

CREDIT MANAGEMENT



A PRACTICAL GUIDE TO CREDIT MANAGEMENT FOR SOUTH AFRICAN BUSINESSES

CAPX
FINANCE

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THE VALUE OF CREDIT MANAGEMENT

This Guide provides some practical guidelines to improve Credit Management in your business.

Credit Management systems are used by businesses which sell products or provide services on credit.

In a cash-only business without any credit sales, the business converts its trading stock or its services into cash immediately. There is no risk of non-payment.

In a business which sells products or services on credit, the transaction actually has three phases:

- 1.The sale of the products or services,
- 2.Granted loans (“credit”) to the customers; and
- 3.Collecting the loans.

In 21 years of financing South African businesses, we have found that many businesses do not focus enough on the second and third legs, i.e. the decision whether or not to grant credit and then collecting the outstanding amount within the agreed time frame.

To us, the main reason for neglecting the credit side in many businesses seems to be that many owner/managers focus too much on driving sales.

Let’s say you sell your products for R100 and your profit is R10. If one client owing R100 does not pay you, you have to sell 10 additional products at a profit of R10 each to get your R100 back. If your profit is R5, you have to sell 20 additional products – and this is just to break even!

There are two types of clients who don't pay:

- 1.The client who would like to pay, but cannot (the “bad luck” client); and
- 2.The client who doesn't want to pay and never intended to pay (the “crook”).

The purpose of good Credit Management is to do whatever possible to avoid doing business with all clients who may not pay you.

Credit Management should be just as important as Sales, if not more.

The benefits of good Credit Management are:

- 1.It increases profits by reducing bad debts and interest paid; and
- 2.It stabilises the business by improving cash flow.

Managing your debtors requires certain skills and processes within your business. It is not just about collecting cash from clients, but also about developing strong relationships and good communication with all your clients.

Granting credit is very much like lending money to someone. If you were the owner of the business you work for, would you lend the amount in question to that client who needs credit? If not, you should seriously reconsider whether any credit should be granted to that client at all. It is important to assess new clients before you decide how much credit (if any) you are willing to extend to them.

Here are some useful credit assessment tools that will assist you in deciding whether clients should be given credit or not.

CREDIT MANAGEMENT TOOLS



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2.1 Know your clients (“KYC”)

You must know exactly who your clients are and obtain as much information about them as possible. Client information is the foundation of any credit process. Gather as much information as soon as possible. You should draw up a list of important basic information which your front-line personnel (reception, sales etc.) should ask from the client.

You should also use the internet (including Google, HelloPeter and social media: Facebook, LinkedIn, Twitter, etc.) to find out as much as possible about the client and its directors/owners even before you meet the client for the first time. This might indicate whether there are potential problems or obstacles to giving credit to the client.

Online reviews or comments can help you to determine whether you actually want to do business with this potential client, and grant credit to it. Don't waste your time and your money trying to sell something to somebody who is unlikely to pay you!

[Download
credit application](#)

2.2 Analyse risks which are not client specific

Having a good understanding of the industry you operate in is vital. You should also understand how your (and the client's) industry fit into the larger South African economy, and even the world economy.

For example, if China's manufacturing industries are suffering and you are in the business of transporting raw materials in South Africa which are destined for China, this could have a huge negative effect on your business in future, even though your local client may appear to be very strong financially at the moment.

2.3 Check Business Credit Reports

Credit reports are available from several South African credit bureaus (Compuscan, Experian, TransUnion, and XDS) at a small cost relative to the potential credit risk you could be taking by granting credit to a particular client.

These reports provide different sets of data about the business, ranging from financial data to legal judgements to a business's credit score.

You can get credit reports on the business, but if you want to get credit reports on its directors/proprietors, you will need their consent first.

Entrepreneurs should not only request these reports, but also ensure that they receive proper training in the interpretation of the reports. Some of the reports are not easy to understand.

2.4 Ask for trade references

Requesting trade references before granting credit to clients is equally important because they are often more up to date than credit reports, i.e. if a client is already struggling with late payments, a negative trade reference may give you an earlier warning than a credit report.

Some good questions to ask these references are:

- What are your credit terms?
- How long have you been doing business with the client?
- What is their credit limit?
- Average monthly purchase amount?
- How often do they do business with the client? (Weekly, monthly etc.)
- Good/bad payer?

2.5 Take out credit insurance

Credit insurance is not cheap, but should be considered very seriously because it can mean the difference between swimming and sinking. Credit insurers are experts at evaluating credit risk – they are far better at it than most South African businesses.

Think of the credit insurer as your client's rich uncle who will step in and pay you if the client can't pay. It takes your risk in granting credit to a customer away from you and places it on the shoulders of the credit insurer. The mere threat of a bad credit report can also sometimes motivate the most difficult customer to speed up payment as a negative report from a credit insurer will hamper the customer's ability to obtain credit elsewhere.

The following are well-known Credit Insurers in South Africa:

1. Hollard;
2. CGIC- Credit Guarantee Insurance Corporation;
3. Lombard;
4. Coface South Africa.





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RED FLAGS: AVOIDING THE CROOKS

Fraudsters will use any opportunity to mislead you into thinking that you are doing business with your new or existing client, only to find out that your client is not aware of any order or deliveries. It is important to visit your clients regularly and to have open and active lines of communication to ensure that everything is above board.

Generally, you should be careful when asked to change banking details and you should also look out for unusually large orders, purchase orders changing format, strange signatures, tipex, lines created by a photocopier, etc.

Other Red Flags to look out for:

-  Do not rely on contact details provided by the customer. Take the contact name, email address, landline numbers, cell phone numbers, website address- and check them out on Google.
-  Fraudsters typically use cell phone numbers and Gmail/Hotmail/Yahoo email addresses or email addresses with minor variations to normal addresses;
-  Be aware of last-minute changes to delivery addresses;
-  Be aware of urgent or casual orders from existing customers. Always insist that they follow your usual purchasing procedures.

A very keen awareness can prevent you and your company from ending up in a sticky position.

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COLLECTIONS

The collection process should be clear, firm and well-documented.

If certain clients should be treated differently from others (typically the very large clients), the collection personnel must be aware that non-payment may have to be handled by more senior personnel.

The process should start within a reasonable time – generally a few days after it becomes clear that the client’s payment has not been received on the invoice/statement payment date. One obviously has to take into account weekends, public holidays and other potential delays.

Generally, it is always better to start with “soft collections” and only when absolutely necessary move on to “hard collections”- litigation.

Soft Collections:

This refers to the collection of accounts in arrears by any means other than legal action. This will include sending follow up emails or telephone calls to make the client aware that its account is outstanding and perhaps enter into a repayment plan. This is a subtle way to collect “bad” debt while maintaining a good working relationship with your client.

Hard Collections:

This refers to the collection of amounts owed by means of legal action, therefore by issuing formal letters of demand, summons or sequestration/liquidation application. This avenue should be pursued if soft collections prove unsuccessful.

You should be aware that once summons has been issued, many clients will not even think of paying you until such time as a Court orders them to do so. They regard litigation as a handy reason for not paying you, because you are being “nasty” to them. Since litigation in South Africa is a very drawn-out and expensive exercise, you should regard hard collection as the last resort and only when the amount outstanding justifies the cost and effort.

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OBTAINING CREDIT INFORMATION

At CapX we assist our existing clients in their credit decisions by doing some desk-top research for them and derive our information from various trusted sources.

Our research uses the information obtained, together with our own expertise and knowledge based on years of experience and assessments done in terms of our internal procedures, focusing on potential risk and credit worthiness.

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