online Credit-Rating Reports Are Not Always Credible," *Los Angeles Times*, August 19, 1998, Part D, p. 6.

⁴⁹ "Survey -- FT Exporter," *Financial Times*, June 1, 2000, p. 4.

⁵⁰ Sinclair, "Reinventing Global Authority," p. 496.

competition, the relative ease with which competitors' products can be compared to one another, the absence of regulations requiring creditors to use the services, and their own sense of the limited nature of their authority, an attitude that is shared by the entire credit profession.

Credit-Reporting Agencies in Developing Countries. Credit-reporting agencies and other private credit registries and bureaus have appeared in nearly every developing country, many in the past two decades. The World Bank's survey, focused primarily on Latin America, notes that approximately half of the private credit registries in its sample began operating only since 1989.⁵¹ A list compiled by Creditworthy, a private business credit information provider, indicates that credit-reporting agencies have been present in Central and South America for several decades but have become more common in Asia and Eastern Europe during the past fifteen years.

The industry today is a mixture of competition and cooperation, as increased cross-border trading compels CRAs to ally together into networks in order to provide better coverage. These networks include ALIAC (Latin American Business Credit Reporting Association), TCM Group International (headquartered in Australia), American Business Information Association (based in New York City), and Eurogate, among many others. Industry giants D&B, Experian, and Equifax have opened a growing number of foreign branches and formed alliances with (or at least buy information from) foreign agencies.⁵² The establishment of foreign branches by large agencies is not a new phenomenon; as early as the 1850s, U.S. agencies began establishing them in countries where U.S. companies conducted sizeable trade, such as Canada, Mexico, and the U.K. By 1901, the R.G. Dun Co. had several offices in Canada, as well as in London, Glasgow, Paris, Melbourne, Sydney, Mexico City, Guadalajara, Havana, and Cape Town. (Unfortunately, few if any of these early foreign branch records survive, so it is difficult to determine the scale and nature of their work.)

Private initiatives. Government initiatives did not play a direct role in the establishment of most foreign CRAs; rather, they were set up by entrepreneurs trying to exploit the growing demand for reliable information on businesses, many of which are

⁵¹ Miller, "Credit Reporting Systems Around the Globe," p. 7.

⁵² Miller, "Credit Reporting Systems Around the Globe," p. 8.

privately owned and comparatively small.⁵³ In some countries, CRAs have stepped in to provide information previously obtainable from banks, which one U.S. credit practitioner claims "have clammed up" in recent years. The U.S. Department of Commerce recently discontinued its Foreign Company Background Reports, another information vacuum that has benefited foreign CRAs.⁵⁴ Financial crises have also contributed. After the recent one in Asia, CRAs sought to take advantage of the desire of companies in that region to appear more credible to lenders. D&B, for example, expected to double the size of its database on Chinese companies in the nine months following the crisis; the same trend was expected for Singapore and Malaysia. Chinese business leaders also sought the help of D&B personnel to learn about how to manage a credit department.⁵⁵ The manager of a credit-reporting agency in China estimates that there are today some 100 large and small agencies currently in operation in that country, almost ten times the number of five years before.⁵⁶

As noted earlier, a growing number of governments in developing countries have encouraged the establishment of public credit registries to supervise and monitor bank lending activity. Yet from the point of view of trade creditors, the information available from these sources is limited. The biggest drawback is simply that unlike private credit registries, public ones do not collect information on trade credit.⁵⁷ Miller therefore

⁵³ There are exceptions. For example, China ProDiligence (based in Vancouver, Canada) describes itself as having been "established with the support of the Chinese authorities." Its shareholders include the China Industrial and Commercial Enterprises Consultants (under the State Administration for Industry and Commerce), the China International Tax Consultancy Corporation (under the State Administration of Taxation), the China International Commercial Information Centre (under the State Bureau of Internal Trade), and the China Financial Information and Consultancy (under the People's Bank of China). See the company's Web-site, www.prodilgence.com.

Keppel Communications, one of Southeast Asia's leading telecommunications and logistics providers, is 33 percent owned by the Singapore government. In early 2000, Keppel agreed to form a 50-50 joint venture with New Zealand's BayCorp to build online credit information bureaus throughout Asia. Keppel also has an interest in a Thai internet company, Anew, which has an online business venture with Dun & Bradstreet.

⁵⁴ "Savvy Exporters Do Credit Checks," *Journal of Commerce*, May 3, 2000, p. 10.

⁵⁵ "Asian Firms Seek Stamp of Approval from D&B," *Journal of Commerce* December 17, 1998, p. 2A.

⁵⁶ Exhibit 3, "Additional Observations."

⁵⁷ Miller, "Credit Reporting Systems Around the Globe," p. 19. However, the manager of a Mexican-based credit-reporting agency states that public and private bureaus in his country "do not carry any information regarding commercial transactions" and "will not provide any other verified topics [such as] present locations, present board of directors, trade references, etc." These observations were in response to a survey conducted by the author via e-mail, September-October 2000.

cautions against expecting public credit registries to substitute fully for private ones; their objectives vary too widely for significant overlap to occur.⁵⁸

Services provided. Like the early U.S. agencies, foreign CRAs are information-sharing mechanisms that are, or are becoming, key components of their countries' business information infrastructure. A survey conducted by the author of ten locally managed agencies located in Argentina, Chile, China, Dominican Republic, India, Kenya, Lithuania, Mexico, Thailand, and Ukraine indicates that they were established to meet the needs of both outside and local business creditors.⁵⁹ Typical clients include exporters/importers, insurance companies, banks and other financial institutions, lawyers, manufacturers, construction companies, consulates and trade organizations, collection agencies, chambers of commerce, embassies and foreign diplomatic missions, other credit-reporting agencies, and information resellers. Although each agency is constrained by the peculiar economic, social, and political circumstances of its host country, all share a number of common features. Subscribers typically are offered services ranging from a simple company profile to a thorough investigation that may include personal interviews of a company's representatives. Some provide their own original reports while others simply wholesale the information prepared by others, but in general the agencies attempt to provide the kind of credit reports that the older U.S. agencies have made standard.⁶⁰

In addition to credit reports, CRAs offer other services that take advantage of their local presence and ability to provide first-hand knowledge and information. These include the following:⁶¹

Debt collection

Market and consumer research, including feasibility research for joint-ventures, local market conditions, product pricing, consumption patterns, public opinion surveys

Search and retrieval of public registry and stock exchange documents, annual

⁵⁸ Margaret Miller, "Project on Credit Information in Latin America: Executive Summary," World Bank, forthcoming, p. 3.

⁵⁹ Exhibit 3, Survey question 1.

⁶⁰ "Savvy Exporters Do Credit Checks," p. 10; Exhibits 1 and 2.

⁶¹ Based on the information on the Web-sites of international credit-reporting agencies linked to Creditworthy.com.

reports of local companies

Networking: facilitating of contacts between international and local businesses searching for mutual opportunities

Prospecting: helping outsiders search for local business opportunities

Surveying agents for cargo insurance companies, including inspection of damaged cargo and preparation of all documents

Real estate and property investigations and appraisals

Life insurance investigations

Consulting

Personnel training

Publishing, especially reference books on local business topics and conditions

Insurance claims

Direct mailing

Effects on business norms. The survey of CRAs in developing countries indicates that their managers and owners have distinct ideas about how the agencies affect business norms, and vice versa.⁶² Not surprisingly, respondents stressed the agencies' positive effects, and their statements tend to be prescriptive rather than objectively descriptive. Even so, their responses shed light on these agencies' agendas and the often tacit assumptions that underlie their work.

Some of the respondents mentioned the educative function of the agencies, including their role in transmitting the business norms of more developed countries. A respondent in Lithuania believes that native producers there have begun to realize the benefits of obtaining information on potential trading partners. Credit reporting agencies, he wrote, have "changed the attitude towards the cost of information and [its role] in company strategy and marketing decision making. For example, there has been increased [requests for information on] foreign partners." Similarly, a Ukrainian manager wrote that in "the last two years we have seen changes produced in the minds of Ukrainian businessmen. They have become more open and credible during interviews. Most of

⁶² See Exhibit 3, Survey Question IV and "Additional Observations."

them now accept the European standards in managing their business." This manager expressed the opinion that credit reporting would not succeed fully until more stringent financial accounting and credit-reporting standards are put in place. Native business owners, she wrote, "do not want to spend money for the information because they think the money will be wasted. The only way to overcome these problems is to educate our businessmen about the standards of developed countries."

Other respondents focused on more fundamental changes. A manager in Kenya stated that credit-reporting agencies and bureaus can help to stem the corruption endemic in that country, which in turn would increase investment:

"We are one of the most corrupt countries in the world. We have the ability to substantially change the way business is conducted in this country. Exposing the abuse of credit can only result in greater liquidity in the market, reduction of the consumer price index which directly translates into increased local and foreign investment. Who wants to invest in a country where no one pays their bills and the legal system is open to debtor manipulation? . . . Basically, our culture has developed into one of gross fiscal irresponsibility. A strong, unencumbered and independent credit bureau is deemed the only sustainable method of changing the way consumers honour their obligations."

In the Dominican Republic, a manager emphasized the way credit-reporting agencies have equalized access to credit:

"One very important and almost always overlooked issue is that the credit-reporting system has allowed 'democratized' access to credit, thus to wealth creating mechanisms, heretofore only available to those who were either wealthy to begin with or simply had the 'right connections.'"

In general, the respondents' stated goals and the language they used strongly echo the early U.S. pioneers, who also spoke of the positive economic and social benefits that flowed from their services.

Disagreements were evident, however, about the desirability of welcoming the international agencies vs. encouraging the growth of locally owned establishments. A respondent in China regarded the entry of the international agencies in a positive light: "More and more foreign credit reporting companies, like D&B, are rapidly developing the market in China. They will bring experience and knowledge of the industry [which will be] very helpful." In contrast, an agency owner in Mexico criticized the international agencies for their lack of regard for local circumstances and culture. He wrote: "Culture

plays a big role since the market is divided [between locally based agencies and] international companies which just want to sell reports and do not look at the regional facts. They produce reports the same way they do in the U.S. or Europe . . . I strongly believe that reports must consider the culture within each country."

Limits to information gathering. Accessing the types of information that U.S. creditors take for granted is more difficult for agencies in developing countries.⁶³ Official data sources do exist; respondents to the above-mentioned survey, for example, referred to the Central Bank database in Argentina, the Superintendent of Stock Companies in Chile, the Administration of Industry and Commerce (AIC) in China, the Registry of Companies in India, and the Ministry of Statistics in Ukraine. Yet the respondents also noted that these sources frequently are inadequate. Information from China's Administration of Industry and Commerce "is not open to the public," the agency manager reported. "At present, we get this kind of information from the AIC through lawyers, which is expensive." The manager in Lithuania spoke of inadequate technology as an obstacle. The "main problem," he wrote, "is that information is insufficient, as most government institutions keep data not in computers or other digital form, but on simple paper blanks." In India, "many a time obtaining this information is extremely difficult as there are no public records available for non-incorporated companies, and on incorporated companies, the extent of the information available at the Registry of Companies is quite often incomplete." Many countries also limit access to particular kinds of data; for example, some Latin American countries including Costa Rica, Ecuador, and Guatemala prevent banks from sharing information on their customers' accounts. A number of the survey respondents stated that privacy laws restricted the type of information they could obtain and report.⁶⁴

Irregular business practices such as tax evasion and the lack of generally accepted accounting practices (GAAP) throw into question the reliability of financial statements. Agency managers in Kenya and China referred specifically to these problems: "No company in Kenya will give you their monthly accounts receivable, plus most companies keep five sets of books, one for the tax man, one for the owners, etc. Which one do you rely on?" In China, "[m]ost accounting offices do not follow the accounting laws [but instead] follow the requirements of companies in audit reports, who pay them. Most,

⁶³ See Exhibit 3, Survey Question II.

⁶⁴ See Exhibit 3, Survey Question III. The Web-sites of Latin American credit agencies, accessible through Creditworthy.com, warn about the restrictions on bank data.

especially private companies and small businesses, do not follow the accounting laws. Very often a company has some secret bank accounts to avoid tax." However, this manager added that "some big companies and foreign-invested companies do well in following accounting practices, " and although "the figures in the financial statements are often inaccurate, they are still valuable for credit reporting, as most . . . cannot be so large as to affect the overall financial condition of the company. If [they are], it is regarded as a serious violation of the law." The World Bank survey of credit registries finds that private registries use a variety of methods to correct for inaccurate information, including requesting a review from the reporting institutions when a data problem arises, suspending access to the data by institutions with recurrent data problems, and providing consumers with a free copy in order to encourage review of the data.⁶⁵ Because these mechanisms have not been systematically studied, their effectiveness remains unknown.

Perhaps the most disturbing obstacles are the security fears of business owners. In Mexico, companies "are not very willing to provide financial information any more. In the past we had 90% of reports with financials, but by 1998 we went down to 75%. Today we are at 50%. This is a response to insecurity in the country . . . [where owners fear] the risk of being robbed or the principals being abducted." The manager in Ukraine pointed to a similar problem. She wrote: "people are frightened by the criminals, and that's why they do not like to give truthful information."⁶⁶

Yet valuable information need not be complex. International debt collection is frequently hampered by simple breakdowns in communication, such as when debtors fail to receive invoices because they neglect to inform their creditors of an address change. Cultural misunderstanding also frequently occur, which leads one practitioner to advise: "before turning to the legal system, try to contact the company directly, or through another company or division where there are collection people who have native language speaking capacities, and familiarity with local customs. In many cases the problem can be resolved with a few telephone calls." Having access to a reliable local source such as a credit-reporting agency can help minimize communication problems for overseas creditors and reduce the need to appeal to the legal system.⁶⁷

⁶⁵ Miller, "Credit Reporting Systems Around the Globe," pp. 22-23.

⁶⁶ Exhibit 3, Survey Question 2 and "Additional Observations."

⁶⁷ Lynnette Warman, "An Overview of Legal Issues Impacting Collections in Mexico and Latin America," *Business Credit*, November/December 1999, pp. 36-39; Les Kirschbaum, "Managing Risks by Selling Internationally on Open Account," *Business Credit*, January 1996, pp. 13-15.

Open-account selling increases usefulness of CRAs. Selling on credit to overseas customers has always been risky because, aside from the obvious barriers of language and culture, legal systems the world over vary in their effectiveness. Yet businesses in a globalizing economy cannot afford to stay out of foreign markets. Until recently, the standard instrument used in international transactions was the letter of credit, issued by an international bank on behalf of the buyer. In this arrangement, the bank takes title to the goods and agrees to pay the seller/creditor a specified amount, and to release the merchandise to the buyer upon presentation of specific documents, within certain time limits and conditions, at a specified place. A letter of credit provides some legal protections to both parties, and the seller can use it as collateral to raise financing.

Beginning in the 1980s, many businesses in the U.S. began dropping letters of credit in favor of open account, an arrangement where goods are shipped pursuant to an agreement to pay within a certain time. Credit granted on this basis is risky because there is no security given for the goods and no official evidence of the debt. For example, international creditors seeking to recover debts granted on open account to Latin American businesses must first go to court to prove that a debt exists; only if this is established can the creditor sue to claim payment. Yet the economics for using open-account are compelling: *Business Credit* estimates that on a transaction of \$4,200, a letter of credit would add \$635 to the costs, vs. \$464 on open account. Moreover, a letter of credit does not insure against damage to the goods or product defects, and it can be rejected if any of the specified conditions are not met, or if the description of goods (including their specific ingredients) contain even slight discrepancies.⁶⁸ One practitioner reports that the discrepancy rate exceeds 50 percent, which can result in costly delays.⁶⁹ Loss of good will further decreases effectiveness; the business culture in some parts of the world requires that creditors who wish to establish a long-term relationship avoid demanding payment in advance.⁷⁰ There are, as well, competitive reasons for selling on open account, which can be used as an incentive to lure customers away from competitors who do not offer credit terms; the seller can then charge a higher

⁶⁸ Michael Flock, "Doing Business Abroad: Open Account or Letter of Credit?" *Business Credit*, March 1995, pp. 23-25; Milton J. Moser, "Collecting Foreign Trade Debt," *Business Credit*, March 2000, pp. 28-30.

⁶⁹ "Savvy Exporters Do Credit Checks," p. 10.

⁷⁰ Flock, "Doing Business Abroad," pp. 23-25; Moser, "Collecting Foreign Trade Debt," pp. 28-30. Another tactic is to use local trade instruments to guarantee payment. For example, in Latin America these consist of pagares, prendas, avales, hipotecas, fianzas and letras de cambio. Eric A. MacDonald, "Adding Some Security to Open Account Sales in Latin America," *Business Credit*, April 1998, pp. 16-17.

price for the convenience afforded to buyers. Finally, open account arrangements allow sellers to help out loyal customers experiencing temporary difficulties, an especially valuable device in countries prone to temporary financial crises.⁷¹

The increased use of open account makes local credit information on customers even more desirable. Foreign CRAs are well aware of their advantage in this area and frequently highlight it in their promotional literature:⁷²

"No database information is supplied. All reports are freshly investigated at the time enquiries are placed, by our qualified reporters and analysts who interview an executive of the subject company in all cases" (Uruguay CRA).

"All of our investigations are made personally in Mexico."

"The understanding of the Romanian social environment and business conditions guarantees the well rounded and relevant information you come to expect . . . 'Your Partner in Romania.'"

"We generate added value to publicly available data and databases by fresh field investigations. Collection activities are supported by a reservoir of information, we know the debtors and can, therefore, tailor-made [sic] our approaches for each single case" (Hong Kong CRA).

"We attribute our present position in the Information Industry to our Business Associates, who form a network of highly reliable Sub-Correspondents/Agents to cover the entire length and breadth of India, for our Valued Customers."

V. Regulatory and Legal Environment, Past and Present

After the panic of 1873, a number of U.S. state legislatures introduced bills that would have punished the agencies in cases where the information they provided proved to be incorrect and resulted in losses to subscribers. None of these was enacted into law. Instead, it was the courts that were most active in controlling credit-reporting agencies during the first half-century or so of their existence.

⁷¹ Jeffrey L. Wagoner, "Extending International Credit and Collecting Foreign Debts," *Business Credit*, November-December 1996, pp. 29-33.

⁷² From Web-sites linked to Creditworthy.com.

Significant Early Court Decisions. The agencies' unprecedented methods of collecting and transmitting sensitive information, some of it erroneous or outdated, made them the targets of numerous lawsuits. One of the earliest occurred in 1851 when two Ohio merchants brought a libel suit (*Beardsley v. Tappan*) against the Mercantile Agency (the R.G. Dun Co.'s predecessor) for inaccurately stating that their firm was about to fail. The technical issue in this case, as in many subsequent others, was that of privileged communication; counsel for the agency argued that the reports fell under this legal heading and therefore did not constitute libel. However, the judge in *Beardsley* interpreted the question narrowly, reasoning that because the information was available to a large number of partners and clerks, and potentially to any subscriber who requested it, credit reports did not enjoy protection as "privileged communication." The agency appealed, but the decision was upheld by the U.S. circuit court. The case did not put the agencies out of business; however, it became a nagging worry when the firms began to publish reference books. R.G. Dun even went so far as to issue their books with a lock and key in order to minimize the transmission of information to non-subscribers.

In later decades, the courts tended to broaden the definition of privileged communication. Seventeen years after the *Beardsley* case, *Ormsby v. Douglass* (1868) resulted in an important rethinking of the issue. Once again, a libel suit was brought against the R.G. Dun Co.; this time, however, the court accepted the firm's arguments and stipulated only that the communication must be "made in a proper manner, without evil intent or malicious motive." The decision provided important safeguards for the agencies, who were transmitting ever-larger amounts of information to their rapidly growing subscriber base. Meanwhile, the agencies refined their contracts with their subscribers to include disclaimers about the accuracy of the information they provided. In the 1870s several decisions established that the agencies needed only to be "reasonably diligent." In most cases, the court rejected the argument that the agencies were liable for losses that resulted from reliance on the information they provided. At the same time, the courts punished individuals who knowingly submitted erroneous financial statements.⁷³

Lawsuits were a constant source of concern to the agencies, but they functioned as an important check on an otherwise unregulated industry. Courts forced the agencies' managers to curb their worst impulses while at the same time allowing them to continue what increasingly was accepted as a necessary and valuable service. Equally important,

⁷³ Madison, "The Evolution of Commercial Credit Reporting Agencies in Nineteenth Century America," pp. 177-182; Norris, *R.G. Dun & Co.*, pp. 54, 132-133; *Beardsley v. Tappan*, 5 Blatchf. 498 (1867); *Ormsby v. Douglass*, 37 N.Y. 484 (1868).

the court decisions helped to legitimize the agencies' activities. Throughout the post-Civil War period the resistance to credit-reporting agencies slowly gave way to acceptance, as greater convenience and uniformity, increased protection from the courts, and the sheer prevalence of the practice succeeded in embedding CRAs as permanent elements of the country's commercial infrastructure.

In subsequent years, the agencies continued to be the target of lawsuits. The most recent to reach the Supreme Court was in 1985 (*Dun & Bradstreet v. Greenmoss Builders*), where the Court affirmed a \$350,000 verdict against D&B for erroneously reporting that Greenmoss Builders, a construction contractor, had filed for bankruptcy. According to a report by the *National Law Journal*: "The majority held that because the speech involved was not a matter of 'public concern,' it was not covered by the constitutional protections that had been extended in earlier libel cases. For matters that are not public concerns, the court held, libel should be left entirely to the law of the states."⁷⁴

In 1990, the Equal Credit Opportunity Act (ECOA), originally enacted to regulate consumer creditors, also became mandatory for business creditors. The act stipulated that business creditors must provide notice within thirty days to applicants who are denied credit. The law also requires that an applicant's records be kept for sixty days after notification; if the applicant requests in writing the reasons for the credit decision, the creditor must keep the records for at least twelve months. In 1997, Congress reauthorized the Fair Credit Reporting Act (FCRA), which was followed by the drafting of new regulations by the Federal Trade Commission. Aimed at enhancing the protection of consumer credit borrowers, the new regulations threatened to restrict access to the credit reports of business owners. The National Association of Credit Managers, an industry group discussed below, objected to the new regulations, arguing that they should not apply to transactions between businesses (as opposed to between businesses and consumers). "It is very common for corporate creditors to receive an application for the extension of open, unsecured business or trade credit to a sole proprietor who may be a consumer," states a recent NACM newsletter. The issue "is whether business creditors have a legitimate business need to obtain consumer credit reports, without obtaining specific written permission."⁷⁵ The new FCRA regulations are still being debated.

Most recent legislation has centered on consumer credit, specifically on the issue of privacy. All credit information-sharing devices necessitate the loss of a certain amount

⁷⁴ "Dun & Bradstreet v. Greenmoss Builders," *National Law Journal*, July 8, 1985, p. 52.

⁷⁵ National Association of Credit Managers, newsletter, n.d., at www.nacm.org.

of privacy; it is what potential borrowers give up in return for access to credit.⁷⁶ But the extent to which individuals are expected to tolerate this loss is continually contested in the U.S., where consumer credit reports are limited to reporting the following information only: the consumer's name, address, Social Security number, place of employment, and spouse's name; open credit lines, outstanding credit balances, credit limits, history of timeliness of payments, and amount of last payment ; bankruptcies, liens, and public judgments against the consumer. Reports do not include information about a person's lifestyle, religion, political affiliation, driving record, or medical history. The FCRA mandates that only those with a "permissible purpose," such as creditors, insurers, employers, and landlords, may purchase the reports.⁷⁷ Although restrictive, the laws are actually laxer than similar laws in Europe, Australia, and many other countries. In Portugal, for example, credit bureaus need to have a person's consent before they can either collect or sell any credit data, and the permission can be withdrawn at any time.⁷⁸ Australian bureaus report only negative information; creditors do not have access to the files of individuals with positive records.⁷⁹

Since the 1960s, a large body of federal laws has regulated the granting of consumer credit in the U.S. They include the following:⁸⁰

- Federal Consumer Credit Protection Act
- Truth in Lending Act (1969; amended 1970, 1982, 1989, 1995)
- Fair Credit Reporting Act (1971, amended 1978, 1989, 1992, 1994)
- Equal Credit Opportunity Act (1975, amended 1977, 1988, 1991)
- Fair Credit Billing Act (1975)
- Right to Financial Privacy Act (1979)
- Consumer Leasing Act (1976)
- Fair Debt Collection Practices Act (1978, amended 1986)
- Unsolicited Credit Card Act
- Bankruptcy Reform Act of 1978 (1979, amended 1984, 1986, 1994)

⁷⁶ Barron and Staten, "The Value of Comprehensive Credit Reports," p. 10.

⁷⁷ Daniel B. Klein, "Credit Information Reporting," pp. 2-3.

⁷⁸ "Tagging Deadbeats is Big Business," *Crain's Chicago Business*, November 18, 1996, p. 15.

⁷⁹ Barron and Staten, "The Value of Comprehensive Credit Reports," pp. 2, 26.

⁸⁰ From U.S. Department of Commerce, *Credit and Financial Issues: Responsive Business Approaches to Consumer Needs*, May 1995.

Credit is also regulated by state laws. While they vary, most cover the following areas:

- Usury or rate ceilings
- Consumer loans
- Mortgage lending and brokering
- Retail installment sales
- Credit cards
- Home solicitation and improvement
- Rental purchase agreements

Complementary Organizations. In the U.S., the work of the credit-reporting agencies was complemented by a number of non-profit, non-government groups that worked in tandem with the for-profit agencies to monitor, facilitate, and legitimize business credit practices. They did so by promoting the professionalization of credit practitioners and by lobbying Congress, the regulatory agencies, and state bodies. Today the most important of these complementary organizations are the National Association of Credit Managers (NACM, formerly the National Association of Credit Men) and the Credit Research Foundation (CRF). Because business credit is not strictly regulated (for example, there are no state licensing requirements for credit managers), and institutions of higher education do not grant degrees on the subject, NACM has taken on the role of monitoring the profession and accrediting its members.⁸¹

The NACM was established in Toledo, Ohio, in 1896, with an initial membership of 600. The panic of 1893 provided the impetus for its creation, and a resolution was proposed during the World Mercantile Congress sponsored by the Chicago World's Fair that year. The new national organization used the existing local associations as its nucleus, and by 1917 it claimed a membership of over 200,000, including the country's largest bankers and merchants.⁸² NACM had a broad mandate, including educating the trade at large and lobbying for the prosecution and punishment of fraud and the reformation of collection proceedings, especially from bankrupt estates. The association

⁸¹ Manuel A. Alfaro, "NACM and the Profession of Credit Management," *Business Credit*, January 2000, pp. 12-13.

⁸² Prendergast, *Credit and Its Uses*, pp. 334-335; R.T. Ettinger and D.E. Golieb, *Credits and Collections* (New York: Prentice-Hall, Inc., 1917), p. 376. The NACM was part of a general movement that saw the establishment of numerous professional business associations. See Alfred D. Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, Mass.: Harvard University Press, 1977), pp. 464-468.

was a strong supporter of the first successful national bankruptcy law passed in 1898 and lobbied throughout the subsequent decade to prevent it from being repealed. Along with the American Bankers' Association, the NACM pushed for a law in every state that would punish the use of false written statements, whether these were made directly to a creditor or indirectly to a credit-reporting agency.⁸³ The association also worked to improve the agencies' services. Both R.G. Dun and the Bradstreet Co. apparently welcomed, or at least did not resist, the association's overtures, and reports on the agencies' progress became a regular feature of the association's annual conventions.⁸⁴ The NACM's Canon of Ethics reflected and affirmed many of the assumptions that underlay the agencies' work. (See Exhibit 4.)

Today the NACM is organized as a network of affiliated associations. Because the group operates both on the national and local levels, its programs and services are varied. They include the formation of 150 industry group roundtables, credit-reporting and collection services, and consulting on troubled businesses. The organization recently moved from its New York offices to Columbia, Maryland, outside Washington, D.C., a decision that highlighted the importance the group places on federal lobbying, especially against laws and regulations that restrict the free flow of business information. Although the U.S. is considered to be the most transparent and open business environment in the world, the National Association of Credit Managers closely monitors developments in this area.

Many policy makers remain unaware of the different dynamics that characterize business, as opposed to consumer, credit. NACM's lobbying efforts are directed at enhancing awareness of these differences. The unrestricted flow of information, the group argues, is more important to business creditors, where the dollar amount of credit extensions is usually much larger, and the timeliness in reaching a decision therefore more critical. (NACM estimates that delays in making credit decisions result in an annual loss of \$60 billion worth of business.) The group maintains that unlike consumer credit, which is typically targeted at a very broad customer base, business credit relationships are characterized by fewer but larger accounts. Business creditors have a greater need for information because they spend more time in assessing applicants, monitor their

⁸³ Blanton, *Credits: Its Principles and Practices*, p. 92; Herman Flatau, "Financial Statements, Their Form and Analysis," in *Mercantile Credits: A Series of Practical Lectures* (New York: Ronald Press Co., 1914), pp. 82-83.

⁸⁴ George R. Barclay, "Address," in *Proceedings of the Twenty-Fifth Annual Convention of National Association of Credit Men, held at Atlantic City, N.J., June 1-5, 1920* (Park Row, NY: NACM, 1920), p. 32.

borrowers more closely, and assess the health of the borrower's business frequently during the course of the relationship. Moreover, businesses are often themselves both creditors and borrowers; they are likely to understand the principles and risks involved and therefore should not be subjected to the same protective legislation as consumers.⁸⁵

The Credit Research Foundation was established in 1949 and is today allied with the NACM; the two organizations share offices in Columbia, Maryland. CRF conducts research and surveys, sponsors forums, and disseminates new techniques in credit and accounts-receivables management as well as information technology. The foundation publishes a refereed scholarly journal, *Credit and Financial Management Review*.

VI. Analysis and Discussion

Why include credit-reporting agencies? The World Development Report poses the question: might market reforms work better if more attention were devoted to the establishment of market-enhancing institutions -- and if so, which ones? The report focuses on institutions that perform three functions: diminishing information asymmetry, providing effective and accessible dispute resolution (contract enforcement), and enhancing competition and opportunity. In addition, the report explores how such institutions interact with and are affected by societal and behavioral norms.

Using these criteria, it seems clear that information-sharing mechanisms such as credit reporting agencies should be given consideration. They clearly fulfill the first desirable function (reducing information asymmetry) which, as recent research has established, can reduce default rates by improving the ability of creditors to predict outcomes. The network (branch) structure that U.S. agencies pioneered, wherein local information on business owners was collected and broadcasted to a wide audience of potential creditors, facilitated the country's transition from a small-scale and personalized form of commerce to a larger, more impersonal one. As trade globalizes and as businesses increasingly look beyond their borders for customers, a pattern similar to the U.S. experience is occurring: large international agencies have established local offices abroad, and homegrown agencies have appeared in nearly every country. Rather than simply competing with one another, they are forming alliances and networks in order to provide better coverage. Along with the establishment of public credit registries (which primarily access information from banks) these developments promise to provide local

⁸⁵ National Association of Credit Managers, newsletter, n.d., at www.nacm.org.

and foreign creditors with better information on a growing number of potential trading partners.

Enhancing opportunity. The WDR also poses the question: why have some countries succeeded in developing efficient, integrated markets from which large segments of the population have not been excluded? No country, of course, provides perfect equality of opportunity for all of its citizens; however, it is true that some countries accomplish this desirable social goal better than others. Is this because their institutions somehow diminish the social and economic barriers to entry that can so often limit the opportunities available to women and minorities?

Credit-reporting agencies were never conceived as a mechanism for progressive social engineering. However, there is evidence that they tended, sometimes inadvertently, to increase competition and opportunity. The early agencies were third-party providers: they made information available not just to members of an exclusive industry group (the traditional arrangement) but to any creditor willing to pay the subscription fee. By equalizing the access to information, CRAs may have enlarged the pool of creditors and enhanced competition among them. The appearance of more creditors increased the opportunities available to business owners and may have reinforced the dynamism and mobility of American life. As the research on consumer credit by Barron and Staten suggests, the enhanced information made available by credit bureaus in the U.S. has

[I]owered the prices for other financial products as customers have been freed from their binding relationships with banks and other depository institutions. In the past the customer's own bank was frequently the lowest cost source for a loan because other creditors lacked the information needed to measure risk. Consequently, banks have been forced to become more competitive for customers at all margins. [Bureaus have also made] consumers (and workers) more mobile by reducing the cost of severing established relationships and seeking better opportunities . . . the portability of information makes us more open to change. There is less risk associated with severing old relationships and starting new ones, because objective information is available that helps us to establish and build trust more quickly.⁸⁶

Moreover, competition among the early agencies drove them to cover a large portion of the business population, including the smallest enterprises run by women, African-Americans, and members of ethnic and religious minorities. Tens of thousands

⁸⁶ Barron and Staten, "The Value of Comprehensive Credit Reports," pp. 26-27.

of these businesses appear in the R.G. Dun ledgers, which cover the period 1841-1889; for historians, they are often the only surviving documentation of individuals whose lives would otherwise have remained unremarked and unrecorded. This is not to suggest that the reports were free of bigotry; on the contrary, they are filled with descriptions of Jews, African-Americans, and other "peripheral" business owners that are deeply offensive to modern sensibilities. But in the context of nineteenth century society, the reports can be seen as progressive. They are mostly respectful of and frequently complimentary about female business owners, for example; that is, they legitimized women's participation in business during a time when most women were barred from engagement in the political sphere. Many small, minority-owned businesses are described, frequently in some detail. There are even reports on black business owners that date from before the Civil War. If inclusion is, in itself, a virtue -- because acknowledgment is the first step to legitimacy -- then the credit reports can be deemed progressive rather than exclusionary.

The character traits that the early reports emphasized were those that focused on individuals' ability and willingness to pay rather than on their social or political connections. The early credit reports seldom mentioned which political party an individual belonged to, a significant omission during a period when membership in political parties played an important role in the construction of (white) men's social identities. Nor did the reports tend to note membership in social clubs or churches -- again, a noteworthy omission given the crucial position these institutions held, especially in small-town life. By insisting on the primacy of traits such as "honesty" (does the individual make a good faith effort to pay? Does the individual pay all suppliers on time? -- and so on), the agencies helped to embed these values more deeply and thereby opened up opportunities to groups that might otherwise have been excluded from participating fully in market activities because of class, ethnic, or gender barriers.

Clearly, the effectiveness of credit reporting agencies and bureaus in this area can be overstated, and policymakers should note that the system currently has serious shortcomings. Critics have suggested that credit-scoring models commonly used today contain hidden biases against minorities and women. This is because banks that lend to small businesses tend to place a heavy emphasis on the owner's personal credit history, a practice that works against minorities, who tend not to engage in practices -- such as taking out home-equity loans -- that are more common among whites. Instead, minority business owners are more likely to have accessed loans from community groups, sub-prime lenders, and local finance companies, which tend not to report their loans to credit bureaus. According to *Business Week*: "some predatory lenders withhold good payment records to prevent customers from refinancing at lower rates . . . The result: no credit

history for such entrepreneurs, and thus no loan from a bank." Women, too, are often subject to bias in the credit markets. For example, many married women do not have credit histories in their own name because their accounts are held in the names of their husbands. Women are also more prone to gaps in employment because of child-rearing and other family responsibilities. And because they tend to start their businesses on a less formal basis than men (working from their homes or only part-time) women are more likely to report that their businesses have operated for less than two years, a significant negative in the eyes of lenders.⁸⁷

Norms and institutions. The history of credit-reporting agencies provide vivid examples of how societal and behavioral norms can shape institutions, and vice versa. One example is the way the early agencies' branch structure became an important mechanism for transmitting norms: standards for creditworthiness that were established by New York City merchants traveled via the branch network to the furthest corners of the continent. Such norms were important because good quantitative information was unavailable, so ideas about which "character" traits mattered functioned as an effective substitute. Although the methods employed by the pioneer CRAs seem quaint from a modern perspective, it is important to note that the "rules" were simple to understand, which helped to ensure that they were consistently and widely applied. The agencies thus provided a homogenizing force in a country whose population was constantly being supplemented by fresh waves of immigrants.

Today foreign CRAs exhibit a similar pattern, as they strive to emulate the standards and the underlying cultural assumptions of international agencies such as Dun & Bradstreet. The managers of these foreign agencies express the desire to educate their native business owners about the standards that prevail in the U.S. and Europe. This is a significant development because, as the U.S. experience demonstrated, consistent norms can reduce transaction costs by minimizing ambiguity.⁸⁸ When the "rules" are clear to both creditors and debtors, business confidence is enhanced, as is the willingness to advance credit.

One final example of how norms and institutions interact is the way that U.S. credit-reporting agencies helped to legitimize credit in the mind of the public. The historical literature demonstrates that credit has often been poorly understood and is

⁸⁷ "No Credit Where Credit is Due," *Business Week*, May 22, 2000, p. F50.

⁸⁸ Douglass C. North, *Institutions, Institutional Change and Economic Performance* (New York: Cambridge University Press, 1990).

prone to being blamed for societal ills, especially during times of economic crisis. Problems with credit have in the past been popularly associated with lax morality and the breakdown of social order, and credit itself has been perceived as a tool of oppression used by the haves against the have-nots.⁸⁹ The danger for developing countries is that business credit could be curtailed by regulators acting out of genuine but misinformed motives, or in order to appease a public that traditionally associates credit with social instability, social injustice, or both. In the U.S. credit-reporting agencies, in association with non-profit organizations such as the National Association of Credit Managers, have been an important force in legitimizing business credit by linking it to larger American values. (See the NACM's Canon of Business Ethics, Exhibit 4). They also promote the professionalism of credit managers, develop more quantitative methods for assessing risk, monitor legislative, regulatory, and legal developments, and actively promote the interests of business credit grantors.

What is the role of government in establishing CRAs? Before tackling this question, it is useful to keep in mind that credit-reporting agencies already operate in nearly every developing country, and that the spread of globalization means that they are likely to flourish. In countries (such as China) that are currently in a state of rapid transition, credit-reporting agencies are in a pioneering, highly pliable stage of development. Any policy recommendations must take into account the quickly evolving nature of this industry and its historically high level of responsiveness to changes in the business environment.

Nearly all countries today have official bodies that collect information on the largest business establishments; many are also establishing public credit registries to collect data from lending institutions. Yet the information provided by official sources is often inadequate for trade creditors, and this situation provides a substantial opportunity for private organizations to make up the shortfall. The American experience suggests that private providers need not be closely monitored by government bodies; however, some

⁸⁹ In the U.S., the issue of credit was most politicized during the "bank wars" of the 1830s. The technical issue involved was whether banks should be liberal or conservative in issuing bank notes, which at the time constituted the country's currency. There is a large literature on this topic. See especially Watson, *Liberty and Power*, and Bray Hammond, *Banks and Politics in America From the Revolution to the Civil War* (Princeton: Princeton University Press, 1957). Other works that discuss how credit became closely tied to political, social, or religious issues include Rosa-Maria Gelpi and Francois Julien-Labruyere, *The History of Consumer Credit: Doctrines and Practices*, trans. Mn Liam Gavin (Basingstoke, U.K.: Macmillan Press Ltd, 2000; Lendol Calder, *Financing the American Dream: A Cultural History of Consumer Credit* (Princeton: Princeton University Press, 1999), and Julian Hoppit, "Attitudes to Credit in Britain, 1680-1790," *Historical Journal* 33 (June 1990): 305-322.

effective form of dispute resolution appears necessary in order to curb abuses. In the U.S. it was the courts rather than legislatures or official policy-making bodies that functioned as the instruments by which the larger society exerted control over the new agencies. The courts were supplemented by a vigorous press that allowed criticism or support to be aired and debated. In addition, trade organizations such as the National Association of Credit Men complemented and supported the work of the agencies through education and lobbying activities. Because the credit profession is not regulated by the states or the federal government, the NACM stepped in to fill the function, and the profession continues today to be self-regulating.

Research on consumer credit further suggests that governments need to be mindful of imposing overly restrictive regulations, which can have a chilling effect on the availability of credit. Barron and Staten argue that consumer credit is less available in countries that restrict access to consumer credit files. "The effect will be especially noticeable for those consumers who are financially more vulnerable (higher risk categories) such as consumers who are young, have short time on the job or at their residence, and lower incomes." They point out that greater credit availability could be encouraged by alternative policies, including regulations that provide for harsher collection remedies or that limit access to personal bankruptcy. However, these "may be less desirable from a social standpoint than facilitating the reporting of more complete credit histories."⁹⁰

Finally, one must pay attention to the problems that arise when institutions are transplanted from one culture to another. Credit-reporting agencies had their origins in the early nineteenth-century U.S., a time and place whose unique circumstances have long since ceased to exist. Credit reporting evolved along with the country itself. The institution was therefore able to adjust to changing cultural norms and an evolving regulatory and legal environment, which in turn accommodated the innovations introduced by the new institution. This kind of extended experimentation is a luxury that is denied to transplanted institutions, which are forced to prove their effectiveness within a highly compressed time period, during which they must become, in Sinclair's term, "embedded" -- that is, locals must view them as endogenous and therefore legitimate, rather than as exogenous entities that have been imposed on them by outsiders.⁹¹ For credit-reporting agencies to work, it is worth asking: Do they have undesirable effects? Do they change local business cultures and practices too radically? Would encouraging

⁹⁰ Barron and Staten, "The Value of Comprehensive Credit Reports," p. 26.

⁹¹ Sinclair, "Reinventing Global Authority," p. 489.

their growth stifle other innovations that, given sufficient time and support, would be more appropriate to local conditions than the CRA model? Are there effective alternatives -- for example, can roundtables, mutual protection societies, and other closed bodies accomplish the same ends, with less social and political disruption?

EXHIBIT 1: Information Provided by CRAs on U.S. Businesses

(The following is an ideal list. Not all of the information is always available)

Full company name, address, phone number, SIC classification, addresses of branches (if any), year of incorporation

Name of chief executive, other officers; their ages, education, and experience

Sales, net worth, current and fixed assets, current and long-term liabilities, profits.

Amount of authorized capital, type of capital, and who owns it

Total employees

Recent news, such as fires

Supplier Risk Score ("predicts likelihood of a firm ceasing business without paying all creditors in full, or reorganizing, or obtaining relief from creditors under state/federal law over the next 18 months.")

Incidence of Financial Stress (compares the company with the national average and with companies in its industry segment)

Company's payment history (i.e., incidence of slow payments)

Evidence of open suits, liens, or judgments, along with details

Quick ratio (current assets minus inventory divided by current liabilities); comparison to others in its industry

Whether business owns its facilities; description

Ratio of accounts payable as percentage of sales; comparison to others in its industry

Return on assets; comparison to others in its industry

Ratio of total liabilities to net worth; comparison to others in its industry

Financial Appraisal Ranking (a calculated average of the supplier's quartile ranking based on the available ratios)

Number of customer accounts, collection terms, market territory, seasonal or nonseasonal

Whether candidate for government programs, based on socio-economic factors (e.g., small business, Labor Surplus Area, minority-owned, women-owned)

Source: Based on sample report provided by Dun & Bradstreet on www.dnb.com

EXHIBIT 2: Information Provided by CRAs in Developing Countries

(This is an ideal list. Not all of the information is always available, and some countries restrict access to some types of information, such as bank accounts.)

Company name, address and phone number, ownership structure, nationality, line of business, principal brands

Executive officers: their ages, place of birth, marital status, education

Business history: where and when established, range of products

Relevant local economic and industry conditions

Financial information: total capitalization, revenues, profit, fixed and current assets, current liabilities, shareholder equity

Financial ratios: net margin, profitability, leverage, liquidity, solvency

Auditors and bankers

Insurance coverage

Terms of payment (i.e., percentage of its supplies bought for cash vs. credit, terms of credit) and sales (i.e., percentage it sells on cash vs. credit, terms of credit)

Payment history; names of trade references

Names of closest competitors

Key customers and sales territory

Whether seasonal or non-seasonal

Imports and exports

Number of plants and warehouses; location and appearance; capacity utilization; whether owned or leased

Equipment owned (such as trucks, computers)

Number of employees

Legal record

Sources: Based on sample reports provided online by Profancresa-PCR (Mexico) and Delos Infocenter (Romania). The reports can be found on www.alaic.com/mex and www.delos.ro, respectively.

EXHIBIT 3: Responses to Survey (conducted by author, September-October 2000)

QUESTION 1: What types of clients use your service most? Are they mostly local or foreign?

Argentina	"Our services are used on a 50/50 basis both by local and foreign firms. Most foreign orders are submitted by export credit insurance companies. Local orders are generated mostly by banks and other financial institutions.
Chile	"Manufacturers, insurance companies, dealers, etc. 35% foreign; 65% local."
China	"Our client base is mainly made up of credit-reporting agencies, plus some foreign-invested [i.e., partly or wholly foreign-owned] companies and international trade companies. Most of our clients are foreign-invested companies. Chinese companies seldom use credit reporting services, even the largest."
Dominican Republic	"Mostly local."
India	"Our services are used by foreign clients, particularly export credit insurance companies . . . Our clients also include credit reporting companies and some direct clients."
Kenya	"Both, but in the main local."
Lithuania	"Our main customers are credit insurance companies, mostly international or transnational."
Mexico	"We have a local portfolio . . . [although] Credit investigation or payment trend investigation prior to a deal is not in the culture of the Mexican credit manager. [Local companies account for] about 80% of our total sales, and the other 20% are inbound inquiries from the rest of the world. The most active regions are of course the United States and then Europe."
Thailand	"Lawyers, commercial companies, and agencies. 80% foreign."
Ukraine	"Our clients are insurance companies, banks, big foreign

companies [doing] business with Ukrainian partners. Our clients are mostly foreign institutions, firms and companies because the credit-reporting service is new for Ukrainian businessmen."

QUESTION 2: In your experience, what is the most reliable source of information for determining the creditworthiness of a business? (For example, their financial statements, payment records, the owner's personal wealth, interviews with management, etc.) Is it easy or difficult to get this information?

Argentina

"The most valuable sources of information for determining a company's creditworthiness are: a recent financial statement, a good description of its payment record (in Argentina we can access the Central Bank database for this information), and of course, a clear business history of both the firm and its owners."

Chile

"It is not easy to find the information in the marketplace. The most reliable are: financial statements, payment records. In Chile we do have the Superintendent of Stock Companies, from which we can obtain financial information and some general information on banks, big companies, insurance companies, etc."

China

"I think that in China, financial statements weights 60% among the factors in a report, instead of the world standard of 40%. It is very difficult to get the financial statements directly from the company through interviews. Some agencies can get the statements from the local/state Administration of Industry & Commerce (AIC). But this information is not open to the public. At present, we get this kind of information from the AIC through lawyers, which is expensive." When asked whether financial statements were reliable, the respondent replied: "Most accounting offices do not follow the accounting [guidelines, but instead] follow the requirements of companies in audit reports, who pay them. Most, especially private companies and small businesses, do not follow the accounting [guidelines.] Very often a company has some secret bank accounts to avoid tax . . . But some big companies and foreign-invested companies do well in following accounting practices. Though the figures in the financial statements are often inaccurate, they are still valuable for credit reporting, as most of the [inaccuracies] cannot be so large as to affect the overall financial condition of a company. If [they are,] it is regarded as a serious violation of the law."

Dominican

- Republic** "In our experience the most reliable source of "character" information is "past historical performance of their obligations" However, this information is subsequently, if the subscriber so requires, documented with financials, commercial references, etc., and eventually supplemented with local knowledge of the market and possible discrepancies with data gathered. Interviews with management are almost always the norm, but not always possible. Yes, it is most difficult to gather the financial information, sometimes (approximately 40% of the time) not even possible." The respondent explained that his agency handles both business-to-business and business-to-consumer credit. Analysts differentiate among credit transactions: for example, those that involve something that can be repossessed (such as a car or appliance), or transactions that are recurring vs. one-time only loans.
- India** "It is difficult to base a credit opinion purely on any particular aspect. We take into account significant elements such as financial information, background information, market conditions, etc. In a developing country like India many a time obtaining this information is extremely difficult as there are no public records available for non-incorporated companies, and on incorporated companies, the extent of the information available at the Registry of Companies is quite often incomplete."
- Kenya** "Very difficult. We deal in only bad debt information, e.g., payment performance. No company in Kenya will give you their monthly accounts receivable, plus most companies keep five sets of books, one for the tax man, one for the owners, etc. Which one do you rely on?"
- Lithuania** "The most reliable sources of information for determining the creditworthiness of a business are financial statements, payment records, and interviews with management. Also credit history plays a big role, but unfortunately it's very difficult to get in countries with [newly] growing economies The main problem is that information is insufficient, as most government institutions keep data not in computers or other digital form, but on simple paper blanks."
- Mexico** "[We obtain] the information through field work, something our competitors do not do. We see and make sure there is a company at the location and we look at it, no matter where it is in Mexico [Our reports include] financials, trade references, location

description, products, commercial activities, insurance, etc. The most difficult to obtain nowadays is the financial. There is no place in Mexico where you have by law to send your statements . . . Companies are not very willing to provide financial information any more. In the past we had 90% of reports with financials, but by 1998 we went down to 75%. Today we are at 50%. This is a response to insecurity in the country . . . [where owners fear] the risk of being robbed or the principals being abducted."

Thailand "Financial statements taken from the ministry, background checks of directors. Some information is not easy to obtain."

Ukraine "It is very difficult to get credit information in Ukraine. The most reliable source is the Ministry of Statistics. We get the registration data and financial data from there. As for interviews with management, first of all the information could be inauthentic, but usually the management strictly refuse to give any information (in particular . . . financial.)"

QUESTION 3: Does your country regulate credit-reporting agencies? Are there laws (such as privacy laws) that limit what credit-reporting agencies can do?

Argentina "No specific laws regulate credit reporting agencies in Argentina. However, the Argentine government is trying to implement legislation dealing with the "habeas data" issue. A draft of the law is currently under examination at the Argentine Congress." This law would protect sensitive information in databases, set a limit to how long information will remain in databases (10 years for bankruptcies), penalize credit-reporting agencies that deliberately include erroneous data, and allow the subjects of credit reports to correct erroneous data and to request that discriminatory information (religious beliefs, sexual conduct, etc.) not be included.

Chile "Credit reporting agencies are not regulated by law."

China "Credit reporting has a very short development history of no more than ten years. There have been no laws and regulations [affecting] this service. But with the fast development of the industry in

China, it is only a matter of time [before we see] the establishment of laws."

Dominican Republic

"Yes, we have both laws and regulations. These however have not been specifically 'tried out' in actual cases, so there is no jurisprudence on these issues. We try to avoid this, but it's bound to be inevitable at some point in time."

India

"No, we do not have any laws that regulate credit reporting agencies."

Kenya

"No, we have voluntarily adopted the U.K. Consumer Credit Act and Data Protection Act. We are self-regulated."

Lithuania

"Yes, we have a privacy law and [regulation of] single company credit (financial) information usage that make our work harder."

Mexico

"Our country does not regulate credit reporting agencies or companies, [but] it regulates credit bureaus. The difference is that the bureau will only provide credit card payment history in the field of consumer information, and how payments to banks have been made in the field of business information . . . Those bureaus are regulated by the banking commission [and] you will have to obtain the signature of your prospect in order to get the information. Some companies do use the bureau and feed the bureau the experience of their clients. This is mostly the consumer side in which companies like cellular phones and a very few others will be involved . . . [Credit-reporting agencies, however] are not regulated and may grant information to anyone without a signature from the investigated company."

Thailand

"Yes, there are privacy laws and they do limit what can be obtained."

Ukraine

"Ukraine does not regulate credit-reporting agencies because it is a new activity in the country. There are no special laws that limit what credit-reporting agencies can do, but there is a law [stipulating] the types of confidential information that cannot be made public."

QUESTION 4: In your opinion, have credit-reporting agencies changed the way business is done in your country? If yes, can you give an example?

Argentina

"During the past decade credit reporting agencies have played a vital role in the way business is done in Argentina. Practically all credit applications, whether local or foreign, require a prior credit opinion issued by an independent party, such as a credit reporting agency. During recent years, the tremendous growth in international trade and the large number of bankruptcies and balance of payment difficulties brought about by economic convulsions, either domestic or international, makes it mandatory to have a credit assessment on prospective foreign customers before extending credit facilities or entering into a business deal. This assessment, obviously, is best performed by credit reporting agencies." [The respondent subsequently clarified that a credit report is not mandated by law.] "However, when an export credit insurance policy is involved, insurance companies do normally demand that a credit report from one or more impartial, independent source be obtained before processing an application to insure payment of an export transaction."

Chile

"Yes, credit reporting agencies have changed the way to do business in our country. [They provide] more reliable and independent information to make decisions."

China

"Yes. There are some changes, but slight changes. It would need a long time to see changes in China. At the current stage, Chinese companies have begun to know about credit reporting services, but they still don't regard them as a useful tool and as something that is important to their own creditworthiness."

**Dominican
Republic**

"Most definitely. Just one example may be that of quality-of-life improvement via the possibility of acquiring a transportation vehicle (car). Before our existence, one needed approximately (at least) 50% of the cost of the car [as down payment], and was given no more than six months to pay the balance. Today it's normal to get a car with only 10% down payment and up to five years to pay for it. This alone has made it possible for people to have their own means of transportation on an otherwise very deficient public transportation system . . . Add to this many other advantages, such as domestic electric appliance acquisition facilities, etc., etc., not to mention the enormous increase in banking capacity and collections

turnover this has caused, leading to higher levels of confidence in their portfolios, etc."

- India** "Whilst the domestic business is primarily done on a face value and relationship [basis], it seems that with the entry of private companies into insurance, credit insurance is likely to be a saleable product in the huge Indian market. With this the scope of credit reporting companies will certainly increase."
- Kenya** "Absolutely! We are one of the most corrupt countries in the world. We have the ability to substantially change the way business is conducted in this country. Exposing the abuse of credit can only result in greater liquidity in the market, reduction of the consumer price index which directly translates into increased local and foreign investment. Who wants to invest in a country where no one pays their bills and the legal system is open to debtor manipulation?"
- Lithuania** "Yes, they changed the attitude towards the cost of information and [its role] in company strategy and marketing decision making. For example, there has been increased [requests for information on] foreign partners before supplying first trial lots of production. These requests usually come from native producers. So in this way they [avoid] selling to companies that will not be able to pay on time or at all. The debt-collection figures . . . show a decreasing number of international short-term debt collection [i.e., debts submitted for collection because of non-payment.]"
- Mexico** "I believe that credit-reporting agencies in my country have defined markets and ways of doing business."
- Thailand** "Yes. In the past there was very little credit reporting requested. Now since the crisis many more requests for such reports are made."
- Ukraine** "During the last two years we have seen changes produced in the minds of Ukrainian businessmen. They have become more open and credible during interviews. Most of them now accept the European standards in managing their business."

ADDITIONAL OBSERVATIONS

Argentina**Chile****China**

"More and more foreign credit reporting companies, like D&B, are rapidly developing the market in China. They weal bring experience and knowledge of the industry [which will be] very helpful. The number of credit reporting agencies is increasing enormously. [There are now] approximately 100 big and small agencies, almost ten times [the number] of five years before. In the near future, large companies will appear, and some small companies will be merged."

Dominican Republic

"One very important and almost always overlooked issue is that the credit-reporting system has allowed 'democratized' access to credit, thus to wealth creating mechanisms, heretofore only available to those who were either wealthy to begin with or simply had the 'right connections.'"

India**Kenya**

"We have approximately 250 billion Kenya shillings of consumer debt in the country. That's about 3 billion US dollars. Basically, our culture has developed into one of gross fiscal irresponsibility. A strong, unencumbered and independent credit bureau is deemed the only sustainable method of changing the way consumers honour their obligations. There are far reaching effects in its application."

Lithuania**Mexico**

"Culture plays a big role since the market is divided [between locally-based agencies and] international companies which just want to sell reports and do not look at the regional facts. They produce reports the same way they do in the U.S. or Europe . . . I strongly believe that reports must consider the culture within each country."

Thailand**Ukraine**

"In my opinion there are two great problems in our work here. First is that people are frightened by the criminals, and that's why they do not like to give truthful information. The second problem is the difficulties in the economic situation in Ukraine and consequently the majority of businesses suffer difficulties. They do not want to spend money for the information because they think

the money will be wasted. The only way to overcome these problems is to educate our businessmen about the standards of developed countries."

Note: The survey was conducted via e-mail in September-October 2000. The respondents were guaranteed anonymity.

EXHIBIT 4:
National Association of Credit Managers
Canons of Business Ethics

- I. Justice, equity and confidence constitute the foundation of credit administration.
- II. Agreements and contracts reflect integrity and should never be breached by either party.
- III. The interchange of credit information must be based upon confidence, cooperation, reciprocity and confidentiality.
- IV. It is deemed unethical to be a party to unwarranted assignments or transfers of an insolvent debtor's assets nor should creditors participate in secret arrangements.
- V. Creditors should cooperate for the benefit of all adjustment or liquidation of insolvent estates or companies.
- VI. Creditors must render all possible assistance to honest debtors who become insolvent.
- VII. Dishonest debtors must be exposed and referred to the authorities.
- VIII. Cooperation, fairness and honesty must dominate in all insolvent debtor proceedings.
- IX. Costly administrative procedures in the rehabilitation or liquidation of an insolvent debtor shall be avoided at all times.
- X. Members pledge themselves to uphold the integrity, dignity and honor of the credit professional in all of their business dealings.

Source: National Association of Credit Managers, Web-site, www.nacm.org