



DON'T BECOME A STATISTIC

With the current economic downturn, the importance of good credit management has been magnified and all companies' credit management policies and procedures need to be critically looked at and improved in order to avoid your company becoming a statistic of the poor economy.

On average businesses are waiting 41 days longer than their agreed payment terms to get paid. Waiting for overdue payments can create a greater strain on your cash flow, so it's important to kick off your debt recovery programme as early as possible.

The longer an invoice goes unpaid the greater the chance that it will become a bad debt. In today's risk-fuelled business environment the need for sound credit management and a professional credit policy has never been greater.

Unfortunately, late payments are such a huge problem to business that they can cause even successful companies to fold.

So what is credit control?

The term "credit control" can be defined as:

Policies aimed at serving the dual purpose of (1) increasing sales revenue by extending credit to customers who are deemed a good credit risk, and (2) minimizing risk of loss from bad debts by restricting or denying credit to customers who are not a good credit risk. Effectiveness of credit control lies in procedures employed for judging a prospect's creditworthiness, rather than in procedures used in extracting the owed money, it is sometimes called credit management.

What do you need to do?

You need to introduce a company credit policy, even in a small business you should have a credit control policy and defined procedures.

An effective credit control policy should deal with at least the following areas:-

- Mechanisms for approving credit for new customers.
- Mechanisms for determining credit ratings and credit terms for new customers.
- Procedures for taking action against customers when invoices due for payment remain unpaid.

This means you should:-

Credit check potential customers before offering credit or supplying service.

Set strict limits for each customer's accounts.

Invoice accurately, efficiently and promptly, clearly stating the agreed payment terms.

Chase late payments straight away, keeping good records of letters sent, telephone calls made etc. (including name & position of the person contacted)

You need to know your customer!

It's amazing how often goods or services are provided to a customer on credit without having full company details or trading address. Knowing the exact name can be vital when pursuing a customer for payment.

- Obtain full name of business and find out if the business trades under any other names.
- Type of business... sole trader, limited company, partnership etc.
- Registration number if a limited company.
- Where to send invoices as this is often different to the delivery address.
- Who the contact for payment is:- Name, Position, address, telephone number, email address etc.
- Ensure that your paperwork is signed by an authorised individual from the company.
- Credit check the customer in order to set credit limits.
- Carry out a credit check on the customer, there are many online systems available.
- Examine the customers published accounts.
- Ensure they complete a credit account application form and arrange credit terms only after you have received a credit report and completed credit application form.
- Apply a credit limit of 2 x monthly sales.
- Apply "amber" and "red" limits. If a customer reaches their "amber" limit you should watch the account very closely and the company monitored for signs of financial difficulty. If they reach the "red" limit you should put the account on STOP!.
- Set clearly defined payment terms.
- Carry out on-going credit checks.

Cashflow

It is very important to monitor cash-flow and a great tried and tested method is the use of a "Cash-flow calculator".

Cashflow Calculator Explained

Day Sales Outstanding or DSO is a financial indicator that shows the average number of days it takes to convert a company's accounts receivable into cash. It is a measure of the effectiveness of a company's credit control function and procedures. The calculator below shows how an improvement in DSO can affect the cash-flow and profitability of a company. DSO is calculated by dividing accounts receivable by sales and multiplying this by the number of days in the respective period.

Formula

Regular DSO = (Total Receivables/Total Credit Sales) x Number of Days

Best Possible DSO - used only with reference to current value of receivables. It shows the number of days it takes to collect the debt in current period. To calculate it the following information is required:

- Current receivables
- Total credit sales for the period analysed
- The number of days in the period analysed

Formula

Best Possible DSO = (Current Receivables/ Total Credit Sales) x Number of Days