

Business Funding Portal

The business services consolidator

T: 0845 602 7318

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CREDIT CONTROL – A GUIDE FOR SMEs

BACKGROUND:

'An unprofitable business can survive for a long time with good cash management; but a profitable business can easily fail without it.'

Whilst most businesses will appreciate the above sentiment, the reality is that in too many cases credit control is treated as a low-priority job delegated to a junior employee, or randomly handled after the 'real work' is done. In extreme cases it is completely ignored until the situation is terminal.

My seminal lesson in credit control came when visiting a family-run engineering firm in Southampton. The owner's daughter ran all admin functions; lined up across the front of her desk were about 40 envelopes, all stamped addressed and sealed. She told me 'As soon as a payment becomes due, I write a cheque and make it ready to send then, as soon as the customer calls, I post it to them'. She pointed to a small handful of yellowing envelopes 'All of those are over 18 months old'!

Without debating the ethics of not paying until asked, it helped me enormously to turn this situation around; when calling to chase money I simply envisaged a line of envelopes, one of which had my name on it ready to post as soon as I called.

Putting a credit control system in place might cost nothing except your time and commitment; it will make your business appear sharp and professional and really can be the difference between success and failure.

PRE-APPROACH:

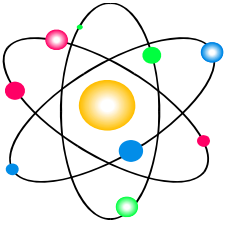
'We never pay until we are asked. Some customers never ask'

Credit control starts at the point when you agree to deal with a customer and only ends when full (cleared) payment is received.

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1. Credit checking:

Always credit check customers, new and existing; don't rely on the old clichés 'I've known them for ages' or 'they're OK, they've got massive premises'.

An online facility such as Creditsafe or Checkability is fairly inexpensive and can provide ongoing alerts of changes in trends, CCJs etc. Alternatively there are many providers of ad-hoc credit checks.

2. Consider your payment terms:

30 days credit is widely considered to be the standard commercial term, however your negotiations can vary this.

If the customer is stipulating longer terms, why? Is your margin really sufficient to justify this (Particularly if they don't adhere to their own terms)?

Do you have facilities to facilitate on-the-spot payment (e.g. credit card)?

Can you afford to offer additional discount for full settlement in 14 days?

3. Know your terms and conditions:

If you are using your own, or industry-generic documentation, then you will probably be familiar with the terms and conditions. If the customer insists on using their own, then be sure that you fully understand what you are agreeing to – money spent on professional advice here could be money well spent.

Beware the customer who wants to rely on vague terms or 'gentlemen's agreements' – you can be sure that they have a clear idea on what their expectations are! If formal paperwork is really not on offer, have a witness on hand where possible and minute your discussions immediately.

4. Delivery:

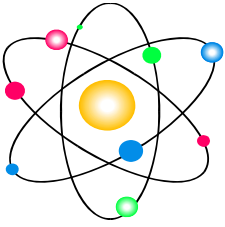
Spurious complaints are bread and butter to the professional non-payer. Be sure that you know what you deliver and when it is delivered.

If there are known discrepancies log them so that you are in a position to separate and handle complaints professionally.

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COLLECTION – FIRST PHASE:

'Many suppliers will spend thousands of pounds on a website to create a professional image, whilst the credit function feels like it is run from a shed.'

1. Invoicing: Prompt and professional:

A prompt invoice immediately sends the message that you take your finances seriously. Whether your systems are electronic or manual, your invoice is an important document and should reflect the professional image you want to create.

Ensure that your invoice is accurate and unambiguous and conforms to any specific terms laid down by the customer. Some customers like to buy time with invoice disputes.

2. First follow-up:

A courtesy call approximately 4 days after the invoice is sent, simply to establish that your invoice has been received and logged and to establish if there are any queries.

3. Second follow-up:

Day 29 – 31 (or within 2 days of due-date) Further call reminding that the invoice is due for payment, asking have they paid, what is their means of payment and, if they haven't already paid, when cleared funds can be expected?

NEXT STEPS:

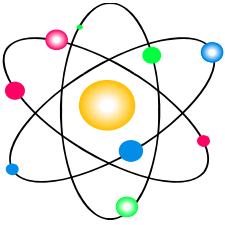
'The reason that big companies pay late isn't because it's not important, it is because they know the value of your cash'.

The minute payment exceeds the agreed term; there is a technical default situation. The progress from here on will depend on the nature of your business and customer relationships. Procedures need to be evolved to match your own circumstances. Hopefully the thoughts below will help to develop these procedures.

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Knowing the customer:

If your client is well known to you and always pays on 45 days, you might be happy to accept this as the norm. With a new client it is crucial to establish yourself as a supplier who takes payment terms seriously.

If an established customer's payment pattern suddenly changes, treat it seriously!

Warning signs:

The first warning sign, of course, is that the customer doesn't pay. However as the customer gets into 'dodging bullets' mode, they will develop their own means of relieving pressure, including:

- Constant queries / spurious complains. Designed either to buy time or to wriggle out of all or some of the debt.
- Mistakes on the cheque. Wrong sums / dates, no signatures missing etc.
- Excuses. 'Your cheque is in the post'.
- Elusive behaviour. The customer is constantly 'in a meeting' or 'on the other line'.

One incidence might be a mistake; several signals should ring warning bells!

Can't pay / won't pay:

What is the reason for non-payment?

Default situation can generally be divided into 4 categories.

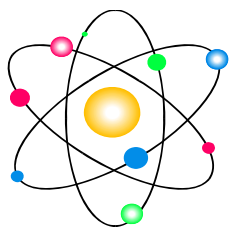
1. Willing & able. Probably just need a reminder.
2. Willing but unable. Important to work with closely.
3. Able but unwilling. Strongly consider legal recourse.
4. Unwilling & Unable. Consider legal, or go to write-off.

It might be useful to have a procedure for each category of customer.

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The pecking order:

As cash gets tight, your customer will develop a pecking order of who gets access to increasingly scarce resources.

Your place in this order will be a mixture of goodwill and strategic power – e.g. everyone pays their phone bill for fear of being disconnected.

Ideally you should forge a relationship that both engenders goodwill but also utilises your strategic power.

- Can you take stocks back?
- Can you 'switch off' service supplies.
- Is the customer on stop? (If so, who is now supplying them?)
- Can you use Credit reference agencies to put out general alerts?

Doing deals with customers:

In the case of temporary difficulty, it might be to your long-term advantage to do a deal with the customer (ensuring that you are not being sacrificed so that others get paid).

This deal should be business transaction, not just a favour.

Options you might like to consider include:

- Share options.
- Restructure the debt as an interest-bearing loan.
- Take a charge over unencumbered business assets.
- Joint venture agreements.

Visit / call / letter:

Each form of communication has a place in your strategy.

Telephone is cost and time efficient, and allows useful interaction with the customer.

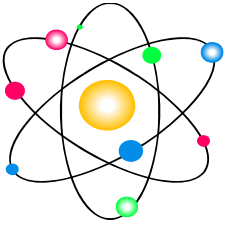
Letters, in the early stages are fairly soft-edged and do not invite interaction. They do, however, form an important part of the legal process.

A personal visit is highly effective (10 times more so than a phone call) and allows you to get some feel for the circumstances of your customer. Dependent on the location of the customer, it can be costly and time-consuming.

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The Blue-Chip enigma:

In many cases we face clients who proudly tell us about their Blue Chip client base however, many (though certainly not all) large companies use their buying power not only to negotiate the best discounts, but also to delay payment for unreasonably long terms.

Ultimately, the value of any customer is a factor between margin on the contract and the cost of collection/non payment. Whatever the headline name, if a customer drains your cash resource you need to re-negotiate or find another customer!

Legal action:

There are, unfortunately, a number of businesses and individuals who simply have no intention of paying until you take legal action. For this reason your procedure should allow for a legal process.

Before pursuing legal action you need to consider:

- Does the prospect of recovery warrant the cost? (Most of your court and administrative fees can be ascertained in advance).
- Does the customer have the means to pay, even if judgement is served against them?
- Is there strategic value to gaining judgement, even if ultimately you don't get paid?
- Is there a possibility of joint action in conjunction with other creditors?
- Can you commit the time to preparing your case and to Court appearances?
- Will you need to engage legal professionals?

Insolvency / receivership / CVAs:

The point may come when your client enters in to some form insolvency. At this point you will be in the hands of the legal process.

Where possible, follow the processes as invited, as there is still a chance of some return.

Bad debt / write-offs:

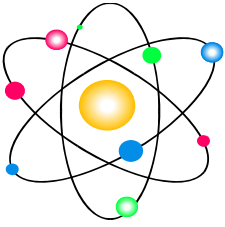
For our purposes, we refer to 'psychological' rather than accounting write-offs. The accounting write-off is part of your reporting process and should be discussed with your professional advisors.

Psychological write-off is the point at which you decide that the cost of recovery outweighs the potential benefit. At this point, it is well worth considering selling the debt, or contracting an agent on a results-only basis, as every penny returned is a benefit.

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FHEs (FREQUENTLY HEARD EXCUSES):

If your debtors extend by 30 days, you have given away a month's worth of work for nothing

We're only a small business, we don't need those procedures:

As a small business, cashflow is your lifeblood. If you don't have procedures the risk is that customers will see this as a weakness and will abuse it.

Once procedures are implemented, they will become a valuable part of your business process.

Our customers pay us ok:

If your customers pay on the nail, or with just one phone call, well done!

However in many cases, we see that 'OK' customers are taking 60+ days to pay, which can only be a drain on your cash resources.

For good performing customers, it is always worth considering if you can change things to your mutual advantage, e.g. further discount for payment in 14 days, or a merchant facility to collect payment in advance.

I don't want to alienate our customers:

The key to collection is polite, professional and firm. There is no reason for any reasonable customer to take offence to this.

Our customers will think we are in trouble:

In any economic climate, there is no shame in admitting to your customer that you rely on prompt payment to pay your staff wages; they won't be surprised or offended to learn that your primary motivation is to earn money!

In the current climate, you have the ideal opportunity to explain that things are a bit tougher, so you are putting strong procedures in place for the future.

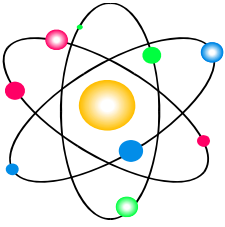
We can't afford it:

The basic cost of setting up a procedure is your time. Once your procedures are running, they might cost as little as 2 hours per week, plus a regular update (perhaps incorporated in a management meeting).

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CONCLUSION:

'It is a better use of time to watch television than to do work for a customer who doesn't pay.'

Until recently, the business environment has been driven by sales, productivity and profitability.

However in the last 18 months, the word **liquidity** has returned to the fore.

The run on Northern Rock wasn't caused by losses; it was a direct result of their lack of **liquidity**.

One of the key contributors to **liquidity** is how quickly you get paid by your customers.

Liquidity is one of the main considerations of investors, lenders and credit reference agencies.

Central to **liquidity** – and therefore business success - is credit control.

By committing time to credit control procedures and implementation, you will be positioning your business to survive and thrive, whatever the market conditions.

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