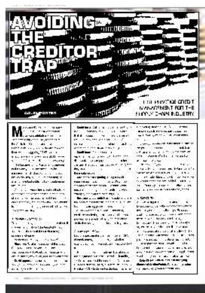

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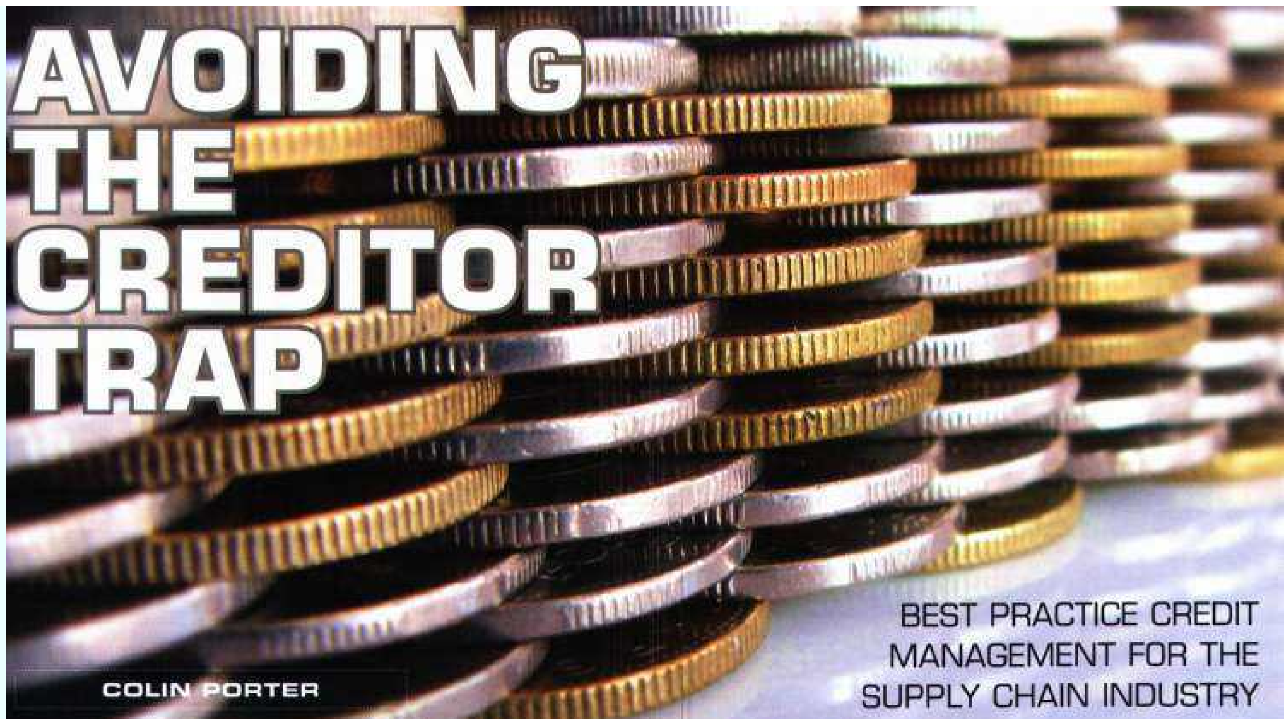

AVOIDING THE CREDITOR TRAP

BEST PRACTICE CREDIT MANAGEMENT FOR THE SUPPLY CHAIN INDUSTRY

COLIN PORTER

More than 40 per cent of company failures in Australia last financial year were attributed to 'inadequate cash flow or high cash use', according to the Australian Securities and Investment Commission (ASIC). ASIC data also revealed there were a staggering 10,481 external administrations due to insolvencies in 2011, representing a 9.2 per cent rise on the previous year.

The big question for Australian businesses in the supply chain industry is how best to minimise the risk of providing credit to businesses that may be at risk of defaulting, or already have bad debts and court judgments against them.

Arranging payment terms and methods to exchange funds across entities in the supply chain is a complex process, and if mishandled, can significantly reduce cash flow. To avoid this trap and better manage your credit, follow these straightforward steps.

1. Develop a credit policy

This is the 'boring but important' phase of credit management, but don't be tempted to skip it, as it makes the rest of the credit management process a lot easier.

What should be in your credit policy?

Objectives: What is the purpose of this policy? Generally, it should provide a reference on the businesses you will extend credit to; under what circumstances; how much; and under what terms.

Credit approval process: Set out the steps for how you will deal with new debtors, including assessing creditworthiness.

Credit limits: Define the factors that contribute to each customer's credit limit. You may decide that all new customers will be held to a certain limit until they have paid a set number of invoices on time, or you may choose to set limits according to the customer's risk rating.

Credit terms: Terms should include the repayment period, for example '30 days', and disincentives for late payment, such as interest charges. The debtor must declare in writing that they understand and agree to the terms to make them enforceable.

Monitoring and reporting: Using a credit-reporting agency, such as CreditorWatch, you can monitor debtors for adverse information (such as court judgments, defaults and ASIC changes) and evaluate them regularly.

Response to bad debt: Plan the actions to take if a debtor's account falls into arrears. This may include a warning process, consequences—such as lowering credit limits, withholding credit, or shortening terms—and a collections process, for example refinancing, mediation/arbitration, using a debt collector or litigation.

2. Assess your debtor

Debtor assessment is the most important part of credit management, it tells you whether to extend credit, by how much, and what to expect from the debtor.

Run a check on the customer to make sure it is a legitimate business, which is still trading. To do this, you need the customer's Australian Business Number (ABN) or Australian Company Number (ACN) to determine the business name and trading names it uses. Run these details through a credit-reporting agency, such as CreditorWatch, which will alert you to defaults or court action.

Once you've determined the financial state of the potential customer, set a credit limit. Start with small amounts and only extend as much credit as you can afford; remember you have expenses to pay too.

The length of your credit terms now comes into play. Every business needs to balance terms that are attractive to customers but also serve its cash flow cycle. Identify how long you are willing to wait for debtors to pay and build in time to chase. You may also develop penalties for late payments and incentives for early payments.

3. Manage risk

A proactive approach to risk management is key to keeping your cash flow cycle in check and to maintain good credit relationships. Be sure your credit manager and accounts receivable department know your business' credit policy and refer to it regularly. Their role is to monitor changes against the debtor's initial credit assessment and act accordingly at signs of trouble. Often, timely communication with debtors is all it takes to keep payments on track and relationships in check.

These practices should provide the backbone to any credit management. By remaining vigilant about credit you can keep both your suppliers and clients happy and maintain a healthy cash flow.

Colin Porter is the founder and managing director of CreditorWatch. For more information visit www.creditorwatch.com.au. ***mhd***

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