



Successful businesses fast track their debt collection.



6 Steps to Improving Cash Flow

A Guide to Better Credit Management

Why is Credit Management important?

Cash flow is crucial for the survival and success of any business. It is generally accepted that cash flow is the single most pressing concern of most small and medium-sized enterprises. The careful management of credit is essential to ensuring reliable cash flow in business.

Cash flow does not simply occur as a result of the undertaking of work or sale of goods. Money does not just appear in your bank account when you render an invoice. It is the result of the implementation of an effective credit management policy and continuous monitoring and enforcement of that policy.

Consider this; if you are making 10% profit on sales, an uncollected debt of \$5,000 cancels out sales (or work performed) worth \$50,000.

The time and money spent dealing with debtors are valuable resources of your business and should not be wasted. The following steps will help your business minimise the frequency and impact of bad debtors and thereby improve cash flow:



- Step 1: Know Your Customers
- Step 2: Make Effective Contracts
- Step 3: Send Invoices
- Step 4: Enforce Credit Limits
- Step 5: Implement Debtor Management Procedures
- Step 6: Use Debt Collectors & Lawyers at the right times.

Step 1: Know Your Customers

Too often businesses extend credit without any evaluation of the creditworthiness of the customer. Credit cannot become bad debt if it is not offered in the first place.

A bank wouldn't lend money without first evaluating the borrower's ability to pay and neither should you. Therefore, the first step to minimising the risk of bad debtors having a negative impact on your cash flow is to limit the credit that you extend to potential bad debtors by evaluating and reviewing new and existing customers' creditworthiness and credit limits.

- Use Credit Applications to find out information about the customer. Make sure you know the correct legal name of the business (company, partnership, sole trader or trust) ACN and ABN. In the main, this information is freely available from the ABN Lookup at www.abr.business.gov.au and/or National Index of Company and Business Names at <https://connectonline.asic.gov.au>. However, paid searches may sometimes be necessary.
- Your Credit Application (or separate Consent Form) should include the required consent and agreement under the *Privacy Act 1988* (Cth) for you to be able to obtain a Credit Report from a Credit Reporting Agency for the purpose of assessing the customer's application for credit. A Credit Report will include legal information about the customer as well as an overall credit score and analysis of payment defaults and Court Judgments. Most Credit Reports also include a recommendation about the customer's credit worthiness and payment habits.

At present, there are 3 main credit reporting agencies operating in the Australian market. These are—in order of market share—Veda Advantage, Dun & Bradstreet and the Tasmanian Collection Service.

- Check trade references. Your Credit Application (or Consent Form) should also include the required agreement under the *Privacy Act 1988* (Cth) to obtain a credit reference for this purpose. Remember that customers will list their best credit references on Credit Applications so ask probing questions of the referees, such as how much is currently owed, how long they have been a supplier of the customer, what was the customer's average payment cycle and whether they have personal guarantees.

- Find out how long the customer has been in business. Most new businesses cease trading in the first 3 years. Consider personal guarantees and/or setting lower credit limits for newer businesses.
- Find out why the customer is changing suppliers and consider speaking to the previous supplier. It may be that the previous supplier is owed money and has refused to extend further credit.
- If the credit being sought is significant, and is to be conditional upon a director's personal guarantee, order searches to ascertain who the directors are and what real property they own. It may be that assets are held in the name of a spouse who should, therefore, also be required to give a personal guarantee.
- If you have a policy of Trade Credit Insurance, your insurer will undertake a credit analysis of your prospective customer when evaluating whether to extend cover in relation to the proposed contract with the customer. Unless insurance is refused, this may be enough to eliminate the need for you to obtain your own Credit Reports. Although, if insurance is refused you may simply decide not to extend any credit at all.

If your business typically has a substantial amount of working capital tied up in Accounts Receivable or extends large amounts of credit to 1 or more customers you should consider maintaining a Trade Credit Insurance policy. With Trade Credit Insurance you can protect your business from losses due to protracted payment defaults or the insolvency of a customer. In the absence of such insurance, the insolvency of a major customer may lead to the insolvency of your business.

Step 2: Make Effective Contracts

A contract will exist when your business agrees to perform work or supply goods for reward regardless of whether the contract is in writing or evidenced in writing. Despite common practice, terms and conditions cannot be validly incorporated into a contract by their inclusion on a tax invoice. They have to be agreed at the time the contract is made. That is, at the time the offer is accepted.

Verbal contracts can be difficult to enforce and in some industries are unenforceable. The effective incorporation of standard form contract terms and conditions into the negotiation and acceptance stage of a contract will reduce the consequences of dealing with bad or disputed debts and ultimately improve cash flow.

Don't draft your own contract terms and conditions unless you are a commercial lawyer. Effective standard form contract terms and conditions are easy to implement and will pay for themselves the very first time you have a problem with a customer.

Credit Applications can also be used to incorporate terms and conditions into the contracts that will arise from the subsequent supply of goods or services to the customer.

Unfortunately, most businesses learn the value of making effective contracts the hard way. When considering the value of effective everyday business contracts keep in mind that:

- Most business disputes arise from uncertainty about the scope of works, price or the cost of variations, due to lack of a written contract or inadequate terms and conditions.
- Contracts that effectively incorporate standard form terms and conditions improve short term cash flow by clarifying the payment terms relevant to an invoice. In the absence of a clear provision, at law, the payment term is probably whatever a reasonable time for the particular industry is.

- Unless your business has an effective contract in place containing a right to suspend further performance of a contract in the event of late payment, the suspension of performance may result in a breach of the contract exposing you to liability to pay damages. The mere fact that a customer has not made a payment on time does not bring the contract to an end or relieve your business of its responsibility to perform the contract. The result is the following dilemma:
 - ✓ Should I continue to perform the contract to avoid a likely breach for invalid suspension (and potential liability for damages), or
 - ✓ Should I suspend further performance of the contract to avoid the risk that I will not receive payment for the further work/goods supplied, despite not having a contractual right of suspension.

A right of suspension clause can eliminate this dilemma and give your business a right to suspend further work or supplies pending payment without risk of breaching the contract yourself.

- In the absence of a contractual right or Order of the Court:
 - ✓ The cost of collecting bad debts is unrecoverable.
 - ✓ Interest on an overdue invoice is unrecoverable.
- With an effective contract incorporating standard terms and conditions you can impose late payment fees and/or processing fees where payment is received by more than 1 instalment.
- Standard contract terms and conditions can make it easy to obtain personal guarantees and other security for payment, for example, a charge over real property or a right to remove goods supplied (retention of title). Even when a director of a customer refuses to sign a personal guarantee, the mere fact that you have asked for it enables you to ask vital questions about the customer's ability to pay and reasons behind the refusal. As a result your business may require the payment of a greater deposit, impose shorter trading terms or a lesser credit limit or decide the customer is too great a credit risk.
- A Caveat cannot be registered over a debtor or guarantor's property unless there is a contract granting you an interest in the land as security for payment.
- Having personal guarantees and/or other security for payment is crucial if a customer becomes insolvent. In most cases where a customer becomes insolvent (liquidation or bankruptcy) the creditor misses out altogether or gets a few cents in the dollar (unless they can make a claim against a Trade Credit Insurance policy). However, secured creditors are entitled to payment in full in priority to unsecured creditors and can pursue guarantors for payment despite the liquidation or bankruptcy of the customer.
- In some industries unless a written contract is made that satisfies legislative requirements the business cannot enforce a right to payment under the contract.

(See for example, Section 10 of the *Home Building Act 1989* (NSW)).

- Contracts effectively incorporating standard terms and conditions can make it easier to comply with industry specific laws designed to facilitate cash flow for businesses and thereby enable you to rely on those laws to recover payments promptly when necessary.



(See for example, Sections 8, 13 and 31 of the *Building & Construction Industry Security of Payment Act 1999* (NSW)).

Step 3: Send Invoices

If you don't invoice, you won't be paid. Typically, invoices should be sent out promptly upon completion of work or the sale of goods or at other earlier agreed times.

- Ensure that your invoices are correctly addressed to the legal name of the customer.
- Ensure that your invoices clearly state the agreed payment terms.
- Include your bank account details or other options for payment on the invoice.
- Send invoices by fax or email so they arrive promptly and don't get lost in the mail.
- If you have entered into a contract that expressly provides for the dates for rendering invoices ensure that you comply strictly with any time limits.
- Learn your customer's payment cycles and render invoices to coincide with them. For example, if your business' payment terms are 14 days and you regularly do work for a customer who only pays at the end of the month, where possible, render your invoices to the customer 14 days prior to the end of the month.
- Ensure that your invoices comply with any industry specific laws.

(See for example, Sections 8, 13 and 31 the *Building & Construction Industry Security of Payment Act 1999* (NSW))

Step 4: Enforce Credit Limits

Set and enforce credit limits for your customers based on their credit worthiness as assessed from time to time. This can be achieved by either refusing to accept further orders or by enforcing a contractual right of suspension, if the amount owing is greater than the customer's credit limit.

Where the customer's liability arises under a single contract; for example, where there are several outstanding progress payments, a credit limit can only be enforced if the contract contains a right of suspension, or if the contract is terminated for non-payment. You should always seek specific legal advice before terminating a contract.

Try to identify specific customers or groups of customers that tend to pay late or have defaulted in the past. Pre-empt the need to refuse further credit or suspend work (where permitted under a contract) and consider making a courtesy call or sending a letter/email informing the customer that further credit or work may be suspended if the credit limit is exceeded.

If the credit limit is exceeded and payment is not received when due send a serious letter requiring payment and suspending further credit. If a problem emerges, engage a Solicitor to resolve the matter without delay. To get fast results you need to get serious from the start.



Step 5: Implement Debtor Management Procedures

Supplying goods or services on credit is a daily part of most business' activities. For some customers the ability to purchase on credit will be the decisive factor on whether they use your business or not. How you manage this process and the collection of deferred debts is a fundamental part of cash flow management.

The timely collection of debts is crucial to cash inflow for any business. Poorly managed debtors can mean delays in converting sales to cash, or worse, trading with customers who are unable or unwilling to pay.

Slow payers can turn into bad debtors. Consider this; if you are making 10% profit on sales, an uncollected debt of \$5,000 cancels out sales (or work performed) worth \$50,000.

Don't feel guilty about collecting debts. You have worked hard and are owed the money for goods or services supplied. The law is on your side.

When developing or implementing a Debtor Management Procedure consider the following:

- Having a clear Debtor Management Procedure and starting the process as soon as the sale is made is essential to maintaining good cash flow. Use the [Sample Debtor Management Procedure](#) at page 7 of this Guide to review or develop a Debtor Management Procedure for your business. Remember, that the reputation, survival and success of your business may very well depend on how well you are able to collect your debts.
 - Make it easy for your customers to pay you. Ensure that your bank account details and payment instructions are included on your invoices, website and in your reminder letters/emails. Operate an EFTPOS machine so that you can accept payments by credit card over phone or in person and considering sending out Credit Card Payment Authorities that can be completed and returned. Many banks also offer a payment gateway so that customers can pay their debts via a link on your website.
 - If you have a good repeat customer who despite the trading terms in your Contract pays its debts according to its own payment cycle (say on the 25th of each month), where appropriate, call a few days before the payment cycle is due to ensure that your business' invoices will be paid in the next cycle.
 - If there is a problem or the debt is disputed, try to resolve the dispute promptly. Have a clear and rapid disputes escalation process and ensure that a senior decision maker is empowered to resolve perceived problems to ensure that problem debts are quickly settled. The swift resolution of a dispute will likely result in the prompt payment of the debt or other agreed amount, potential further business from the customer and the avoidance of:
 - ✓ legal costs incidental to defended litigation, which can be significant, or
 - ✓ the need to write off the debt to avoid such legal costs.
- If the dispute is resolved by an agreement to accept a lesser amount and/or a payment plan, insist that the payment agreement is recorded in a binding agreement. We recommend that you use the *Fast Track Payment Agreement (See below)*.
- If a debtor asks for extra time to pay, or to pay by instalments, provided the proposal is acceptable, insist that the payment arrangement be recorded in a binding agreement. Again, we recommend that you use the *Fast Track Payment Agreement (See below)*.

What is the Fast Track Payment Agreement?

When you agree to accept a payment plan or compromise a debt because of a dispute there is an opportunity to:

- Obtain a written acknowledgement of liability for the debt and release from any claims that the debtor may have against your business. If legal action becomes necessary in future, the debt cannot then be disputed. This will mean that significant legal costs involved in defended Court proceedings can be avoided.
- Obtain additional security for payment of the debt. Whether in the form of third party guarantees and/or security over real property or other assets, having additional security for payment will mean that you are more likely to be paid in full if in future the debtor becomes a bankrupt or goes into liquidation.
- Create a right to future interest at an appropriate commercial rate relevant to the debtor's circumstances. This clause will be significant if you did not have a prior contractual right to recover interest.
- Include a term entitling you to recover future debt collection costs, especially where you may not currently have any right to recover debt collection costs.

Our unique *Fast Track Payment Agreements* achieve the above objectives and more. When a debt is subject to a *Fast Track Payment Agreement* the chance of not recovering payment or incidental costs is vastly reduced.

In addition, by directing debtors who want to enter into a payment plan to submit their proposal via our online *Payment Plan Offer* portal the offer will come complete with the following:

- Disclosure of the debtor's (and where the debtor is a Company, the director's) financial circumstances,
- The Debtor's consent and agreement enabling you to obtain a Credit Report in relation to the Debtor should you want further information to assess whether to accept the payment plan offered, and
- An irrevocable offer to enter into a *Fast Track Payment Agreement* on the basis of the payment plan offered.

All you will have to do is email the debtor confirming acceptance and a legally binding payment agreement incorporating the terms of our copyright protected *Fast Track Payment Agreement* Terms and Conditions will be made.

Simply call or email Fast Track Debt Collection and we will send you a template email and link to the *Payment Plan Offer* portal so that you can easily make *Fast Track Payment Agreements* with debtors in future.

Step 6: Use Debt Collectors & Lawyers at the right times

Collecting debts is a competitive sport – if you're not getting paid someone else probably is. Often the Creditor making the most noise will get paid first. The longer you wait the harder it can be to collect. Statistically, the probability of collecting a debt drops between 60 and 90 days to around 73%. By 180 days you have only about a 50% chance of collecting at all.

Avoid getting emotionally involved in the debt collection process or dealing with unreasonable debtors. For best results, we recommend that debts be referred for collection between 60 and 90 days. By the time an Account is 90 days overdue, if the debtor actually intends to pay you, you should at least have made a Payment Agreement (see *Fast Track Payment Agreements*). If you don't, waiting any longer is usually a mistake.



Too many businesses waste valuable time chasing debtors on the telephone and sending letters that get ignored.

Fast Track Debt Collection provides a professional and no nonsense debt collection solution for businesses throughout NSW, VIC and QLD. Our proven techniques and methods have been developed by an Accredited Specialist (Commercial Litigation) within our integrated law firm, Roberts Legal. We collect debts fast. That's why we also buy debts.

We aim to collect every debt without the need for Court proceedings, and in most cases, debts are collected within 14 days.

We also offer a *Customised Approach* to debt collection on request. This means that we will devise a written and/or verbal approach to requesting or demanding payment of a debt in conjunction with you with the aim of preserving your relationship with the Debtor as far as reasonably possible whilst still achieving prompt collection of your debt.

If you are not getting the results that you need to maintain your cash flow defer to Fast Track Debt Collection or engage a Lawyer to deal with any dispute.

If your business operates in the building and construction industry, we can also arrange for a legal assessment of your rights under the *Building & Construction Industry Security of Payment Act 1999* (NSW) in connection with the debt.

Disclaimer: *This Guide contains general advice only. You should obtain specific advice on any matters of interest arising from this Guide.*

Sample Debtor Management Procedure

Example: Assume the business has made an Effective Contract stipulating 30 day trading terms.

- Day 1: When rendering an invoice diarise the due date or early reminder date for payment or review the Aged Debtor reports in your Accounting system regularly.
- Day 25-30: Send a reminder letter/email on the due date or reminder date including a Statement setting out the balance payable.
- Day 35-40: Send a second letter/email advising that the payment is now overdue and asking for payment within 7 days.
- Day 45-50: Telephone the debtor to enquire about why the debt remains outstanding and to discuss when and how payment is to be made.
 - ✓ Confirm the outcome of the discussion in a letter/email, for example, we confirm that you will attend to payment by 5:00pm, Friday, 25 November 2015.
 - ✓ If the debtor requests time to pay and you are willing to accommodate them:
 - Ask the Debtor how much they can pay now and try to get authority to process a credit card payment over the phone, and
 - Tell the debtor that they will need to enter into a formal Payment Agreement, then email them the link to the FTDC *Payment Plan Offer* portal to ensure that you will obtain the advantages of entering into a *Fast Track Payment Agreement*.
 - ✓ If there is a dispute that you can't resolve quickly consult a Solicitor or speak to one of our debt collectors about our *Disputed Approach*.
- Day 55-60: Send a final letter/email to the debtor demanding payment within 7 days and advising that it is your policy to take appropriate recovery action in relation to a debt over 60 days unless a satisfactory formal arrangement for payment is in place. If sending an email include a link to the FTDC *Payment Plan Offer* portal or email it subsequently if contacted by the debtor in relation to making an arrangement for payment.

If the customer is a repeat customer or has an ongoing project (under a contract with a right of suspension) inform the customer in writing that the failure to pay will result in a suspension of further credit and/or supplies of goods or services.
- Day (55-60)+7: If payment had not been received and no satisfactory arrangement for payment is in place (preferably in the terms of the *Fast Track Payment Agreement*) refer the debt to Fast Track Debt Collection for collection.



How We Help

Credit Applications and Terms of Trade

Credit Management

Debtor Management

Debt Collection

Fast Track Payment Agreements

Investigations & Skip Tracing

Litigation Management

Judgment Enforcement

Debt Buying