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How to keep your debtor list from growing too long

Small businesses cannot be complacent about outstanding debts if they want to survive, writes **Mark Fenton-Jones.**

The global financial crisis had the inevitable impact on business activity of organisations and individuals taking longer to repay debts or collapsing in a financial heap if they are unable to.

For small businesses dependent on regular payments to stay alive, late or non-payers can strangle their cash flow, leading to limited or no growth, or even their own demise.

The worst aspects of the global financial crisis have worked their way through the economy but small businesses cannot afford to be complacent about outstanding debts if they want to survive and grow.

The number of business customers that can no longer pay their bills – partly reflected in Australian Securities and Investments Commission's insolvency number – is falling but not disappearing.

A year ago, the number of companies entering external administration jumped from 796 in February to 1095 in March. Since then the number has steadily fallen, recording 706 failures in December, the most recent figure.

At the personal level, bankruptcies in the September 2009 quarter – the latest available from Insolvency and Trustee Services Australia – increased by 9.62 per cent to 7329 over the same quarter of 2008.

While those figures are nearly six months old, anecdotal evidence would suggest that the number of individuals going bankrupt is falling but again, not by enough for careful business owners to take the brake off their credit management systems.

Another high-profile group with its foot on the credit brake is the banks. During the global financial crisis, available credit contracted as foreign lenders withdrew from the local market and those remaining reduced their commercial lending.

Besides contributing to corporate failures, it meant that survivors with cash flow problems would hold onto their money longer by stretching out their payment terms.

Managing director of Azure Group Michael Derin says banks have drastically reduced the percentage they will lend against the value of a property development. "Development has come to a standstill – unless you've got cash or you're wealthy," he adds.

Dun & Bradstreet's February National Business Expectations Survey found that 35 per cent of firms reported a negative impact from credit market conditions in the December quarter (up 4 per cent), while 17 per cent experienced a positive impact (up 10 per cent).

For small businesses that don't want to take a financial hit from businesses suffering a cash flow squeeze, the message is to keep as close to your customers as possible and glean as much information as you can about the state of their businesses.

Unless you are a fly on their wall and know which of your customers plan to keep in debt at your expense, the most common sense approach is to have a cash flow management system in place that can alert you to any worrying trends.

D&B's trade payment analysis of the more than 9 million current accounts receivable records reveals that a deterioration in payment terms (2.1 days) in the December 2009 quarter has taken terms up to 53.9 days. This has largely reversed the gains made in the September quarter 2009.

According to the analysis, 35 per cent of executives are being affected by lagging business-to-business payment terms, a 14 per cent fall since July. But who wants to be among the 35 per cent if they have a choice?

D&B has come up with some practical advice about lessening the chances of being burdened by lazy payers.

First, check the financial health of your customers with a credit checking process – before extending credit – and regardless of the business's size. Don't assume that size of a business will correlate with its payment behaviour.

You should refuse credit to a financially unhealthy customer as the loss of a sale can be a better option than wasting resources on a

persistently delinquent payer.

Implement an efficient accounts receivables process that stipulates when you expect payment.

A signed contract should spell out what you will provide and when; what the customer must pay and when; how disputes are to be settled; and the penalties for late payment.

Invoices should be issued promptly if you want to get paid promptly.

Have a robust process in place to track accounts receivable, including monitoring invoices as they head towards the end of the standard 30-day payment term.

Start the collection process the day after the bill comes due: The longer a debt remains outstanding the less likely it is to be paid, D&B says.

Once over the deadline, SMEs are advised to gradually escalate pressure rather than crashing through customers' doors on day 31 just in case a bill is genuinely lost or overlooked.

Allow for individual circumstances such as a case where a customer experiences a short-term problem or they have a valid reason for non-payment.

You'll have to decide if it is worth your while extending the customer's credit terms.

But if this becomes a persistent problem, D&B advises that the best option is to end the credit agreement. The extension of credit on overdue accounts should cease, although it is tough to do, particularly if an SME deals with big business.

In some cases, you may decide to outsource debt management to professionals such as D&B, which is a credit reporting agency, debt collectors such as Prushka, or debtor financiers such as Oxford Funding or Bibby Financial.

Prushka's chief executive, Roger Mendelson, says more businesses are paying attention to effective credit and collection functions based on a significant increase in new clients since January.

"We are currently more than 35 per cent up on our annual average," he says.

Debt referrals increased by more than 50 per cent this January and February.

"Eighteen months of recession talk has resulted in businesses becoming more hard-headed and focusing on cash rather than growth," observes Mendelson.

Another trend he has seen is more clients requesting a solicitor review their trading terms. "Many businesses, if not most, have quite inadequate trading terms."

For many SMEs that cannot squeeze outstanding payments out of their customers in time, one growing and attractive option is invoice financing where businesses can convert between 70 per cent to 85 per cent of the value of their invoices into cash almost immediately, instead of waiting until the invoice is paid.

The remaining percentage is returned on payment of the invoice, less a fee.

If the invoices are late being paid, the financier can chase up the debt, although the original creditor may elect to undertake that task.

Oxford Funding's chief executive, Rob Lamers, says invoice discounting and factoring products increased as more businesses outsourced their debtor collections because of the knock-on affects of the global financial crisis.

The global financial crisis affected the cash flow of many SMEs last year, stretching out debt payment terms even further, he says.

"Our sales have grown by an average of 20 per cent per annum in recent years," Lamers says.

After experiencing growth of 24 per cent in 2009, Bibby Financial Services expects demand for invoice financing to grow by about 20 per cent this year as small businesses seek better ways to manage cash flow and more flexible business finance arrangements.

According to NAB's *Monthly Business Survey and Economic Outlook* in January, expected GDP growth for 2010 was 3 per cent and unemployment was expected to fall by 4.75 per cent by end 2010 and 4.25 per cent by the end of 2011.

Official cash rates increased to 4 per cent in March and may rise in May, June, August and November with a peak of 5.5 per cent in mid 2011.

Despite the improving economy, financiers warn that pressures remain on cash as interest rates increase, insolvency appointments rise and average trade payment times deteriorate, making it more important than ever before to have effective cash management systems in place.

Time is money

- The number of businesses that can no longer pay their bills is falling but not disappearing.
- The longer a debt remains outstanding the less likely it is to be paid.
- Have a cash flow management system in place that can alert you to any worrying trends.
- Invoices should be issued promptly to get paid promptly.