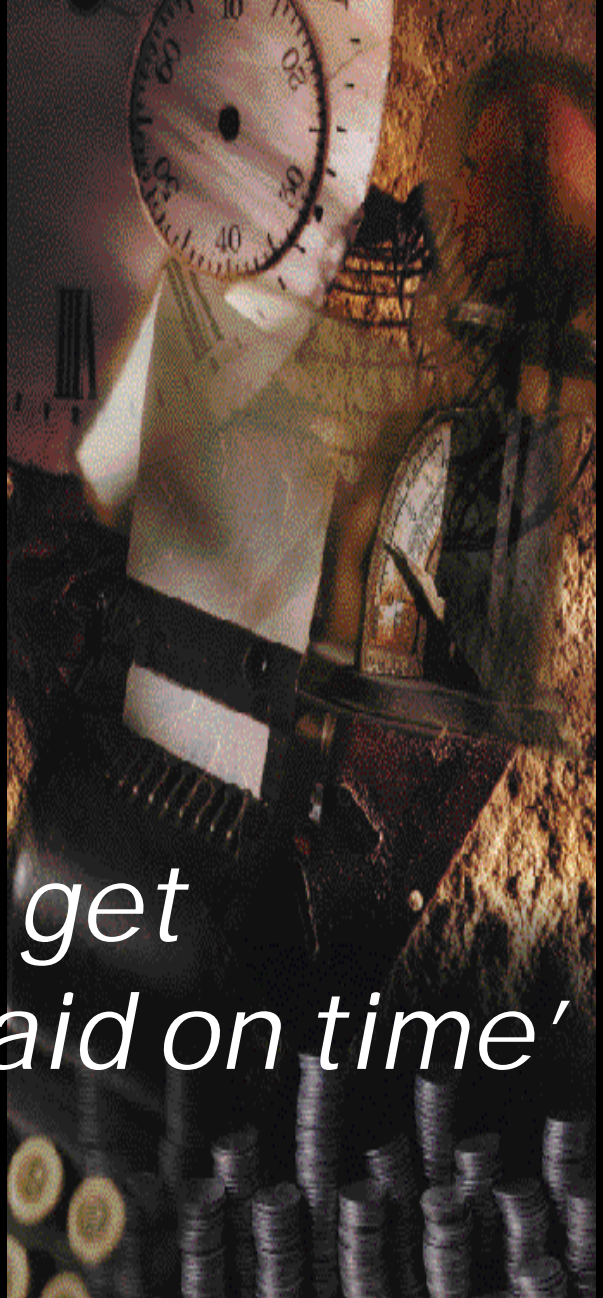


SFA
GUIDE

*'how to get
paid on time'*



Introduction

When a small company fails it is seldom because it has run out of customers, ideas or products. It simply runs out of money. Ask yourself this question - Would you extend a loan or give cash to a complete stranger you just met in the street, yet this is what thousands of small businesses do every day by advancing credit to new customers.

Getting paid on time is a never-ending problem for most small businesses. It causes serious cash flow problems; it requires firms to extend overdraft facilities or engage in additional borrowing and consumes a great deal of scarce management time. This in turn affects the ability of the business to compete, be profitable and expand. The problem of insufficient cash to pay immediate creditors has brought down many otherwise profitable and innovative businesses.

Too many small businesses think debtors on the balance sheet represent assets. But until they have paid up, those figures are worthless squiggles on a piece of paper. When small businesses fail, they don't run out of ideas, customers or products. they simply run out of money.

People who are intimidated by collecting money that is owed to them will not last long in business.

This guide, produced by the Small Firms Association with the support of the Department of Enterprise, Trade and Employment and the European Commission is intended to help small business overcome the difficulties associated with cash flow management. It represents the third element in our research of the impact, scope and extent of late payment on small business.

I would like to thank everyone who participated in the process through questionnaires, seminars and workshops in developing this guide and also the Department of Enterprise, Trade and Employment and the European Commission for supporting this project.

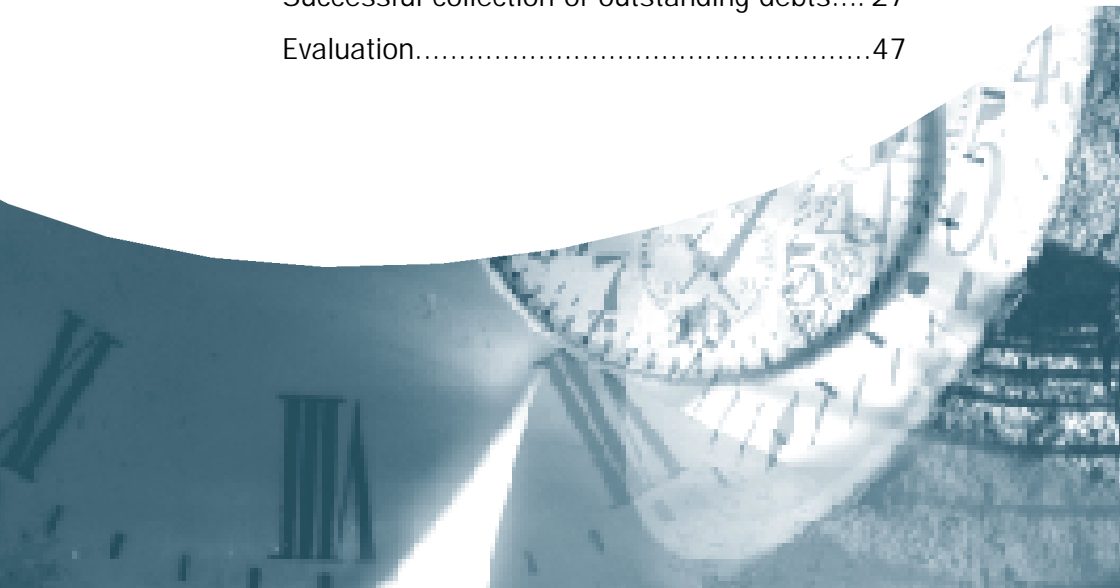


Pat Delaney.
Director, SFA.



Contents

Main causes of small business failure.....	4
Financial structure.....	5
Credit management.....	8
References.....	13
Annual reports.....	14
Accounts	16
Contracts.....	17
Retention of title.....	19
Customers.....	21
Power steps.....	24
Top 10 excuses.....	26
Successful collection of outstanding debts....	27
Evaluation.....	47



Failure

Main Causes of Small Business Failure

Factors regarded as a key cause

- Late payment damaging cash flow
- Directors lacking crucial business skills
- Inadequate understanding about the financial state of the business
- Too much debt
- Under capitalised
- Inadequate business strategy
- Poor cost controls
- Excessive domination by a single executive or narrow executive group
- Price cutting which undermines margins unwisely
- Poor marketing / sales
- Diversification away from core business

Financial

The Financial Structure of Companies

The Need for Capital

A business cannot start up without the injection of some initial “cash capital”. A business cannot grow without injections of further capital, from whatever source.

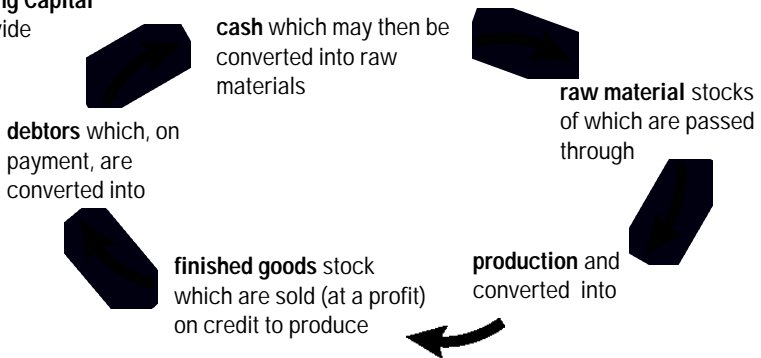
This original cash is invested as:

(i) **Fixed Capital**

for investment in assets such as property, premises, plant, equipment, motor vehicles, fixtures and fittings. These assets are to be held long-term in the business, providing a base for the company and enabling it to start up and maintain its operations.

(ii) **Working Capital**

to provide



Working Capital is often described as “circulating capital” because it passes around the business with the objective of generating a profit.

The Importance of Profit

Most businesses exist to make profits. Generally speaking the higher the profits the better for the business. These profits can be used both for growth and to provide dividends for the shareholders, thus making the company an attractive prospect for further investment.

$$\text{PROFIT} = \text{TOTAL SALES} - \text{TOTAL COSTS}$$

Sales and Costs can be further broken down so that the above formula becomes:

$$\text{PROFIT} = (\text{VOLUME} \times \text{UNIT PRICE}) - (\text{VOLUME} \times \text{UNIT COST})$$

$$= \text{VOLUME} \times (\text{UNIT PRICE} - \text{UNIT COST})$$

Financial

The Financial Structure of Companies

Does a profitable company automatically give good cash flow?

By definition a company makes a profit when it increases the net value of its assets, less liabilities, over a period of time. Cash is only one of these assets. Some managers define "profit" as "the difference between the bank balance at the beginning of the year and the bank balance at the end of the year". This is definitely incorrect - there is no direct relationship at all between "profits" and "cash" in the short term.

Note particularly that the Sales and Costs in our equation above will not correspond with the actual inflows and outflows of cash during the period. This is partly due to the fact that some expenses are "non-cash" expenses (eg. depreciation), and also that costs will be included according to when they were incurred rather than when they were actually paid. Also, sales revenues will be calculated as the value of goods dispatched and invoiced during the trading period and not on a cash received basis. A profitable company can have a very high bank overdraft; an unprofitable company can be flush with cash.

The Profitability Concept

If asked whether a company's profit is at an acceptable level most managers would wish to know the:

- (a) Sales of the business (Turnover) and / or
- (b) Capital Employed in the business.

Generally speaking, the higher the profit, as a proportion of either figure, the better. When profit is compared with capital employed, the resulting measure is known as the **Return on Capital Employed** (usually expressed as a percentage). The Capital Employed comparison is, theoretically, a better measure of profitability than the comparison with Sales Income.

Return on Capital Employed

$$\frac{\text{Profit}}{\text{Capital Employed}} \quad (\times 100\%)$$

this may also be expressed as

$$\frac{\text{Volume (Unit price - Unit Cost)}}{\text{Fixed Capital + Working Capital}}$$

There are, therefore, five management actions, each with the aim of improving profitability. These "Profitability Objectives" are:-

- Increase Volume
- Increase Unit Selling Price
- Reduce Unit Cost
- Reduce Fixed Capital Investment
- Reduce Working Capital Investment

Financial

The Financial Structure of Companies

Improving cash flow

Whilst the first three profitability objectives will affect cash flow, the manager who is trying to improve business cash flow will make a more immediate impact by first considering the levels of investment in Fixed and Working Capital.

To reduce Fixed Capital investment consider:

- (a) whether more equipment has been purchased than is required?
- (b) could plant or vehicles be leased instead of bought outright, or would hire purchase be appropriate?
- (c) would it be better to rent premises than to buy them?
- (d) are all the assets held really required, or are some of them there merely for status or prestige?

To reduce Working Capital investment consider the velocity of circulation through:

- (a) Raw Materials
 - buy at best prices,
 - keep stock levels low without losing sales,
 - arrange credit terms with suppliers,
 - delay payment so that stocks are financed by suppliers.
- (b) Production
 - efficient production control,
 - utilise the most efficient machinery available,
 - improve productivity,
 - make to order.
- (c) Finished Goods
 - protect goods,
 - review slow moving stock,
 - speed up distribution to customers.
- (d) Debtors
 - tighten credit control,
 - more stringent trading terms,
 - vigorous follow up procedure.

Credit

Credit Management and Credit Control

This vital part of a company's financial management system has to be considered at three different levels.

- 1. Credit Policy:**
 - What place is the giving of credit going to have in your overall marketing strategy?
 - How much credit will you offer officially or unofficially to customers?
 - How flexible will you be?

- 2. Credit Assessment:**
 - Who will be given credit?
 - Up to what limit and after what checks?
 - How will credit limits be assessed and changed?
 - Who makes the final decisions?

- 3. Cash Collection:**
 - What methods will be used?
 - How will the system be organised?
 - What time parameters will be laid down?

Credit

Establishing Credit Worthiness

A true test of the value of credit management is its ability not merely to collect overdue accounts, but also to enable the company to achieve the maximum overall profitability from trading. To do this in competition within a market means that a company cannot restrict its sales to “safe” customers, and must establish a trading relationship with those customers who may stand on the margin of risk. This requires the credit manager to become expert in risk assessment - the investment in trade accounts receivable on the sales ledger is the manager’s responsibility.

Risk assessment should thus logically be under the control of the credit manager. Some of the sources of information used by the professional credit manager are the following:-

- References provided by the customer
- Bank references
- Trade references
- Other suppliers
- Competitors
- Credit reporting agencies
- Agency rating books
- Company annual and interim reports
- Press comment
- Companies House
- Stock Exchange opinion
- Experience
- Credit business
- Sales force

All businesses involved in making credit sales are confronted at some time with the problem of initially assessing the creditworthiness of a potential customer. The assessment relies on the interpretation of information, some of which will be supplied by the prospective customer. Independent information, which the experienced credit manager will have access to, will probably be more useful.

Certain sources of information are especially useful when establishing credit for the first time.

Credit

Establishing Credit Worthiness

Trade references

A potential customer should supply the names and addresses of two or three businesses from whom he/she already buys goods on credit, so that contact can be made with them to ascertain their opinion regarding his credit standing.

The disadvantage here is that usually the potential customer nominates the referees, and most businesses will keep at least a few of their suppliers happy so that they can constantly use them as referees in this way.

This fact may be used positively by phoning up reasonably good payers when they pay well - congratulating them on their record of payment and suggesting that you would be very pleased to supply a trade reference, stating the facts of their payment record should they ever require such a reference. In the bad times they will then strive to keep a clean payment record with your company.

Bank References

All reputable businesses will be able to supply the name and address of a banker with whom they have an account.

The bank's opinion (which can only be made to your own banker who in turn will pass it on to you) attempts scrupulously to reflect the standing and credit worthiness of its customer in the light of all known facts. The source of the opinion can generally be regarded as being unbiased, it being a banker's absolute duty to report with honesty and correctness. Certainly the bankers take such reporting very seriously indeed and though the reply will be couched in vague terms, a sensitive, correct interpretation by the Credit Controller can provide useful information.

The Top accolade from a bank might read:

"Highly respectable: known to us for thirty years. Undoubted for your figures and purpose!"

You will rarely see such an unqualified report.

Credit

Establishing Credit Worthiness

Credit Registers - Trade Associations

A further independent source of reference is the commercial bureau. They supply a register of all concerns considered to be **good credit risks**, together with the level of business they consider them good for. These registers are updated frequently so that the current position is shown, and for an annual fee a copy of the register will be supplied.

Similar information can be obtained from trade associations, only this will be from the opposite view - that is, they circulate a list of names of businesses that are **slow payers or bad debt risks**. During a credit squeeze or a period of general shortage of money, it is possible for perfectly sound and reputable companies to appear on a trade association's **slow payers** list.

Information Publicly Available

Under the provisions of the 1985 and 1989 Companies Acts it is possible to inspect the final accounts of all limited liability companies.

This means that for a small fee and a visit to the Companies Office, a person may inspect all the statutory returns that a company has to make to the Registrar of Companies every year. Such information provides the names and addresses of all the directors of the company, and of the company secretary.

It also gives details of shareholdings (so that it is possible to see who has control of the business) and details of the company's accounts.

In addition, there will be details of any charges or mortgages the company has undertaken. From this information the financial soundness of a company can be assessed.

It is important to remember that, even if the company has filed its information quickly, the figures shown will reveal somewhat historical information, and things could have changed dramatically since the preparation and filing of the accounts. Therefore, these figures must not be taken in isolation, but used to supplement other knowledge.

Credit

Establishing Credit Worthiness

Credit Bureau

It may not be possible or practical to deal with the Companies Office direct, and an independent evaluation of a balance sheet may be preferred. In such cases it is possible to ask a credit bureau for a status report on a business.

For a small fee this will show all the relevant information that is required together with the bureau's report on their own findings. If the investigation was satisfactory under the heading Payments and Conclusions; the status report would appear something like:

"The company bears a favourable reputation and enjoys a satisfactory connection, normal credit facilities are deemed admissible."

Sales Representatives

The information provided by salespeople is too often discounted, on the basis that they are primarily only interested in making a sale, and therefore will tend to view a new customer much more sympathetically than the credit department. However, no sales representative wants to incur a bad debt, and although they may err on the side of the customer, this does not mean that their report should be ignored. They are in a position of close contact with the client and, therefore, they may acquire information about him that can influence the credit limit allowed. Apart from the names of other suppliers, the sales representative can supply general background information which can help a judgement to be formed.

Customer Visits

For credit evaluation purposes the credit manager will sometimes do well to invite the sales manager to accompany him.

Much of the benefit of a customer visit can be lost if such meetings take place wholly in the office of a director or one of the management. You should make every effort to see as much for yourself as possible, bearing in mind that in addition to the specific questions which you may wish to ask, you should also carry out a realistic appraisal of the business as a whole.

References

Bank References

There are many types of replies which could vary from bank to bank, but there are generally accepted “standards” of which the following are examples:-

1. Undoubted
2. Respectable and trustworthy, considered good for the purpose of your enquiry.
3. Respectably constituted Private Limited Company considered good for the purpose of your enquiry.
4. Respectable and considered trustworthy for the purpose of your enquiry.
5. Respectable and trustworthy; should be good for the purpose of your enquiry.
6. Respectable and trustworthy. We do not think he would enter into a commitment he could not see his way to fulfil.
7. Respectable and trustworthy. His resources would appear to be fully utilised at present but we do not think he would undertake a commitment he could not fulfil
8. Respectable and trustworthy. The amount of your enquiry is larger than we normally see passing through the account but we do not think he would undertake a commitment he could not fulfil.
9. Respectable and trustworthy. His resources would appear to be fully utilised at present and as such we do not feel able to speak for the amount of your enquiry.
10. Respectable and trustworthy. We have, however, insufficient knowledge of his resources to enable us to speak for the amount of your enquiry.
11. Unable to speak for the amount of your enquiry.
12. No account.

Definitions:

1. Beyond reproach - why are you asking?
2. All you need to know - high praise from a banker.
3. Looks good - the banker has no worries.
4. Slightly less positive - considered = fairly sure.
5. Should be = probably.
6. We might be wrong.....he looks alright.
7. Surprised he is stretching himself further!
8. How much? Looks a bit too big!
9. We certainly wouldn't give him any more credit!
10. He may have accounts with other banks and he would need them - we can't see the full picture!
11. Don't touch him! This client may injure your health.
12. Who?

Reports

Annual Reports

All limited companies must by law file their Annual Report and Accounts at Companies Office. As they are open to public inspection the **Profit and Loss Account** and the **Balance Sheet** do not have to show too much detail - they only have to reveal enough to allow creditors, shareholders and potential investors to assess the financial state of the company.

The Profit and Loss Account must show:

- Turnover
- Income from rents (if material)
- Income from quoted and unquoted investments
- Broad details of directors' emoluments
- Plant hire charges
- Depreciation charges and how they are arrived at
- Auditors' remuneration
- Interest on various types of loans
- Corporation tax charges
- Transfers to and from reserves
- Dividends paid and proposed
- Any exception "accounting adjustments"

Reports

Annual Reports

The Balance Sheet must show:

- Breakdown of capital employed into its various constituent parts
- Certain details about shareholdings and conditions attaching to reserves, loans and shares
- Contingent liabilities and commitments to future capital expenditure
- Details of freeholds and leaseholds
- Written down value of goodwill, patents and trademarks
- Valuation of fixed assets and how the figures were arrived at
- Details of investments held, and their valuations
- Loans to and from directors, employees and associated companies
- Cash and debtors
- Stock and its basis of valuation
- Aggregate of bank loans and overdrafts

The accounts form the basis of the Annual Report of a company and the equivalent figure for the previous year must also be shown. Under company law various other less significant details have to be shown in the Annual Report by way of the Directors Report and notes to the accounts.

The Auditors' Report should always be read before examining the accounts. If, in the opinion of the auditors, the accounts do not give a true and fair view of the state of affairs of the company, the report will be qualified. Some qualifications may be recording some minor infringement of established accounting practice but some qualifications can be very serious.

Accounts

Analysing Accounts

A full scale analysis of a (potential) customer's Profit and Loss Account and/or a Balance Sheet is a task which a Credit Manager could be expected to do. A basic analysis of a company's figures can be made for credit assessment purposes by using a few of the more straightforward measures:

(1) **Current Ratio**

$$= \frac{\text{Total Current Assets}}{\text{Total Current Liabilities}}$$

This is a "solvency" measure, but a relatively "optimistic" one.

(2) **Liquidity Ratio**

$$= \frac{\text{Total Current Assets - Stock}}{\text{Total Current Liabilities}}$$

This is relatively "pessimistic" as a measure of solvency because it recognises that Stock is not only hard to value in the first place, but may be even harder to turn into cash.

(3) **Average Credit Period**

$$= \frac{\text{Outstanding Debtors}}{\text{Sales During Last 12 Months}} \times 365 \text{ (days)}$$

This shows how long on average a company is taking to collect its own debts - it is an indication of how quickly it is likely to pay its own creditors.

(4) **Stock Turnover Rate**

$$= \frac{\text{Total Stock}}{\text{Annual Sales}} \times 365 \text{ (days)}$$

This is a measure of how fast a company's stock moves through the "buy/process/sell" cycle. Slow Stock Turnover Rate could well cause liquidity problems. Stock here includes raw material, work in progress and finished goods at the valuation shown in the Balance Sheet.

(5) **Gross Profit Margin**

$$= \frac{\text{Gross Profit}}{\text{Annual Sales}} \times 100 \text{ (\%)}$$

This ratio is not available from published accounts. But it indicates what sort of a mark-up is being put on a company's buying-in or production costs to set selling prices. It takes no account of selling or administrative expenses.

(6) **Net Profit Margin**

$$= \frac{\text{Net Profit Before Tax}}{\text{Annual Sales}} \times 100 \text{ (\%)}$$

(7) **Return on Capital Employed**

$$= \frac{\text{Net Profit Before Tax}}{\text{Total Capital Employed}} \times 100 \text{ (\%)}$$

(8) **Gearing Ratio**

$$= \frac{\text{Borrowings}}{\text{Equity Capital}} \times 100 \text{ (\%)}$$

Contract

The Law of Contract

1. Contents

A contract is an agreement which will be enforced by the law. To be legally enforceable an agreement must have the following elements:

- An offer by one party and a firm acceptance of that offer by another party resulting in agreement,
- Legality of the object contracted for,
- An intention that the agreement will result in a legal relationship,
- Capacity of the parties to reach a contract (i.e. both parties must have the necessary authority as servants of a company or in their own right as individuals),
- A consideration that one party makes as part of the contract (e.g. where goods are paid for in cash, the money is the "consideration" in the contract.),
- A contract in writing or under seal where the law demands it specifically (eg. sale of land).

A void contract is one which cannot be enforced (e.g. where a wager has not been paid by the other party).

A voidable contract is one that can be put at an end by one party (e.g. where a fraud was attempted by the other party).

An unenforceable contract is one where some technical defect (such as the absence of writing) renders it impossible to enforce at law.

2. Offer and Acceptance

All offers must be communicated before they can be accepted, and written offers containing exemption clauses must comply with the Sale of Goods Acts and the recent EEC regulations which are tending to limit the exclusions of liability which were once so prevalent. An offer must be distinguished from a declaration of intention, an invitation to make an offer and an option to purchase.

A declaration by one party that he means to do something and then fails to do it, does not give a right of action to another party who suffers loss because of the failure.

Contract

The Law of Contract

An invitation to make an offer (e.g. a shopkeeper displaying his wares with a price ticket) is not the same as making an offer that is acceptable (e.g. the shopkeeper may still refuse to accept the offered price).

An option is a conditional contract to complete or do something that allows one party to complete the contract if he/she so wishes. Acceptance must be absolute and unqualified of all the terms of the offer. It may be in writing or by words or conduct, but must be communicated to the offeror.

In the case of instantaneous communication - by telephone, fax or by parties present - then the contract is complete only when the acceptance is received by the offeror and not merely when transmitted.

3. Lapse

An offer lapses:

- On the death either of the offeror or of the offeree before acceptance
- By non-acceptance within the time prescribed for the offer
- When no time limit has been stated then it lapses when the court decides is reasonable if a subsequent acceptance leads to a dispute.

4. Revocation

An offer may be revoked at any time before acceptance. Revocation does not take effect until it is actually communicated to the offeree.

5. Rejection

An offer is rejected:

- if the offeree communicates his/her rejection to the offeror
- if the offeree makes a counter-offer

6. Legal Relations

The offer must contemplate that legal relations will be formed on its acceptance, and the parties must intend to make a legally binding contract.

A condition expressly excluding legal liability is now open to action in the court depending on its relation to public policy.

Title

Retention of Title

What is it?

Retention of title is a legal mechanism which enables a seller of goods to retain title in the goods until the price for them has been paid. A clause is inserted in the terms of trade under which the sale is made whereby, if after delivery but before payment for the goods, the buyer becomes insolvent, the seller may claim return of the goods.

How may it be used?

There are three main requirements which must be present to enable successful use of a claim on this basis.

1. The clause must be incorporated in your contract with the buyer. To ensure no problems here you should:
 - get written acknowledgement from the buyer when trading relationships have begun (perhaps on the credit application form),
 - distribute to existing customers a note enclosing terms and conditions of sale,
 - print terms and conditions of sale on price lists and sales materials,
 - print terms and conditions of sale on the reverse of letters of other company documents where appropriate.

The question of whose terms of trade are used will rest on the last notification before delivery was effected. A legal contract is made when definite offer is met by an unqualified acceptance. When one party sends the other an offer only to be met by an acceptance which includes a new set of terms of trade then the "qualified acceptance" amounts to a counter-offer and no contract exists until the counter-offer is accepted. Thus the first terms of trade have been superseded and the second set have become part of the contract. There have been cases where a company has introduced its own terms of trade shortly before entering receivership, effectively repudiating a retention of title clause.

2. The goods under consideration must be identifiable. This may simply be by the supplier's name on the product packaging or distinguishing marks, product serials or code numbers (perhaps in bar coding). Alternatively, can it be proven that no-one else could have supplied the goods?

Title

Retention of Title

3. The goods have not been paid for. This may be simply by production of an unpaid invoice. It is more difficult, however, when a number of similar transactions have been made, some of which have been paid for and some not. It will be necessary to prove that the goods claimed are part of the unpaid supply and not the paid supply. In order to do this it will be necessary to identify the date of the last payment, then refer to product serial numbers, codes and delivery dates and establish that goods were delivered or even manufactured after the date of the last payment.

Debtor's Receivership or Liquidation

1. Visit the debtor's premises, inspect and identify the goods claimed by listing them. Sign the list and get a member of the receiver's/liquidator's staff to countersign the list.
2. Obtain an assurance that the goods claimed will not be sold, disposed of, or transformed by manufacture or other processes by which they may lose their identity.
3. Persevere with your claim as long as it has merit. You will have a good chance of recovering the goods or securing a cash payment from the liquidator/receiver, especially as the receiver may need your goods and indeed goodwill if the intention is to try to sell the business as a going concern.

Companies in Administration

When advancing claims against companies in administration the rules are slightly different. You may inspect and identify the goods but you may not take action to enforce the claim without the permission of the court or the administrator. Such restraints make the claimant's position much weaker. If the claim has merit then negotiation with the administrator will tend to produce best results.

The use of retention of title clauses may put a supplier in a very much better position than the ordinary unsecured creditor. Using the retention of title clause effectively elevates the unsecured creditor above the preferential creditors such as banks and government departments.

Categories

Categories of Customers

There are five clearly identifiable categories of customer

1. **Those who can pay and do pay on time.** They are rarely much of a problem.
2. **Those who could pay but won't.** They prefer to keep their cash to themselves. You have to find a means of either pressuring them to pay or persuading them to pay. They are not a credit risk but they are costly in time and money.
3. **Those who would like to pay but can't.** They have no cash themselves and are permanently behind in paying everybody. If you decide to deal with this category you must accept the risk. Either they pay you in advance or you have to strike a balance between being too hard and bankrupting them, or being too soft and never getting paid.
4. **Those who can pay some debts but can't pay all.** You have to ensure that what little cash there is comes your way. The right mixture of firmness and empathy has to be employed. But remember if you are too understanding then someone else who is more aggressive will probably be paid first.
5. **Those who don't pay, can't pay and never pay.** There are not many companies deliberately in this category. Your credit assessment should pick them out before you give them credit. If you ever find yourself being owed money by this sort of business then hard, decisive action is required unless you know that you will get nothing from them anyway in which case you may as well cut your losses.

Communicate

Communicating with the Customer

True and accurate communication is conversational, friendly and relevant. Obviously, asking questions and listening carefully to the answers is essential and there are a number of types of questions for us to use.

Closed

Do? Will? Can? Have? May?

eg. Will you let me have payment by April 18th?

These produce a definite “Yes” or “No” response and can help to control the talkative customer.

Open

How? What? Where? When? Who?

eg. What problems exactly did you have with the lost invoice?

Open questions obtain information, and by avoiding the “Yes” or “No” response, they encourage the reticent customer to talk.

Probe

Why?

eg. Why do you feel that point is particularly important?

Often, a general answer is not sufficient for you to identify needs.

A probe will bring out your customer’s opinions.

Forced Choice

Which?

Which of the amounts specified on the invoice is giving you the difficulty?

This will help to focus your customer’s attention and avoid generalised answers.

Link

Bearing in mind what you said about.....

eg. Bearing in mind that you said the invoice arrived last week, would you pass it for payment today?

Leading

You would agree that.....

eg. You would agree that the amount is long overdue?

Communicate

Communicating with the Customer

To “soften” the impact of your questions you can preface them with such phrases as:

“Tell me.....”

“Explain to me.....”

“Describe to me.....”

This makes your questions sound more conversational, and helps to ensure that your questions are “open”.

Combined with sound questioning techniques, you also need interviewing techniques that allow you to control, remember, and aid communication by building rapport. The first of these is...

- Signposting** This gives an idea of the pathway and the reasons for the questions.
eg. I see, so to resolve the problem completely I would need to send you the four copy invoices?
- Confirmation** This acts as a check of your understanding.

eg. So, you require invoices in future no later than the 23rd of this month?
- Summarising** A method of recapitulating a lengthy or complex discussion.
- Note-taking** This means that you get the facts right and you buy thinking time.
It also shows that you have a high level of interest in your customer.
- Listening** It is not sufficient just to listen: you must demonstrate that you are actively listening. This means that you have to show by every means possible that you are involved and interested in the discussion. You must use your eyes, your body, your head and your voice to encourage the customer to contribute to the discussion.
- Being aware of these interviewing techniques and the wide variety of types of questions which you may ask helps you to make your conversations with your customers more effective

Power

The Power Steps

To remember the Five Keys to Successful Collection, think of “Power”.

The **P** stands for **Pre-call preparation**. Gathering the facts you need to control the conversation and make a well-directed call. Once you’ve prepared, **Open strongly** by asking for full, immediate payment.

Work through any objections and stalls so you can **End the call with a commitment** to pay and, of course, if the customer does not live up to his/her commitment, **React quickly** with a follow-up call.

Collection Call - “Power” summary

Prepare for the call prior to making the call. Tony Kelly, a collector, prepared by reviewing the account.

Open Strongly

Ask for the Right Person **Tony:** Good afternoon, I’d like to speak to Mrs. Brown, please.
Mrs. Brown: Mary Brown.

Identify yourself **Tony:** Mrs. Brown, this is Tony Kelly of City Office Equipment.
Mrs. Brown: Oh, yes, how are you Tony?

Tell why you are calling **Tony:** Fine thanks Mrs. Brown. I’m calling about an overdue account. It’s invoice no. 9774 for £485.45, dated June 8th.

Ask for full immediate payment **Tony:** Mrs. Brown, will you please post us a cheque for the full amount today? (pause)
Mrs. Brown: Well Tony, to be honest with you, we’re having some cash-flow problems right now. I’m not collecting my money.

Work through objections **Tony:** Mrs. Brown, when you needed fast delivery on copier parts to keep your business running smoothly, we were there to help you. Now we need your co-operation. Surely you must have some money coming in to maintain essentials you need for your business. Please view this account as one of those essentials, and send us a cheque today.
Mrs. Brown: Okay Tony, I should be able to get a cheque out to you in a couple of days.

Power

The Power Steps

- End with commitment** **Tony:** Mrs. Brown, since this account is so overdue, could you please give me a specific date when we can expect your cheque?
Mrs. Brown: Okay, I'll send it out in tomorrow's post, alright?
- Summarise** **Tony:** All right Mrs. Brown, let me mark my records to show that we'll have your cheque for £485.45 no later than the sixth. I'll give you a ring when we receive it. (optional)
or
Tony: To save you the bother, we can get it collected.
Mrs. Brown: Okay then.
Tony: Thank you.

Famous Lies

- "The cheque is in the post"
- "We did not receive an invoice"
- "We're waiting for a second signature"
- "He's at a meeting at the moment"
- "I'll phone you back in five minutes"

Not so Famous

"We sent the cheque by courier, but a dog bit the motorcyclist and he's in hospital with rabies. The dog ate the cheque."

(Yes, that one was used once. These excuses are all widely used to stall payment.)

Excuses

Top Ten Excuses

These excuses are all widely used to stall payment. Some excuses reflect new business methods, but many remain as “hardy annuals”

- 1. No Invoice - Please send a copy**
The answer here should be to check who should receive it and to confirm that on receipt of the copy, payment will be made immediately.
- 2. No One Available to Sign Cheque**
A really good excuse! But it is important to check that the paperwork has been processed, and to find out when the cheque will be signed.
- 3. Query on Invoice or Order Number**
This might show two problems - a real discrepancy which needs investigating or an attempt to hold back payment; if the latter then it could be sorted out on the telephone.
- 4. Shortage of Cash/Waiting to be Paid**
A real problem nowadays - but a commitment for payment should be sought, and dates agreed with the debtor.
- 5. Performance and/or Quantity Dispute**
This should not have arisen at this stage where a debt is being chased. The use of a “satisfaction card” helps prevent this excuse. Otherwise ask for a part payment while the query is resolved.
- 6. Not Paid? I'll look into it**
Obtain a time limit and record the name of the individual. If you don't hear then you must ring back.
- 7. The Computer!**
An easy way out - but all limited companies must have a separate manual system for meeting their liabilities.
- 8. We have a special date for paying accounts - you've missed it!**
Find out when it is and make sure that you get paid next time. This excuse should only be accepted once, and the “special date” noted for the future.
- 9. It was paid yesterday**
At least you can check on the arrival (or otherwise) of the payment in the near future. If you have any doubts about the truth of the statement then you can ask for a cheque number and despatch date.
- 10. Too Busy/Auditors/Shortage or Illness of Staff**
These boil down to incompetence or lack of organisation! They are simply justifying a blatant failure to meet objections. Don't accept an excuse like this and speak to someone in higher authority.

Collection

Making a Collection Call

1. Before you make a collection call, take a few minutes to prepare yourself and to plan the call. Time taken in preparation is an investment, not a waste. Make sure that you have all the information you need and that anything you may want to refer to is at hand = a good credit system will provide the information.
2. Recognise that there are always three limiting factors in a telephone call, compared with a face-to-face discussion, and that careful planning is necessary to overcome them.
They are:-
 - a. **Time**
Face-to-face, you will take as long as may reasonably be necessary. On the telephone, you will usually restrict yourself to just a few minutes.
 - b. **Senses**
Face-to-face, you will use your hands, to aid description and show things to the person you are talking to. On the telephone, your whole communication has to involve only the sense of hearing. You need to use your powers of description to the full.
 - c. **Reaction**
Face-to-face, you instinctively look at the person you are talking to and judge the reaction to what you are saying. On the telephone, being unable to do this, you must train yourself:-
 - (i) to simulate reaction, by asking questions
 - (ii) to listen actively to what is said
3. Bearing these limitations in mind, ask yourself:-

Who am I calling?

What is his/her name?
What is his/her job title?
What is his/her company?
What should I know about his/her company?
How long are they overdue?

Why am I calling?

What is the purpose of the call?
What do I wish to achieve?

How to obtain a commitment?

What action should be taken?
What time limit should I set?

Telephone

Making more effective use of the Telephone

The telephone is the best way of reaching people quickly, particularly in a cash collection context. The difficulty is that it has limitations, frequently resulting in wasted time and effort.

For example, when we make an outgoing cash collection call, the following situations arise all too easily:

We are often left holding for a time, frequently minutes; when finally we get through, the person we require is unavailable; we explain our situation to the wrong person, and end up repeating our story to someone else; the person we call is not aware of or doesn't understand the problem; we don't understand the problem; more than one person in the customer company is involved on the account. And so on; the list can be endless.

Imagine a situation where you make 30 cash collection telephone calls per day, each lasting on average five minutes. If you could shorten the length of each call by one minute you would save 30 minutes per day. That means by the end of a working week you could save 2.5 hours. In a working year you would save almost 15 days. That is an objective well worth pursuing.

There are a number of steps that will help to achieve this objective. They are as follows:-

Preparation:

Ensure you understand the situation thoroughly from both your point of view and the customer's. Talk to others within your organisation (eg. sales people) if you suspect a query that cannot be resolved easily, in order to get a clear picture from the customer's point of view. Remember, in the end it is the customer who will solve your cash collection problem for you.

Getting Through:

This is the biggest time waster of all. Try to learn the time of day when the customer is most likely to be available. Ask questions such as: "When is the best time to call you?" Make sure you are talking to the right person; ask questions such as: "Can you help me with regard to this outstanding invoice?"

If you persistently have trouble with a customer who will not take your calls, write a letter and then follow it up with a call. When through to the switchboard in the customer company, instead of saying "it's about payment of an account" say "it's about a letter I have written."

By the way, ensure you have the correct person's name and business title in full for follow up and good communication purposes!

Telephone

Making More Effective Use of the Telephone

The Approach:

Never be hostile; always adopt a friendly reasonable attitude. Most people are reasonable (even customers!) if they are approached in the right way. If you can get the customer in the right frame of mind he/she will want to solve the problem just as much as you, provided you are reasonable.

Discussion/Excuses:

Again, be reasonable. Ask questions if you don't understand the customer's problem: "I'm sorry, I don't understand how you didn't get the full order. Maybe you could explain to me what happened at your end". Or: "Maybe you could put me on to the person who checked the order in at your end". Deal with excuses as if they were genuine. When you know you are dealing with a reason for non-payment which is not genuine, you can say: "apart from that, is there any other reason for non-payment?"

The Promise:

Always secure a definite commitment from your customer: a commitment to check into a query by a certain time; a commitment to pay by a certain date; a commitment to let you have part payment on the account immediately. Also, you must make definite promises and keep them. Not "I'll look into it for you and get back to you", but "I'm going to check your query which is.....and telephone you back at 3.30 this afternoon. Will you be able to take a call from me at that time?"

Records/Follow up:

If you do not keep accurate records of what you do you will not remember. You will then appear unprofessional and uninformed to your customer and he/she will use that to take extra credit and give you even more excuses. You cannot expect your customer to deal with your account in a businesslike way unless you are businesslike. Record details of customer conversations and operate a diary accurately.

Always follow up:

If you send a customer a copy invoice call him/her to make sure they have received it by a predetermined time. If your customer promises you payment by a certain time and it does not arrive, call them and ask why it has not. Operate this system ruthlessly but politely. Those who knock hardest and most often on the customer's door always succeed before others.

Collection

Telephone Call for Cash Collection

Caller: Date:

Company: Person:

Phone no.: Title:

Address: Existing/Prospective
Customer:

Any other Accounts: Their Reference
Number:

How often I Telephoned:

Check:	Sales Ledger Reconciliation Statement	Invoice Reference Order Reference Sales Representative
--------	---	--

Objectives of this call:.....

Objections which might be raised	Answers/Pre-emptions
----------------------------------	----------------------

1.....

2.....

3.....

4.....

5.....

Commitment:.....

Current:	Action:
----------	---------

Overdue:

Letter:

Letter:

Legal:

Collection

Cash Collection - Responses

Your success as a collector depends largely on how you handle customers' objections. So let us look at some basic ground rules.

Think of a collection call as a tennis match. Your request for immediate payment is the serve. The customer's response is the return of that serve.

In a collection call, there are only four types of responses (or return serves). These are:

1. **"I already paid"**
 2. **"I won't pay"**
 3. **"I can't pay"**
 4. **"I promise to pay"**
-
1. **I already paid**
 - Get the cheque number, cheque date, cheque amount, when it was posted, to whom it was posted, where it was posted from.
 - If other invoices are still due, get commitment.
 2. **I won't pay**
 - If there is a dispute, listen and get details. Try to get payment for undisputed portion. If unable to resolve, refer the matter to whomever handles payment disputes.
 - If the customer asserts "I haven't received your invoice"- provide details and ask that payment be arranged. Send another copy.
 3. **I can't pay**
 - Assess circumstances.
 - Determine the nature of the problem.
 - Evaluate prospects of collection.
 - Act in accordance with your company's policy.
 4. **I promise to pay**
 - Work for a specific commitment.
 - Remember a vague promise can be a stall in disguise.
 - Take the initiative, keep control of the conversation and obtain a commitment before you close the call.

Collection

Collection Systems

Cash collection can be administered in a wide variety of ways, ranging from computer systems to simple “slip” systems. But however it is administered, a good collection system must be:

- flexible
- reliable
- secure
- adaptable
- economical

The component parts of the collection system are likely to be some or all of:

- Invoice
- Settlement discount
- Statement
- Reply-paid card/envelope
- Collection letter(s)
- Telephone
- Fax
- Stop List
- Personal collector
- Collection agency
- Legal action

The right “mix” of these components is needed and each one employed must be of maximum effectiveness:-

1. **The Invoice** should be complete and accurate; make it easy for the customer to understand it, check it, and authorise it, put on an order number or an authorisation code if possible. Also a remittance advice with the invoice helps you and your customer.
2. **Settlement Discounts** are intended to accelerate cash collection, save cost and improve cash flow; but make sure that the discount you are giving is economically reasonable - work out its cost as against its saving.
3. **Statements** should be designed and produced with twin objectives in mind:
 - as a reminder of the debt outstanding,
 - as a reconciliation document between your sales ledger and your customer's bought ledger.
4. **Reply Paid Cards/Envelopes** can be used with statements (or letters) to encourage customers to reply to you, especially with complaints or reasons for non-payment; this gets the excuses out of the way at an early stage.

Collection

Collection Systems

5. **Collection Letters** should be Clear, Concise, Courteous, Correct and Complete. Don't send too many as those clients who don't respond to the first "soft" letter are unlikely to respond to anything other than a "strong" one. Remember that the **Aims** of the letter are:

- Attention** - if you don't get it the rest is wasted
- Interest** - without this the reader won't concentrate
- Message** - put it across clearly - don't dress it up
- Satisfaction** - close in such a way as to make sure you get it!

Personalising a letter will always help, although it is more trouble. Registered Post or Recorded Delivery will add impact, although it is more costly.

6. **The Telephone** has the advantage of direct personal communication, which at the very least means you know where you stand; it gives you the opportunity to receive information as well as to relay it and is a vital part of any collection system. But it is expensive and time-consuming so it must be used effectively - calls should be planned according to this sequence.

- Preparation** - including information collection
- Getting through** - to the right person, not just the right number
- The Approach** - and identification of the reason for the call
- The Discussion** - and usually the excuses
- The Promise** - if you don't get one you've failed - alternatively they paid and the error is yours, in which case you've failed anyway!
- Record and Follow-up** - for future reference and for chasing if necessary

(**N.B.** One idea that usually involves a lot of telephoning is the "Key Accounts" approach to cash collection - every senior executive in the business, no matter what his function, is responsible for collection of certain major accounts, leaving the credit control department to deal with the smaller ones).

Collection

Collection Systems

7. **Fax Messages** add urgency and provide proof of receipt; best suited to large amounts, and best sent to senior executives.
8. **The Stop List** can often be the most effective of all - provided that your product or service is necessary on a continuing basis and provided that your client cannot obtain supplies elsewhere.
Not necessarily good for customer goodwill!
9. **Personal Collection** by sales representatives or managers, collectors or accountants has the advantage of a personal "presence" - it is much harder to make excuses and impossible to say "I'll put it in the post". But it is costly in terms of time and not economically justifiable in many cases.
10. **Collection Agencies** vary in the way they operate and in the way they charge. But they can sometimes get results by using their name or their special expertise; the very fact that an account has been passed to a collection agency may motivate a customer to pay. If you like the idea of using an agency but you want to save costs you can always register your own private agency.
11. **Legal Action** is usually the last resort - in the County Court or the High Court. Generally the threat is enough, and even the most obstinate debtor will often pay up to avoid actually going to court. You need a policy laid down about how far you take legal action - it does not improve goodwill and sometimes costs more than it is worth.

These are basically the tools of the credit controller's cash collection trade. How you choose and combine them will determine how effective your system is in operation.

To maximise your return on money, time and effort you should follow these simple rules:

- make every part of the system do as much work as possible - make sure it is complete
- review the system regularly and adapt it to changing conditions
- be novel - there are plenty of other people after the same money!

Collection

Credit Control by Letter

Whilst it is true that a telephone call is often more effective than a letter, you will still need to write to customers who do not pay their debts on the due dates.

It is important that you have an agreed procedure on how many letters you write, when you send them and what they say.

The following timetable is a suggestion which you can amend to meet the requirements of your company:

Invoice:	as appropriate (but as soon as possible)
Statement:	at end of month or 30 days after invoice
First Letter:	7 days after statement
Second Letter:	7 days later
Proceedings:	7 days later
Initiated:	7 days later

Two different suggested formats (A and B) for the two letters you require are attached, though you must review these against your company standards, procedures and your general business philosophy. They are not put forward as being perfect letters but they will provide you with a good starting point for designing the perfect letter for your purposes.

The first letter reminds the customer that the debt is overdue and payment is required immediately.

The second letter seeks to achieve two purposes. Firstly, it attempts to persuade the customer to make payment in order to avoid further, and more serious, action. Secondly, it seeks to ensure that if Court action is required you will be entitled, under the rules of the Court, to claim Court fees from the customer. This letter must therefore give clear details of the debt involved and give a fixed date after which proceedings will be issued in the Court.

Is your letter:

- Clear and Concise
- Reasonable
- Courteous
- Positive
- Firm
- Urgent
- Addressed to an individual
- Sent by recorded delivery
- Acceptable as evidence in court

Does it state clearly:

- How much is to be paid
- When it is to be paid
- To whom payment should be sent
- Where to send it
- What is covered

Does it avoid:

- Asking for excuses
- Appearing like a circular
- Labels like "first reminder"
- Harassment
- Causing personal or family alarm, distress or humiliation
- Indicating falsely that criminal proceedings will be taken in the event of non-payment
- Falsely representing the sender as being authorised in some official capacity to enforce payment of the debt
- Use of documents which are falsely represented as being official documents

Collection

Cash Collection Letters

Possible First Letter to Customer

Dear

Invoice Number.....

Your Order Number.....

You will note from the attached statement that this invoice is overdue for payment.

Please let me know if there is a particular reason why this payment has not been made, so that I can ensure there is no unnecessary delay in fulfilling any other orders you may have placed.

Alternatively I look forward to receiving your immediate payment of this outstanding invoice.

Yours,

Name

Job Title

Collection

Cash Collection Letters

Dear

Invoice Number.....

Your Order Number.....

I have received no reply to my letter of
concerning this invoice for which is now days
overdue.

Unless I receive your remittance for by ,
I shall commence legal proceedings against you without further
notice or delay.

Yours,

Name
Job Title

Possible Second
Letter to Customer

A

Collection

Cash Collection Letters

Possible Second Letter to Customer

B

Dear

We are sorry that we have not received payment of your account which is now well overdue.

The next step in our collection procedure is to ask our Legal Office to start Court proceedings and this may result in a judgement against you which could have a serious effect on your future credit status.

We place great value on your business and naturally want to retain your goodwill, but we are reliant upon your co-operation in the settlement of your account. Please send your cheque to reach us no later than and so avoid the cost and distress of this action.

We thank you in advance for your help. A full statement of your account is shown below for your guidance.

Date:	Transaction:
Invoice no.:	Amount:

Yours
Name
Job Title

Collection

Cash Collection Letters

Dear Sir/Madam

In the present business climate you will realise that the effective control of money is now vital to the efficient operation of all companies. Our pricing policy is costed on the basis of payment being made on time, otherwise prices increase. In order to avoid this, we are asking you to assist in controlling the cost of collection of outstanding accounts.

The balance shown below is now outside our credit terms. Whilst we understand that you are not withholding this amount purposely and that this may be an oversight on your part, we would appreciate your co-operation by forwarding your payment today.

Should you have made payment in the last day or so, or should you have any query, please advise us immediately and accept our sincere thanks.

Yours faithfully,

Name

Job Title

Collection

Cash Collection Letters

Mr John Smith.
Smith & Co.

Dear Mr Smith,
Account No. 12344567789

Thank you for your letter received this morning regarding your account.

I have looked at your situation carefully and am sorry to advise you that we cannot allow the arrears to continue. I have set out below details of your payments for the last three months, and I think you can see the seriousness of the situation for yourself:

Month	Amount Paid	Accumulating Arrears
January 1992	IR£75.00	IR£350.00
February 1992	IR£62.00	IR£388.00
March 1992	IR£43.00	IR£445.00

You should contact me immediately with a plan for discharging these arrears, otherwise we will pass this matter over to our solicitors.

Yours sincerely,

(Accounts Department)

Collection

Cash Collection & Credit Control

Follow-up and its importance

1. Many people in business today could do much better for themselves if they paid more attention to following-up their customers. There are many examples;-
 - a. We said we would telephone the customer back but didn't
 - b. We said we would write to the customer but somehow it was forgotten.
 - c. We said we would telephone the customer at twelve, but we telephoned at four.
 - d. We promised ourselves we would telephone the customer to see if he/she got their goods safely but somehow that was forgotten.
 - e. We said we "would look into the matter, and get back to you" but that didn't happen either.

2. Well, this time the boot is on the other foot. The customer owes us money, so we don't have to go too far out of our way to please him/her. He/she had better pay up or else. We are well protected by a legal system, so somehow sooner or later, we will collect the money that we are owed. Somehow.

3. The customer's reasoning pattern is not too far away from this either. Somehow they will get me, and someday I'll have to pay. Someday. In the meantime, because they need my business more than I need them I can go on dodging from now 'til the end of time. I'll gibe them all a bit now and again to keep them happy.

Collection

Cash Collection Letters

4. All, that is, except for one. I keep him happy because if I don't he gives me a hard time. I pay him regularly and fully and take a bit extra from the rest to make up for it. Here are some of the crazy lengths this man will go to to get his money:
 - a. He 'phones me early in the morning or late in the evening when the switch-operator is gone; that way he has a better chance of being put through to me by one of the lads.
 - b. When I ask for copy invoices, they always arrive, by fax, courier or post.
 - c. When I have a query on an invoice, he says he will 'phone me back' by a certain time, and he always does.
 - d. If I say that goods were damaged when they arrived and I'm not paying, I get a telephone call from the salesperson within hours.
 - e. He phones me to let me know my cheque arrived safely and to say thank you. Or else he's phoning me to say my cheque didn't arrive and did I put it in the post.
 - f. He's always polite on the phone, but firm. He never raises his voice or picks an argument. I'd love to lose my temper with this chap but somehow he just never gives me an opportunity.
 - g. I get awkward, but he never gets rattled; he just offers to 'phone me back at a more suitable time when I can discuss the matter more easily.
 - h. If I owe him for a long time he very nicely, very courteously but very firmly tells me I've got his money in my back pocket. In all the time I've known this chap he's never once mentioned "solicitor" or "agent" or anything like that. He's not messy like other people.
 - i. At the end of it what way would you describe this guy? He keeps his **promises** and he's **persistent!**

Collection

Cash Collection & Credit Control

CONCLUSION

For effective credit control we must:

- determine our credit policy vis-a-vis our competitors including our normal payment terms
- determine how long we will allow before taking legal action
- set our credit control targets
- determine the percentage of bad debts to sales
- determine the average number of days credit outstanding
- decide how to organise credit control
- decide to whom the credit control manager shall be responsible
- determine his/her decision making powers\who shall arbitrate on exceptions
- lay down the credit control procedures
- establish creditworthiness checks
- indicate customer gradings in the sales ledger
- establish overdue, refer, and stop lists, and clearance lists
- decide on the collection steps - which, at what intervals and who should take them
- emphasise the need for quick communication and good relations with general management, the sales ledger section of Accounts, Manufacturing and Dispatch and especially with Marketing/Sales
- train the relevant staff in the policies, procedures and skills involved
- establish control measurements on credit control performance
- determine monthly ratio of bad debts to sales
- determine monthly ratio of debts/sales (or average number of days credit outstanding)
- determine monthly debt age analysis

Remember that credit control is the last vital link in the marketing chain - and that no sale is complete until it is paid for.

Remember too that you are competing with other suppliers for a customer's money. The supplier with the best credit control system is the one who will be paid first - make sure it is you.

Finally, remember that effective credit control can:

- build turnover by a positive attitude to accepting new customers, and by retaining and reinforcing the goodwill of existing customers.
- release cash for more profitable use.
- reduce costs and thus increase profits.

Evaluation

Self-Evaluation Form

Call No. _____

Customer _____

PRE-CALL PREPARATION

- Reviewed the facts
- Customer's Record

Rating

OPENED STRONGLY

- Asked to speak to the right person
- Identified yourself
- Stated amount due
- Asked for full, immediate payment
- Conveyed a sense of urgency
- Made a strategic pause

Rating

WORKED THROUGH OBJECTIONS

- Overcame objections & stalls

Rating

ENDED WITH COMMITMENT

- Turned a promise to commitment
- Closed effectively

Rating

REACTED QUICKLY TO BROKEN PROMISE

- Followed up quickly after customer defaulted
- Determined reason for default
- Got renewed commitment

Rating

CALL SUMMARY

- Overall efforts & results
- Did you use the right collection style?
- Maintained a businesslike approach
- Did you keep control of the call

Overall Rating

Ratings: 5 • Excellent 4 • Good 3 • Average 2 • Fair 1 • Needs Improvement

Comments/What should I do differently next time

'how to get paid on time'

Produced by



THE SMALL FIRMS ASSOCIATION

With the assistance of:



Department of Enterprise, Trade and Employment
and the European Commission



THE SMALL FIRMS ASSOCIATION

CONFEDERATION HOUSE, 84/86 L.R. BAGGOT ST., DUBLIN 2

TELEPHONE: 01-6601011 FAX: 01-6612861 e-mail: patdelaney@ibec.ie