

RENTONS' BUSINESS TIPS



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Australian Credit Stationers is wholly owned by Renton Management Services Pty Ltd
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MERRY CHRISTMAS FROM ALL OF US AT ACS

My original intention was to write a couple of paragraphs about this month's topic – When do you stop credit? Then I realised how important it is to make the right decision on this subject, so this article has been covered in some detail. You will be surprised how many things need to be considered.

At the beginning of September, we moved about 15 kilometres west to Seven Hills. Our new premises allows us room to do our own printing and hire more staff. It was certainly a big project and it has put us a little behind in our mailings. You are receiving this newsletter about two weeks later than normal.

Also, we now have three trading names - Australian Credit Stationers, Australian Christmas Cards and Precision Printing. We can provide you with collection stickers, Christmas cards and printing services.

Finally, I would like to thank you for your business in the past year and wish you and your family a happy and safe Christmas.



Ian Renton
Australian Credit Stationers

WHEN DO YOU STOP CREDIT

Before deciding when to withdraw credit facilities from a particular customer, it is worth considering why you offered them credit in the first place. The only reason you would offer credit to a customer is if the reward of profitable sales from that customer outweighs the risk of not being paid. Secondly, you would need to consider what your competition is doing. This is how credit began many centuries ago. Someone felt at some stage that they could get a competitive advantage over someone else by allowing for payment of goods and services at a time in the future.

It is important to have a flexible policy on the withdrawal of credit facilities. All customers are different and as a result, represent different degrees of risk to your business. Withdrawal of credit should not be seen as a punishment for slow payments or a relatively large amount of arrears. Credit facilities should only be withdrawn if the risk of future non-payment is greater than the reward for potential future sales. Some things to consider with assessing creditworthiness are:

- the size of future purchases
- the profit margin on these purchases
- the frequency of the orders
- the age of the account
- why the account is unpaid
- who is the customer.

Let's say you have provided goods to a government department. The account is in 90 days. A representative from this department contacts you to say that they have just received approval to purchase ten times the amount of your product as before and what's more, they would like these delivered urgently. What should you do? Whilst it is frustrating that this account is in 90 days, a government department is generally rated as one of the safest organisations to which you can offer credit. Every effort should be made to collect the overdue account quickly and provided you were confident this account

and future accounts were to be paid, then the opportunity to make future profitable sales to this government department should not be missed. Clearly, for most businesses, the rewards are greater than the risks involved.

However, if this customer was new and had not been in business very long and had a much higher risk profile, then you would be less likely to extend your credit facilities to this customer, simply because the risk of non-payment would be too high. The ability of the organisation to remain solvent and be able to pay your bill should always be the most important factor in determining whether or not you should offer credit.

Even if this government department was to regularly pay your account in 120 days, extension of credit would be justified provided the margin on your product is high enough to cover the additional cost of money. At today's historically low interest rates, you would effectively be lending money to this department at about 3%. Provided your margin was large enough to cover this additional cost, then this sale would still be profitable. However, if the pressure on your cashflow caused by large debtors paying your account very late threatens the existence of your business, then it would be appropriate to reject this government department's request for more credit. A rejection of additional credit is not necessarily a lost sale. If you are providing goods and services at a fair price and are looking after your customers, then there is still a chance that your customer will want to do business with you – with or without the extension of credit.

Always consider why an account is overdue. Is the customer short of money or in financial difficulty, or is the reason for non-payment less serious? The person paying the accounts might be on holidays or no one in the office has the authority to sign the cheque or your invoice is not on their computer system. Trivial excuses for late payments such as these are frustrating, but are less serious because none of these

reasons on their own suggest a definite risk of non-payment. However, if your customer is short of money or in financial difficulty, then you need to assess how serious this looks and whether you can afford to offer more credit to this customer. To extend credit to a business in financial difficulty is usually foolhardy but there are exceptions. Firstly, the additional credit requested might be very small. Secondly, you might be selling obsolete stock so the loss would be insignificant. Thirdly, the margin might be very high, say 100% or more, so the consequences of non-payment would be less severe. You may consider in these three cases that the rewards for granting further credit are greater than the consequences of non-payment, even if the risk for such an event is quite high.

The frequency of your customers' orders will also have a big influence on whether you wish to grant additional credit to your customer. However, two seemingly identical situations can result in different decisions. Suppose you supplied a particular product to a small store in your local area. You know that you are the only supplier of this product in the region and this customer really depends on your product. You are actually one of their biggest suppliers. This customer is getting later and later with their payments so you decide to withdraw credit. This is a legitimate decision because you consider this slowness in payments as a sign of a weakening financial position of the store. Clearly, you are in the stronger bargaining position. This small store needs you more than you need them. Also, the potential for larger sales in the future from this store is small.

Suppose you supply a similar product of a similar value to a large retail store like Woolworths. The payment history for Woolworths is identical to that of the smaller store. In this case, you decide to continue to grant credit to Woolworths. Firstly, Woolworths is a listed company and you can check its financial records quite easily on the internet. Secondly, Woolworths is in the stronger bargaining position. You need them more than they need you. Thirdly, you hope to increase your sales to Woolworths in the future so it would be foolish to stop their credit facilities because of a few late payments.

Many small businesses complain about big businesses paying their accounts well after the due date. Certainly, every effort should be made to collect your accounts as quickly as possible. However, it is usually more comforting to lend to large businesses since they have many more assets to support the payment of your account. As more laws are passed to improve company disclosure, it is likely to be even safer to grant further credit to larger businesses in the future. Nevertheless, big businesses are not immune to financial difficulties. The recent collapse of HIH and the current difficulties experienced by Pan Pharmaceuticals can attest to this. It is likely that most of your bad debts will come from small businesses since they are inherently riskier operations simply because of their size.

The Use and Misuse of Credit Limits

Often, I am required to complete a credit application as a new supplier. A question often asked is the amount of credit I require per month. I really don't know how much credit I am going to need. I really don't know how much of their product I am going to use. I don't even know how long I am going to use this product for. Their products and services may be substandard - forcing me to change suppliers. Often the figure I put on this form becomes my credit limit.

Now credit limits have their uses. Credit card companies have a credit limit based on age, assets, income and other factors. They have a large pool of data to arrive at this decision. Also, this credit limit is regularly revised as you develop a credit history and your circumstances change. Credit card companies accept that they will have significant bad debts, but they know that the interest charged will be high enough to more than cover their losses.

Rather than set a credit limit, it is best to monitor every situation individually. Time constraints may prevent this so credit limits are often set. Also, it makes it easier for administrative staff to monitor the account. However, most businesses have maximising their sales as one of their objectives, so credit limits can be restrictive. After all, you want your customers to continue to buy more and more from you. A credit limit says to your staff - we want this customer to order more but not too much more. If you need to set a credit limit, use it as a guideline, rather than as a strict company policy. The reasons outlined earlier should be the only reasons for stopping credit, not some artificial limit.

When do you Threaten to Stop Credit?

A simple answer to the above question is whenever you plan to stop credit. The golden rule in credit is if you make a threat, you should be prepared to carry it out. Having said that, it is quite permissible to threaten to stop credit as a tool for collection. There are some debtors who respond better to threats. They are just seeing how long you will take to threaten to withdraw their credit facility. Getting to know your customers is the key to good account collection. For these types of customers, a threat to withdraw credit may happen quite early in the collection process. You can make your threat with a sticker on the account. Generally, the message would say, "No further credit allowed until this overdue account is paid". Alternatively, you could convey the same idea in a letter or a phone call.

The decision to stop your customer's credit should not be taken lightly, since thousands of dollars in potential sales or potential bad debts are at stake. The best policy is to look at each case separately rather than as a group. Then it is just a matter of assessing the potential reward in future sales against the cost of the bad debt and the chances of that bad debt occurring.

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QUOTATIONS TO PONDER

"The quickest way to double your money is to fold it over and put it in your pocket."

- Roy Rogers

"A judicious silence is always better than truth spoken without clarity."

- Philip Mann