Managing Credit Effectively

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A compendium of studies argues that repeat selling is much less expensive than selling to new customers. Hence, gaining and sustaining long-term customer relationship is important to minimise the cost of running a business. This may entail selling on credit to satisfy the needs and expectations of customers, which sequentially requires the necessary resources to manage this credit effectively in order to secure sound cash flow for the business. But resources are often limited and maximising the available limited resources is inevitably vital. In business terms, this is usually referred to as the effectiveness and efficiency of a firm.

To this effect, people employed in the credit function should be skilled and trained to strike a balance between the credit demands of the customers and the profit imperative of the firm that s/he works for. Best credit results are achieved by the credit staff who possess good interpersonal skills, complimenting their numeracy and literacy. These ingredients make a credit practitioner able to sustain long-term customer relationship while keeping the customer current and paying according to the credit sales terms.

Nevertheless, there exists no perfect world!

Late payment occurs when selling on credit and the best way to being both effective and efficient in managing credit is by categorising the credit customers and take the appropriate action proactively in respect of each and every category.

It is commendable to categorise the credit customers according to their payment behaviour. Categorising customers helps the credit practitioner to get to know the customers better and to understand the customers' different attitudes and behaviour, while deploy the limited resources where they are effective most.

Credit customers can be mainly divided into two groups:

- **Prompt payers** – *those customers who pay within the agreed credit terms.*
- **Overdue Customers** – *those who do not honour the agreed credit terms.*

Both groups offer challenges to the credit practitioner!

It is unfortunate to note that few credit practitioners are aware of their contribution towards prompt paying customers. Prompt payers are those that require the credit practitioner to sustain long-term customer relationship by means of striving to continue meeting the customers' needs and expectations. It may not be easy to retain this long-term customer relationship due to various internal and external factors. Therefore, it is critical for the credit practitioner to deploy efficient and effective working practices by which competitive advantage in their respective market(s) will be supported.

The challenges posed by overdue customers are different from those of prompt payers. Customers falling under this category may differ in their payment behaviour. Therefore, this category of customers should once again be segmented to help the credit practitioner understand the reason why the customer is paying late and also to take the appropriate actions according to the reason of late payment.

There may be three types of late payers:

- **Type I Customers:**

a. ***Customers who may not be well-organised or whose account payable function is slow moving.***
b. ***Customers who may be extending credit from their suppliers as a form of short-term financing.***

The Type I customers are profitable customers. It is advisable to build and keep good rapport with the persons responsible for payments. Big firms falling under this type of customers may pay their suppliers late to secure sound cash flow of their business. Although this may sound to be unwarranted by suppliers, the latter should acknowledge that these customers may still be profitable and hence, it is recommended to keep them buying and paying as their contribution may be significant to the bottom line of the supplying company.

- **Type II Customers:**

a. ***Customers who don't pay due to disputes with their supplier.***
b. ***Customers who may not be able to pay by due date but can and will pay in the near future.***
c. ***Customers who cannot meet their liabilities and will eventually file for bankruptcies.***

The credit practitioner should resolve promptly any disputes and misunderstanding with customers. Customers will not pay until disputes are resolved, and rightly so!

Other customers falling under this category may be suffering short-term cash flow difficulties. These customers should be identified and supported continuously. This should be considered by the suppliers as long-term investment in their customers. Nevertheless, suppliers are to ensure that customers are not overtrading, which is the recipe of business failure.

Some customers may also have cash flow difficulties due to various reasons that would ultimately lead to business failure and bankruptcy. Some of these reasons may well include undercapitalization, overtrading, lack of adequate resources, lack of proper management, and inability to change and meet market demands. In such scenarios, it is recommended to stop selling on credit and continue selling COD. Whenever possible, suppliers may obtain guarantees to secure payment.

- **Type III Debtors:**

a. ***Debtors who try to avoid payment.***
b. ***Debtors who may be operating fraudulently, with no intention of paying.***

One has to note the difference between '*Customers*' and '*Debtors*'. The Type IIIs are referred to as debtors and not customers. Customers, unlike debtors, have genuine intentions to trade honestly, thus pay their suppliers as appropriate. Therefore, credit practitioners should do their utmost to minimise risk by avoiding Type III customers at the onset.

Good credit management practices suggest to evaluate the credit worthiness of the prospective customers before granting credit and to monitor changes in the payment pattern of the existing customers. The Maltese business community, members of MACM, have the necessary systems available to take the most profitable credit decisions in an effective and efficient manner.

Good credit management practices also acclaim that after taking any possible action to recoup money from these customers in-house, it would be wise to take legal action at an early stage (only if such actions are justified) and, or refer them to collection agencies.

Type III customers should also be referred to MACM as overdue accounts, so that other members would know about them and take the necessary decisions and actions. Exchanging information of these Type III customers would help the local business community to stay away from selling on credit to these customers in order to prevent further fraud. Exchange of overdue debtors' information would not only help the particular supplier but also help the economy at large.

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