

Credit Control

How to get paid promptly

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CREDIT CONTROL

SECTION 1 INTRODUCTION

Most firms have to provide their customers with trade credit. The aim of this workbook is to ensure that your customers do not take advantage of your willingness to provide this credit.

We will look at:

- the problems caused by providing credit, including the consequences of bad debt and late payments
- how to assess whether your customers are credit worthy
- how good credit control routines prevent customers from keeping your money longer than necessary
- where debt collection fails, we will see how to claim income tax and VAT relief on the bad debt.

This unit won't make you an instant expert at credit control and debt recovery. However, it will give you some useful guidelines to collecting debt efficiently. Good cash flow is essential for business success. We hope that this unit will make the cash flow for you.

In later units of the course we will look at how you can supplement your experience and knowledge by using specialist agencies and bodies to enable you to ensure payment from your debtors.

We will also look at some general communication skills which can enable you to make the most of your credit control procedures.

We will base our examples and exercises on an imaginary business called Toobie Fore. Toobie Fore is a builders' merchant specialising in timber sales. It is run by Ron Toobie and Jim Fore. Ron and Jim have been giving their customers too much credit. They need to tighten up their procedures. We will see how they do it in this workbook.

A Note on Terminology

Throughout this workbook we will use the terms 'debtor' and 'creditor'. People often get these two terms confused so let's get it straight from the start.

- A 'debtor' is someone who owes you money. They are in debt to you.
- A 'creditor' is someone you owe money to. They are providing credit to you.

CREDIT CONTROL**SECTION 2
CRACKING THE
CREDIT PROBLEM**

Competitive pressures mean that many businesses have to give their customers trade credit. Credit is an unsecured, interest-free loan to customers. Uncontrolled credit is like giving customers the key to your bank account. If you have a bank overdraft on which you are being charged 15% interest, every £1000 advanced to customers costs you around £12.50 per month in interest charges. Even if you don't have an overdraft, you are still losing the opportunity to earn interest on money 'lent' to your customers.

Cutting Down on Credit

Before we look in detail at methods of controlling credit, let's think if there are any ways in which we can cut down on the amount of credit given.

For example:

Do you really have to give credit? Is there any way that you can get customers to pay cash with order? Can you promote a cash based business (like 'cash and carry' or factory sales outlets)?

Can you issue an invoice but only release the goods when paid? This is called 'proforma' invoicing. This way your customers give you cash 'up front'.

Can you get a deposit with order? This way you can cut down the amount of credit given to each customer.

Can you ask for stage payments? This will lessen the amounts outstanding (but it only works for contractors - like builders).

Should you give credit on *every* order? It is very expensive to administer credit, especially for those customers who normally spend small amounts of money with you. You could end up spending more money on debt collection than the profit generated on small orders. Is there a certain order size below which you should insist on cash with order?

Of course you may find that, in your line of business, none of these options are available. You simply have to give credit. This is unfortunate because giving credit involves a great deal of administration. You probably know, from bitter experience, that you have to take the following steps to collect cash from your credit sale.

- Raise an invoice and delivery note
- Record the customer's debt in your books
- Send credit notes (for returned goods) when required
- Keep a list of poor payers (called an Aged Debtors report)
- Send statements (which are reminders to pay the invoice)
- Send chase letters to slow paying customers
- Telephone debtors asking them to pay you
- Record receipts from customers in your books. Pay the receipts into your bank account

If you raise *a lot* of credit invoices, you should seriously consider a computerised

accounting system. This will save a great deal of time which would otherwise be lost on credit administration. This course does not go into detail on computerised accounts packages.

Why We Need Credit Control

The normal credit period offered to customers is 30 days. In fact, the average debt collection time is nearer 90 days because of slow payers. This extra credit period can put pressure on your cashflow.

Often small firms suffer most because they have fewer administrative staff available to chase debt. They are also reluctant to apply pressure to their larger customers for fear of losing their custom. Let us have a look at some of the ways in which unregulated credit can damage your business.

Bad Debts

A debt becomes 'bad' when all reasonable means of collecting that debt are thwarted. Not only do you lose the value of the bad debt, you also lose the administrative costs incurred in chasing the debt.

Few businesses appreciate the true cost of bad debt. To recover a bad debt, the business must make additional sales. The following table works this out for you.

Additional Sales Required To Recover Bad Debts

| Amount of Bad Debt | Business Profitability (%) | | | |
|-----------------------|----------------------------|--------|-------|-------|
| | 5% | 10% | 15% | 20% |
| | £ | £ | £ | £ |
| £100 | 2000 | 1000 | 667 | 500 |
| £250 | 5000 | 2500 | 1667 | 1250 |
| £500 | 10000 | 5000 | 3333 | 2500 |
| £750 | 15000 | 7500 | 5000 | 3750 |
| £1000 | 20000 | 10000 | 6667 | 5000 |
| £1500 | 30000 | 15000 | 10000 | 7500 |
| £2000 | 40000 | 20000 | 13333 | 10000 |
| £3000 | 60000 | 30000 | 20000 | 15000 |
| £4000 | 80000 | 40000 | 26667 | 20000 |
| £5000 | 100000 | 50000 | 33333 | 25000 |
| £10000 | 200000 | 100000 | 66667 | 50000 |

The left hand column lists the amount of bad debt suffered. In this example, we show bad debts ranging between £100 and £10,000. We then show four columns labeled 5%, 10%, 15% and 20%. These figures represent the profit generated by the business. For example, a business with £100,000 sales turnover showing a profit of £10,000 would have a profit of 10%. Figures for this business would all appear under the column labeled 10%.

The amounts shown in the body of the table reflect the extra sales which have to be made to recover the bad debt.