Credit Management for SMEs

How to avoid late payments, boost cash flow and accelerate growth

A White Paper by Pegasus Software

Executive summary

Stuart Anderson, Sales and Marketing Director at Pegasus Software, explains why late payments pose a serious threat to business growth and the wider economy, and highlights how tighter processes and enhanced debt correspondence can transform sluggish cash flow into prompt payments.

Cash flow: a definition

Cash flow, the ability to generate enough cash at the right time to meet liabilities, is one of the most common inhibitors of business growth and a key reason for insolvency, affecting profitable and unprofitable companies alike.

According to research[1], small and medium-sized companies are owed nearly £40bn as a result of late payments, a figure which is up from £30bn in 2013, and higher than a previous peak of £37bn in 2012. The findings highlight that 60% of SMEs are now experiencing late payments, with the average overdue payment figure totalling £38,186. One in four SMEs said that if the amount they were owed grew to £50,000, they would risk bankruptcy.

A code for change

Late payments don't just impact individual companies but the broader economy, as they inevitably extend across the entire supply chain. In fact, a study[2] recently highlighted that late payments represent the biggest source of credit in the UK economy today at £327bn.

Recognising this, the UK government has become one of the first in Europe to put measures in place aimed at tackling the issue of late payment. The Prompt Payment Code aims to encourage and promote best practice between organisations and their suppliers, and is being championed by organisations including the British Chambers of Commerce (BCC), the Confederation of British Industry (CBI), the Forum of Private Business (FPB), the Federation of Small Business (FSB) and the Institute of Directors (IoD).

Signatories to the Code commit to 'paying their suppliers within clearly defined terms and to ensuring there is a proper process for dealing with any issues that may arise'.

But with around 40% of business failing to sign up to the Code, and widespread evidence that companies are falling short of adhering to it, it seems the Code is by no means a silver bullet. As one commentator put it, why would companies agree to a voluntary Code, when outstanding invoices provide them with a handy, interest-free loan?

There are plans to strengthen the Prompt Payment Code, and the Government's Small Business, Enterprise and Employment Bill will force companies to publish information about their payment terms, thus shaming big businesses into paying on time. Many, however, argue that not enough is being done to address this problem.

Taking action

It is abundantly clear that SMEs need to adopt their own practices when it comes to expediting payments. And although you cannot always control when customers pay, the good news is that through instilling greater rigour across the order cycle, a huge step change can be achieved. It might sound obvious but an automated approach to cash flow is crucial. It's amazing how many organisations don't create profit and cash flow forecasts, and as a result they end up putting their profitability at risk.

Instilling the right processes and following these diligently, including systems which can generate various levels of debt correspondence to individual customers, can make a huge difference to facilitating prompt payments.

Many modern systems offer the facility to specify and design multiple levels of debt correspondence letters per company, and per individual customer for customised letters. When looking at systems, it's important to ensure that when a letter is generated, a sales ledger note and credit management diary action is automatically recorded against the relevant customer, to facilitate visibility of the customer's history and payment habits.

By harnessing this level of understanding, cash flow issues may be pre-empted. Armed with a full picture of a customer, companies can make decisions on whether to reduce credit or suspend accounts to stop the problem escalating.

[1] BACS Payment Schemes

[2] Charting the Trade Credit Gap, a report by Professor Nick Wilson of the Credit Management Research Centre at Leeds University and Taulia, the credit research group

10 tips for improved cash flow

1) Where possible, capitalise on financing options such as loans, to help mitigate against the impact of cash flow volatility.

2) Run regular credit checks on your customers. Circumstances can change quickly, so ideally this should take place every six months.

3) Ensure you know the history of your largest customers. For example, if directors have a history of bankruptcy, a degree of caution may be necessary.

4) Be bold. If a customer regularly defaults on payment terms, are they worth the resources it takes to service them and chase down payments? Turning away business might seem counterproductive, but could positively impact the bottom line.

5) Consider your credit terms and look at introducing 14-day payments or small deposits for the largest customers. Look into offering a small discount for early payment.

6) Invest in a software solution with robust financials, to generate invoices automatically and in a timely manner, provide alerts when payments become overdue, and facilitate immediate action to recover debts.

7) Ensure you have a clear credit control policy in place and create a series of automated letter and e-mail templates to communicate appropriately with customers and recover late payments.

8) When chasing payment, always act appropriately. Be firm, polite and diplomatic.

9) Monitor your cash flow closely and in real time. Dashboard applications will help you prepare for things going wrong by giving you a clear picture in an easy-to-understand format.

10) Review cash flow processes and resources on a regular basis and set realistic targets to ensure continued improvement.

Closing the circle

It’s clear that poor credit management can at best hinder profitability and, at worst, risk bankruptcy. But if handled well, good credit management can benefit the individual businesses as well as strengthening the economy as a whole, bringing the whole process full circle.

By improving cash collection processes and performance, streamlining credit control procedures and addressing bad debts appropriately, it’s possible to help build and maintain strong relationships with customers to identify and mitigate against late payments.

With £327bn hanging in the balance across the UK, taking a diligent approach to recovering debts is fundamental to capitalising on growth, boosting profitability and ensuring a healthy, scalable business.

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