10 simple rules for credit control

Why credit control is so important

Cash flow is the lifeblood of every business, and poor credit control will greatly affect your cash flow and your ability to pay your debts on time. Bad debts can also increase the amount of interest that you pay, shrink profits, and ultimately close the door on your business.

Yet in many industries, credit is a fact of life. By not offering credit, you could be losing customers to competitors who do give credit, and this could jeopardise your business success.

By following some simple procedures, you can keep track of credit to minimise the risks and maximise your chances of prompt credit collection.

How can I protect my business from credit losses?

If you are in manufacturing, wholesaling, service or retail business, and you find it necessary to give credit to your customers, you should take action to protect your business from credit losses.

You cannot afford to offer credit to your customers without including the cost of providing credit in your prices. And you cannot expect to give better credit terms to your customers than you receive from your suppliers. Remember, credit is a two-way function. Your own credit rating is based on your ability to pay and your customer should receive the same consideration.

An easy way to think of credit to a new customer is to regard it as lending money. Would you lend money to a total stranger without some security?

The following will provide some basic rules for controlling credit:

1. Establish who you are dealing with

Set up a credit application form, which all customers must use before credit is allowed. This enables you to ascertain who you are dealing with, the credit limit sought, who can access credit, if directors guarantees are necessary and if so from whom, credit referees and other relevant information. Consider the credit collection pattern in your industry.

Please note: The information provided on the credit application form and customer records may be subject to the *Privacy Act 1998 (Cwlth)*. Please contact your legal advisor for more information.

2. Approve credit

Provide written response to a credit application promptly when either approving credit, declining credit or requesting further information. A credit approval letter should state the amount of credit given, credit terms, guarantors (including guarantee forms), penalty/default terms and any other terms and conditions pertaining to the credit approval.

3. Mail invoices promptly

Prompt and accurate invoicing with straightforward product descriptions and terms of trade will show your customer that you are serious about payment terms and conditions. It is often advantageous to close off your credit system mid-month to ensure those businesses that have end of month cheque runs for their creditors, have your statement early enough to effect payment at that time (rather than at the end of the following month).

4. Keep up-to-date records

One of the keys to effective credit management is to maintain accurate and up-to-date records. An ageing of debtors (how long they take to pay their accounts) should always be available. Follow up of debtors trading outside their approved credit terms should be immediate in all cases (treat large and small accounts the same).

Do you have a clear and unambiguous credit policy? Such a policy determines and communicates:

- When payments are due.
- The amount of interest (if any) that is to be charged and the total amount of each payment (including interest).
- The type of references (character and credit) and other information that is required for a customer to open an account with you.
- Any discounts that are available for prompt payment.

These should be made clear in your written credit approval.

5. Avoid special cases

Making special arrangements can backfire. No company is so large or important that you should let them ignore your terms. Rather than damaging goodwill, insistence on firm, and simple settlement terms will create a healthy respect for your financial efficiency. Remember, it may only take that one exception to drain your business of its cash. All verbal arrangements should be confirmed in writing.

If the customer is a company, make sure that you get a personal guarantee for payment by one or more of its directors. Consult your solicitor for advice about the *Credit Act 1987* and how it may affect your business.

Ensure that a credit ceiling (a maximum amount of available credit) is established for each account customer in view of their ability to repay their debts.

6. Read the financial press and trade journals

Due to their day-to-day responsibilities, many small business operators neglect the “big picture” and are out of touch with changes in the marketplace or the economy. Financial media and trade journals are a cost-effective way to get the feel of your market. Where available, subscribe to an appropriate credit reference bureau.

7. Start at the top

When attempting to settle accounts, you should deal directly with the decision makers. Discussions with other people on overdue accounts can waste time. It's usually far quicker and more effective to deal with the person whose signature appears on the cheque. By all means send a letter, but you should follow it up with a personal visit if possible.

8. Keep your promise

Don't threaten legal action unless you intend to go through with it. Issuing empty threats will probably mean you will wait even longer in the future.

9. Watch trends

Guage how well you are controlling your credit with some easily understood measures such as average days sales outstanding, results against targets, and proportion of disputed accounts. Other warning signs to watch are changes in cheque signatories or cheques coming from other than the debtor. When this happens, inquiries should be made immediately.

10. Spread the message

Communication is the key to preventing or resolving most problems. All your employees should be well informed of credit control procedures and the reasons behind them. Your ability to communicate internally will probably be linked to your business' ability to control credit in the marketplace. Regula staff meetings to discuss credit will assist this communication and improve your credit management.

Further information

Your financial or legal advisor, or bank manager, may be able to provide further advice with regard to solving particular credit problems, or at least refer to you a mercantile agent or credit consultant.

The Australian Institute of Credit Management delivers education and training support – contact via telephone 07 3352 7546 or www.aicm.com.au.

The following fact sheets provide further information on these issues:

- Reduce your exposure to losses
- Risk management