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Debt Collection

Reviewing your credit and collections system

By Roger Mendelson*

As an observer of thousands of business credit systems over the years, my conclusion is that most businesses handle this element of their business poorly.

Part of the problem is that publicly-listed companies do not have a major focus on cash flow.

Their focus is on reported profits, rather than on the money which follows. The reason for this is that senior management is invariably rewarded on the basis of profit performance and the stock market also looks largely at the headline profit figure, rather than lagging cash flow.

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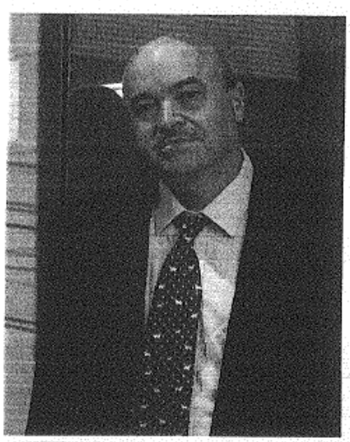

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As a result, credit departments tend to be under-resourced and treated as an unglamorous back-room area of the business.

Generally, the closer the owner or owners are to the business, the greater will be the focus on actual collection of money, resulting in the situation where small owner-operated businesses are entirely focused on cash flow. The owner-directors know that if the money doesn't come in, they are not going to have enough cash at the bank to pay their wages next Thursday.

The checklist I have prepared which is appended to this article, was initially put together by me as part of a presentation to thirty-five partners of a national accounting firm and it was intended to be a simple but comprehensive guide for them when they are reviewing the financial affairs of a client.

Well run credit departments should be able to tick all of the yes boxes. However, in my experience, there are few who would honestly be able to do this.

A quick and easy initial test of whether or not a credit department is well run, is to ask for a one page summary of the total outstanding ledger, broken down into appropriate categories such as current, over 30 days, over 60 days, over 90 days, subject to dispute, paying by installments, referred to external agency etc. If the business is unable to provide a report quickly or if the report is clearly not accurate, then warning bells will normally begin to ring.

I doubt if there is one reader of this article who would dispute the relevance of each of the points in the checklist and yet I also doubt that there are few who could honestly say that they are able to tick yes in each of the boxes. The areas of failure are often easily rectified. The following are points where I see consistent failure.

New customer form

Most businesses I come across tend to use terrible forms, which are not appealing on the eye, include many irrelevant questions, are difficult to use and then leave out relevant questions, which should be incorporated. This is such an easy thing to get right.

Credit terms

A good base to incorporate credit terms is on your company website.

By placing them there, you are able to amend and update them easily, to ensure that they are always relevant.

You then need to ensure that your customers understand that they are bound by those terms. This may require a provision on the back of your quotation form or as part of your New Customer form, to direct them to that section in the website and to make clear that if they do business with your company, those terms will be applicable.

The minimum provisions referred to in paragraph 3.3 of the checklist must be incorporated.

Invoice

Most businesses send out terrible invoices. As with New Customer forms, this is not difficult to get right. It simply requires focus and clear thinking.

Collections processes

Every credit manager would agree with point 6. Notwithstanding that, the greatest failure of most collections systems is that the collections staff do not adhere to that maxim – i.e. each step in the collection system must be an escalation from the preceding step. Once the debtor becomes aware that your collection system allows for steps to go sideways or even backwards, you have really lost credibility and will find it hard to re-establish any real credibility with the debtor.

> "Most businesses send out terrible invoices ... this is not difficult to get right. It simply requires focus and clear thinking."

Referral to collection agency

The biggest mistake smaller businesses make is to hang onto overdue accounts for too long.

If any account is overdue at 90 days, the chances are that it will be overdue at 120 and if it is overdue at 120 days, the odds of it becoming a bad debt increase dramatically. Larger businesses tend to well understand the principle that there must be referral to external collection agency at a predetermined point in time.

However, where many fail is in not having the systems in place, which allow this to automatically occur. ■

Roger Mendelson is CEO of Prushka Fast Debt Recovery and is a Director of Mendelsons Lawyers Pty Ltd. He is also author of The Ten Mistakes Business Make and How to Avoid Them and Business Survival Guide, both published by New Holland Publishers.

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