

The MACM Credit Management Reference Book

Published by

The Malta Association of Credit Management

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Foreword

On the occasion of MACM 10th Anniversary, we at MACM have the pleasure to publish our third book for the business community selling on credit. This publication is not an ordinary credit management text book. Having first hand experience and the expertise in the field of credit management, this publication has been specifically written to assist the busy credit staff at all levels in their day-to-day duties.

The main scope of this concise publication is to serve as a quick credit management reference book. It focuses on the practical issues and tactics in the process of granting and managing credit in order to protect cash flow and secure profit, while gaining and sustaining competitive advantage in today's hostile market environment.

A number of diagrams and business models have been included in this reference book to make it both easier and also quicker for the credit practitioner to refer to and to understand the various concepts throughout the whole process of managing credit.

The world is changing, customers' demands and expectations are changing and hence, the way we do business with customers is also changing. This also includes the processes and procedures deployed to grant and manage credit. In today's business environment, credit has become not only critical but it also plays an important part in the selling process. Therefore, it is imperative to manage this key liquid asset effectively to meet today's market needs efficiently.

The MACM Council and its Secretariat are honoured to have the Prime Minister, Hon Dr Lawrence Gonzi to launch The MACM Credit Reference Book during the MACM Conference on Thursday, 12th May 2011 on the occasion of MACM 10th Anniversary.

Finally, I wish to take this opportunity to thank all MACM Members for their continuous support and cooperation throughout this last decade. I also wish to thank both the sponsors of this publication, namely FIMBank Plc, Simonds Farsons Cisk Plc, M Demajo Group, Express Group and Josef Busuttill, the author of this book, without whose help, assistance and dedication this third publication would not have been possible.

Dr Louis Bianchi B.A., LL.D.
MACM President

Josef Busuttil *MBA (Henley), DipM MCIM, FICM, Chartered Marketer*

Josef is the Director General of MACM. He has been a member of the Council of FECMA - Federation of European Credit Management Associations (www.fecma.eu) representing the Maltese trade creditors, since MACM joined FECMA in May 2003. In 2004, 2006, 2008 and 2010 Josef has been re-elected Vice President of FECMA.

Josef has sixteen years experience in the Financial Services Sector, starting his career as a bank official and later joined a Maltese leading Financial Services Company specialising in financial advise. He is a qualified financial advisor.

Josef read Marketing obtaining a Post Graduate Diploma of The Chartered Institute of Marketing (UK), and later became a Member of the Institute. In 2007, he has been awarded Chartered Marketer status by the Chartered Institute of Marketing.

Josef has obtained his Masters in Business Administration - Henley Management College (UK), and in recognition to his work in the field of credit management, both in Malta as well as in Europe, the Institute of Credit Management of the UK awarded Josef Busuttil Honorary Fellowship.

He is trained and certified to train others on the Profit System developed by Abe *WalkingBear* Sanchez – A/R Management Group, Inc. USA and is founder member of PCCG – *Profit Centred Credit Group*.

Josef is an intuitive lecturer, speaker and trainer, specialising in trade credit management strategies that enable the credit function to gain and sustain competitive advantage in the market, whilst ensuring sound cash flow and long-term profit.

Josef lectures Advanced Credit Management and Business Studies at MACM Training Centre - The accredited Teaching Centre of The Institute of Credit Management (UK) in Malta. He has contributed to a number of in-house training, business seminars and conferences organised by different organisations in Belgium, Dubai, France, Ireland, Mexico, UK and Malta. He is a regular contributor of business articles to local and foreign business press.

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Profile – The Malta Association of Credit Management

The Malta Association of Credit Management (MACM) was set up in June 2001 following a number of bankruptcies in the retail sector, a slowing down of payments by customers in all areas of the economy, and a large number of dishonoured cheques being faced by manufacturers, wholesalers, distributors and retailers in the Maltese business arena.

MACM is a members-owned, not-for-profit organisation, made up of Maltese organisations (hereafter called Members) coming from different sectors of the Maltese economy (peer groups).

A Council, made up of eleven Members, headed by the President and three Deputy Presidents, directs and manages the business of the Association through its secretariat, headed by the Director General.

Following the Annual General Meeting, held on Wednesday, 24th June 2009, and in accordance with the Statute of MACM, new officers and Council Members were elected for a two-year term as follows:

Dr. Louis Bianchi, B.A., LL.D.

President

Mr. Peter Wirth

Deputy President, Administration

Mr. Hugh Mercieca, ACIB

Deputy President, Political & Legal Affairs

Mr. Joseph Dimech, MICM (Grad)

Deputy President, Education Affairs

The elected Council Members were:

Mr. Charles Arapa AICM

Mr. Gaetano Cordina

Mr. Mario Delicata, B.Sc. (Hons)

Mr. Joseph Falzon

Mr. Antoine Galea, BA (Hons) Accty., FIA, MIM, ABHA, MBA

Mr. Joe Hili

Mr. Charles Xuereb B.A. (Hons) Accty, FIA, CPA, MIM

Mr. Geoffrey D. Borg B.A. (Hons), MBA(Warwick) is Honorary President.

The Mission and objectives of MACM

The mission of the Malta Association of Credit Management states that:

“MACM is a members-owned, not-for-profit organisation, providing a central national organisation for the promotion and protection of all credit interests pertaining to local businesses.”

(Ref: MACM Statute, 2001)

To attain the mission of the Association, a set of broad objectives are formally included in the Statute of MACM to be adhered to by the Council and the Secretariat:

- *To promote honest and fair dealings in credit transactions.*
- *To foster and facilitate the exchange of credit information.*
- *To encourage efficient service in the collection of amounts due.*
- *To promote and expedite sound credit administration in international and local trade.*
- *To foster and encourage research in the field of credit.*
- *To disseminate useful and instructive articles and ideas with respect to credit management techniques.*
- *To promote economy and efficiency in the handling of estates of insolvent, distressed or bankrupt debtors.*
- *To provide facilities for the investigation and prevention of fraud.*
- *To perform other functions such as the advancement and protection of business credit.*
- *To promote, support or oppose any legislative or other measures which affect the aforesaid interests represented in these and other developments.*
- *To raise funds by means of subscription of members or otherwise for all the purposes and objects of the Association in such amounts and in such manner as may be authorised by the Association.*
- *To do all such other lawful things as are incidental or conducive to the attainment of the above objects.*

Sub-committees

To achieve and facilitate its objectives, the Council set up the following five sub-committees:

- a. Legal & Enforcement Sub-committee
- b. Education Sub-committee
- c. Information Management & Technology Sub-committee
- d. Finance Administration Sub-committee
- e. Research & Development Sub-committee

Each and every sub-committee is chaired by a council member and is made up of MACM Members. Sub-committees have their own specific objectives to which they strive to achieve by analysing, developing strategic plans, implementing strategies and managing and controlling activities. Sub-committees report to the Council of the Association.

Legal & Enforcement Sub-committee

Various meetings are held with politicians from both sides of the Maltese political sphere and with Maltese professional bodies, promoting changes to the present legislation and lobbying for adequate enforcement for such legislation accordingly.

The various legislative areas discussed during these meetings were:

The Data Protection Act

The Companies Act (Company Recovery Procedure)

- Company Receiverships, insolvency, distressed businesses etc.

The Business Promotions Act

- With reference to late payments and changes to provisions within this new act

The Commercial Code as regards Negotiable Instruments

- And the proposition of a new Dishonoured Cheques Act

The Banking Act

Relating to Confidentiality, Local Banking practice

The Late Payment in Commercial Transaction Directive

The Consumer Credit Directive

In general, these meetings turn out to be positive and encouraging, achieving both the necessary awareness of what should be done in Malta and the promotion and recommendations to changes in the existing legislation to the benefit of the Maltese business community at large.

Education Sub-committee

Despite 'debtors' represent one of the key assets in the balance sheets of the majority of organisations trading on credit, the Maltese labour market lacks trained people in the field of credit management.

To enhance the role of the Credit Profession in Malta and to improve the managing of credit in general, MACM organises a number of workshops, seminars and conferences to its members, as well as to the local business community. It also takes part in activities organized by other institutions both locally and abroad.

In addition, MACM has been accredited Training Centre for Malta by the Institute of Credit Management (UK) to offer education programmes leading to Diploma L3 & L5 in Credit Management. Maltese students are able to attend for courses and sit for the respective examinations of the ICM (UK) in Malta. This would make it easier for the Maltese employers to employ people with the required skills and knowledge to deal with their credit matters.

It is our pleasure to note that Maltese students, studying with MACM have consistently achieved high marks and have been awarded prizes from the ICM (UK). MACM Training Centre has also been awarded with Certificates of Excellence by the Institute.

Information Management & Technology Sub-committee

MACM Members need information pertaining to credit management to analyse and continuously monitor the credit worthiness of their existing customers (*debtors*) and any potential credit applicants.

The primary objective of the Information Management & Technology Sub-committee is to satisfy the Members' needs by providing effective and timely information.

Thus, ensuring the following benefits:

- *Minimising the risk associated with trade credit.*
- *Avoiding bad debts*
- *Being consistent in credit decisions.*
- *Controlling of processes.*

- *Monitoring Debtors on a daily basis.*
- *Increasing performance.*
- *Enhancing long-term customer relationship, thus improving customer retention.*
- *Identifying financially solvent prospects, turning credit risk into credit rewards.*
- *Maintaining sound cash flow*
- *Sustaining profitability.*

Finance Administration Sub-committee

The objective of the Finance Administration Sub-committee is to oversee the finances of the Association.

Research & Development Sub-committee

The objective of the R&D Sub-committee is to ensure that MACM provides services requested by its members in an effective and efficient manner.

It strives to provide innovative services and products to continue satisfying the needs of the Maltese credit people working in credit.

Foreign Affiliation

Following a meeting held in Oslo on Friday, 16th May 2003, The Malta Association of Credit Management (MACM) joined the pan-European organisation FECMA (Federation of European Credit Management Associations – www.fecma.eu). MACM was accepted unanimously by all the members of FECMA present at the meeting.

Mr. Josef Busuttil, Director General of MACM, has been elected Vice President of FECMA in a meeting held in Ghent in November 2004 and was re-elected for three consecutive times for this post in a meeting held in Mestre, Venice, in November 2006, in Cologne, in October 2008, and in Paris in November 2010.

Other Services

MACM helps the local business community by offering comprehensive Credit Rating Reports issued by Graydon International, the one-stop shop for worldwide business credit information.

Graydon International is one of the leading database information providers specialising in credit risk management. The company helps clients reduce the uncertainty of doing business by providing a complete, differentiated and high-quality package of credit risk management services. Graydon provides access to credit information and reports on companies in more than 130 countries worldwide. The Graydon group is owned by Atradius, Coface and Euler Hermes, three of Europe's leading credit insurance organisations.

Through MACM, Maltese businesses have access to millions of online credit reports in over 130 countries. Fresh investigations by Graydon International are also available for any country in the world.

'The cost of a credit report may be less than the cost of several weeks interest on a major outstanding invoice.'

For further information, enquiries, and credit rating reports, please contact:

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www.macm.org.mt

Chapter 1

Who is Your Customer?

By Josef Busuttil

People in business know well that today's business environment is characterised by increasing competition, dwindling demand for goods and services and homogenous products with narrow scope for differentiation. This scenario entails the business community to focus their limited resources on gaining and sustaining competitive advantage in the market.

In order to gain and sustain competitive advantage, firms should be customer-focused. They should understand their customers and should be fully aware of their needs and expectations. Hence, firms should be familiar with their customers' attitudes, culture and behaviour.

Additionally, firms are also being faced with another commercial reality:

- **Credit is becoming more expensive – *it is becoming rationed.***
- **80% to 90% of business-to-business transactions *involve payment at a later date and credit terms are often extended.***
- **A/R is one of the largest liquid assets *representing on average 40% of the total assets of an organisation.***
- **More customers are demanding and expecting credit from their suppliers.**

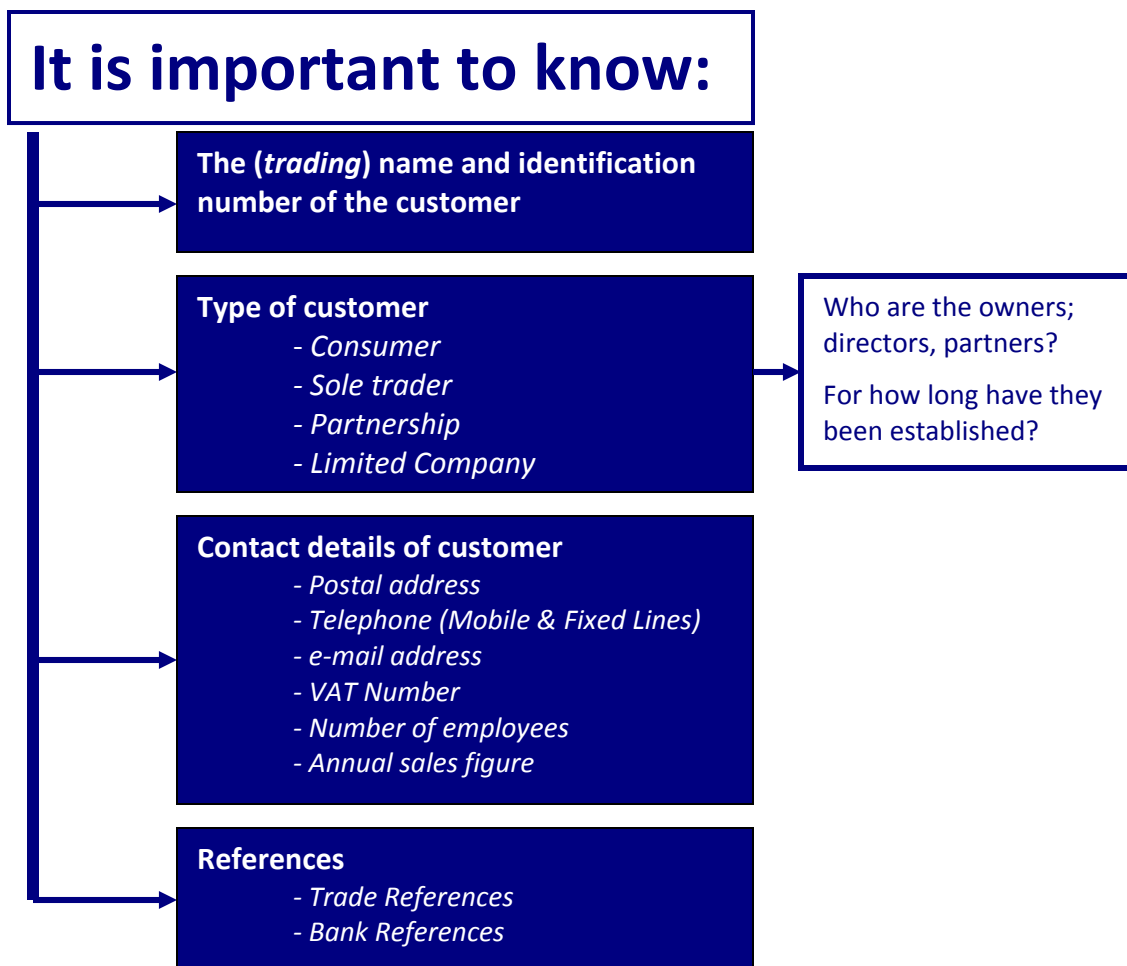
This credit scenario implies that businesses should invest in the credit function in order to grant / extend credit to customers and to manage Accounts Receivables in a profitable and secure manner. This requires the credit practitioners to refrain from the traditional practices of just crunching numbers and making '*collection*' calls.

In today's business world, people involved in credit management should possess good interpersonal skills that complement numeracy and literacy. They should be willing and able to build long-term customer relationship; to integrate and work in synergy with their colleagues and peers; to keep themselves motivated at all times and above all, to understand and meet customers' expectations and needs.

An efficient credit department having the scope of meeting today's commercial challenges has to be people-driven. It should be an integrated business unit within the business organisation. The credit function determines the level of cash flow of the organisation, and to an extent, the profitability of the whole organisation.

Nonetheless, credit costs money and has an element of risk attached to it. Therefore, credit decisions should be taken wisely and professionally taking into consideration the internal and external business environmental factors.

The only way to take effective, profitable and competitive credit decisions, as well as to manage risk associated with credit is basing credit decisions on accurate and timely information – **Know Your Customer!**



Is this information enough?

This information constitutes only the basic details of the customer. For a firm to grant / extend trade credit to customers, it requires to gather more information about the customer and the market that the customer operates in.

The credit worthiness of customers depends on a number of factors both within and also outside their business organisation:



Internal Factors

Internal Factors affecting the credit worthiness of trade customers	Strength in the market – <i>branded products on offer</i>
	Financial Assets – <i>profit, working capital</i>
	Physical Assets – <i>property, facilities & tools</i>
	Operational Assets – <i>systems, processes</i>
	People Assets – <i>skills of employees</i>
	Systems Assets – <i>infrastructure, systems</i>
	Customer-based Assets – <i>market share</i>
	Distribution-based Assets – <i>channels to reach customers</i>
	Cost structure Assets – <i>economies of scale</i>
	Innovation Assets – <i>internal culture supporting innovation</i>
	Process Skills Assets – <i>employees flexibility, communication</i>
	Alliance-based Assets – <i>agreements with third parties</i>

Adapted from: Hooley *et al.*, 1998

External Factors

External Factors affecting the credit worthiness of trade customers	Political & Legal factors – <i>Legislation & Regulations, government stability, etc.</i>
	Economic factors – <i>disposable income, interest rates, inflation rates, unemployment rate, level of demand, etc.</i>
	Socio-cultural factors – <i>education, skills, work behaviour, attitudes & values, etc.</i>
	Technological factors – <i>infrastructure, systems, etc.</i>
	Competition – <i>level of competition, branding, pricing, positioning, etc.</i>
	The customer – <i>bargaining power, perception, expectations, changing needs, communication systems, etc.</i>
	Market trends – <i>changes in the market, reasons and drivers for change, etc.</i>

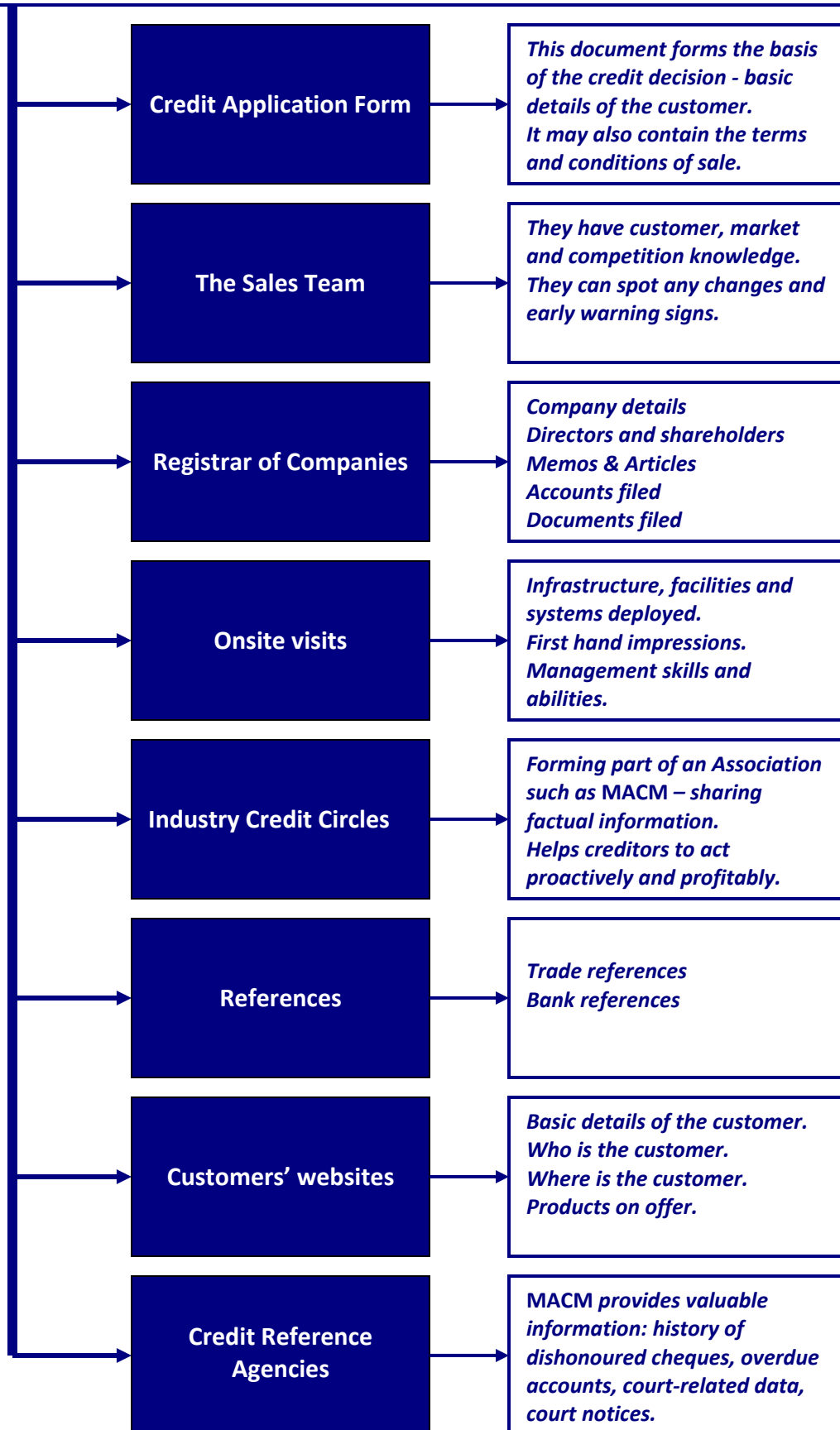
What are the sources of information?

Depending on the industry and market, a firm has a number of sources from which information on its customer can be obtained. However, it should be appreciated that the amount of time and resources required to collect, assess and analyse the information and then putting it to work, to either create long-term credit relationship with profit generating clients or to reduce credit risk can be considerable.

However, the costs involved and the resources needed for better credit management can be reduced if the credit manager identifies clearly what information s/he needs in order to manage credit profitably and to improve the processes and procedures when granting and managing credit.

Since there are no two organisations alike, each organisation has its own credit information needs and therefore, every credit manager needs to identify the proper sources of information which best suit his/her needs. Some of the sources which are available to the credit manager may include:

Sources of Information



Knowing your customer is an ongoing management process and should not stop once credit has been granted to a customer.

Change has become today's business mantra.

The world is changing, the commercial environment is changing, the needs and expectations of consumers are changing and these changes are affecting businesses in the way they trade and relate with their customers in the supply chain. The consequence is that customers are changing. A good (*'profitable'*) customer today may not necessarily mean that s/he will remain as good forever!

Therefore, creditors should strive to be proactive and maintain long-term business relationship with their customers. They should constantly and consistently seek to learn more about the customer and the marketplace that the customer operates in.

Continuously learning about your customer is one of the fundamental ingredients of the recipe for business success.

References:

Hooley, G.H., Sounders, J.A. and Piercy, N.F., *Marketing Strategy and Competitive Positioning*, 2nd edition, Prentice Hall, 1998

Chapter 2

Relationship Management in Accounts Receivable

By Josef Busuttill

'No Man is an Island' can be eloquently translated in business terms as *'No Business is an Island'*.

The name of the game in today's business world is to gain and sustain competitive advantage in the market. This can only be achieved by establishing and developing meaningful business relationship with the various stakeholders and more importantly with customers. Strong business relationship with stakeholders would result in better customer service and customers' retention.

And what is credit? Is it customer service? Is it a service that customers demand and expect?

Therefore, granting and managing accounts receivable can help a business organisation to gain and sustain competitive advantage but the credit practitioners should strive to build bridges not only with customers but also with all their stakeholders.

Who are the stakeholders?

Freeman (1984) defines stakeholders as any individual or any group who can affect, or is affected by the performance of the business organisation.

Therefore, stakeholders may commonly include the following groups and individuals, each having different level of power and interest in the business organisation:

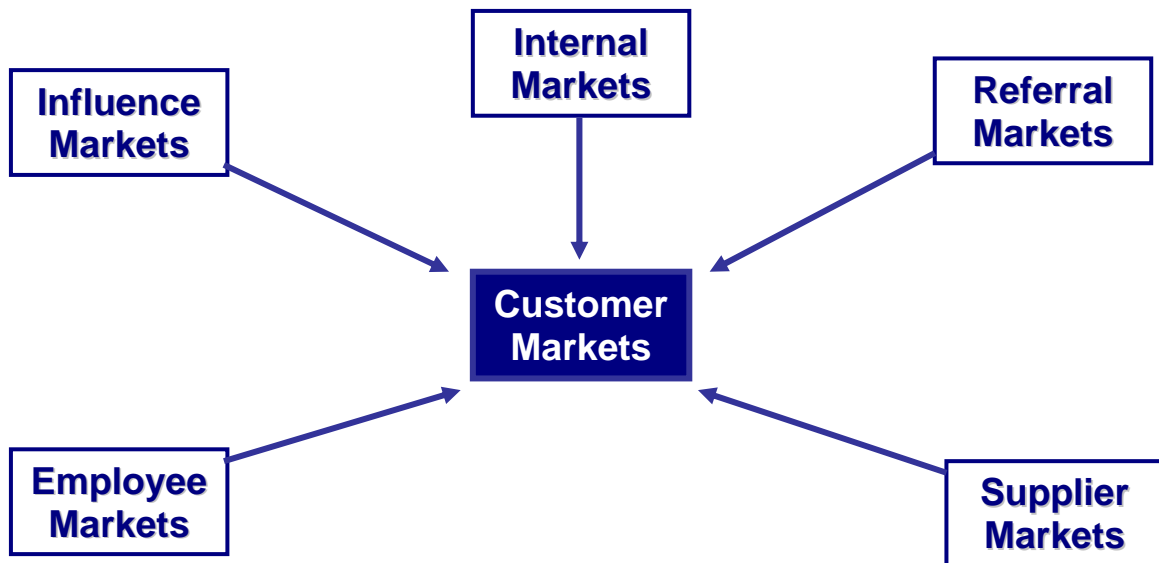
Stakeholders of a business organisation	Shareholders
	Managers & employees
	Customers
	Suppliers
	Distributors
	The Government
	Media
	Trade Unions and Associations
	Pressure Groups
	The Society in General

Table 2.1 Common stakeholders of an organisation

Table 2.1 shows that not all the stakeholders have the same level of power and interest in a business organisation, but establishing the level of power and interest of each and every stakeholder is critical in order to build and sustain the necessary relationship as appropriate for the smooth running of the business.

Likewise, the credit function interacts with a number of stakeholders and these stakeholders need to be identified according to their respective level of power and interest in the credit function.

Christopher *et al.*, 1994 developed a Six-Market Model that assists a business or a business function to identify stakeholders with high interest and influence on the organisation / business function.



Source: The Six-market Model, Christopher et al., 1994

Customer markets

Customers should be the central focus of any business. Without customers, a business simply cannot survive. Therefore, business organisations should be customer-focus and strive to meet the demands and expectations of customers at all times. This also applies for the credit function. Credit practitioners should make every effort to say 'Yes' to profitable sales.

Businesses should also recognise the importance to retain customers and generate repeat business. Repeat business reduces costs and is more profitable to the business. The credit function has a major role to play in this regard. The credit staff are those employees who are in direct contact with the customer from the beginning to the very end of a sale transaction. Hence, they can be instrumental to build long-term customer relationship and retain customers.

Supplier markets

Strong supplier relationship improves the processes involved in the supply chain. This leads to reduced costs and potentially enhanced overall quality of the customer experience.

Strong supplier relationship adds value to customers as businesses would meet deadlines and provide better products and delivery of services.

Employee markets

It is important to recruit the right people for the job. It is the employees who deliver the desired level of customer satisfaction.

Therefore, employees should be trained and skilled to provide good customer service. Continuous staff development is a must if a business wants to gain and sustain competitive advantage in the market by means of maintaining high level of customer satisfaction.

Internal markets

By treating employees, departments or other business functions as internal customers, businesses will deliver a better service to customers as the internal processes and procedures will be facilitated and supported more effectively.

This would result in staff motivation, improving efficiency and effectiveness, reducing costs, and ultimately enhancing the external customer experience.

Influence markets

External groups can have a significant influence and impact on the organisation and its customer base.

Building sound relationships with the media, green groups, trade unions, local communities and any other influential groups may eventually help to build and sustain good relationship with the customers through positive perception and strong branding. Reputation and perception help to sustain customer relationship.

Referral markets

Referral market leads to new business. Businesses that deliver high degree of customer satisfaction usually receive customer referrals. Word of mouth is the most effective promotion and costs much less than any other form of advertising.

The secret lies in sustaining good customer relationship!

The role of the credit function

Business should always keep in mind that they are competing with each other not only when selling to customers but also when they ask for payment.

Very often, customers are common to a number of suppliers, and all the suppliers are trying to get paid on time. For various reasons, customers may not have available money to pay all their suppliers on time and this will cause late payment.

But what makes customers decide who to pay? Why do customers prefer to pay one supplier and not the other? Although branding plays an important role, more often than not, it is all about business relationship. Customers prefer to pay those suppliers with whom they have good working relationship. It is human nature!

Therefore, the credit function can definitely help as they are in direct contact with the customers and can build sound business relationship. If credit, a much demanded service by the customers, is granted and managed efficiently, customers would appreciate the service being provided to them and it would help the suppliers when they ask for payment.

Sound customer relationship also has its positive consequences on the entire business as shown in the Win-Win Customer Relationship Cycle below.

The Win-Win Customer Relationship Cycle



Conclusion

It is proved that long established customers are more profitable to a business organisation, as they tend to be larger, more frequent purchasers, and major sources of referral business.

Therefore, businesses should retain customers by:

- *supporting customers in their needs, including credit needs;*
- *sending referral business;*
- *briefing customers on new developments.*

References:

Freeman, R.E., *Strategic Management: A Stakeholders Approach*, Pitman, 1994

Christopher, M., Payne, A. and Ballantyne, D., *Relationship Marketing*, Butterworth-Heinemann, 1994

Chapter 3

Credit Sales Approval

By Josef Busuttill

Credit costs money. Credit does not come for free. Credit carries also an element of risk – that of being paid late or not paid at all. The business organisation selling on credit has to calculate the costs involved in credit, the opportunity cost of granting credit and has to develop effective internal systems, processes and procedures by which credit is granted efficiently and risk associated to credit is identified and hence managed.

This entails granting credit responsibly. The credit practitioner should focus on the customer's needs and expectations while keeping in mind that credit sales should be profitable to the organisation granting it.

It has to be acknowledged that the key to business success is the '**customer**'. Business organisations can only survive if customers are willing and able to buy their products and services.

Therefore, the approval of credit sales is the priority of the credit function and hence, the necessary resources required to carry out this activity should be allocated as appropriate. Deploying adequate resources for the approval of credit sales would result in taking effective and efficient credit decisions in order to close the sale profitably and in a timely manner.

The Sales Process

Businesses invest heavily in the sales process in order to attract potential profitable customers and convince them to buy.

Therefore, all employees, including those involved in credit, should strive to secure profitable sales. But all employees should be aware that customers go through four steps before they commit themselves to buy.

These four steps can be summarised using the acronym AIDA.

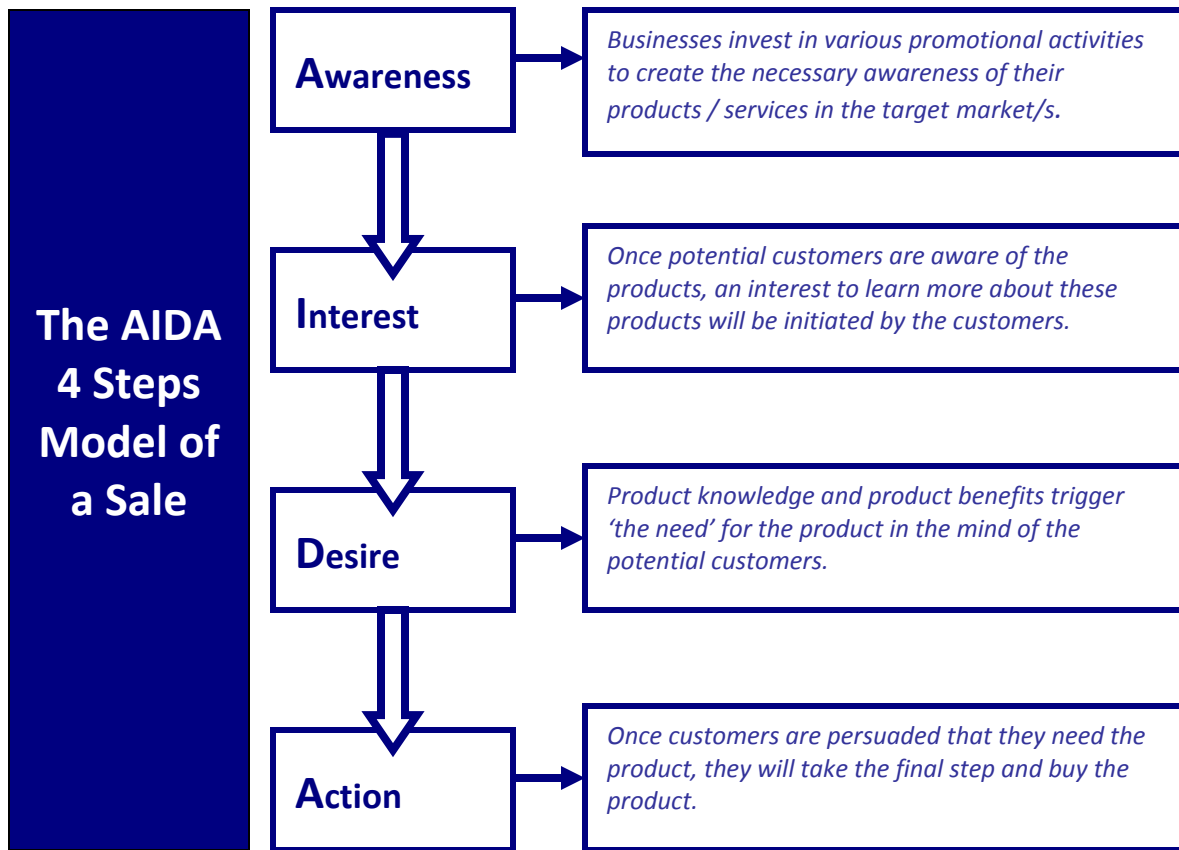


Fig 3.1 The Four Steps Model of a Sale

The AIDA 4 steps Model of a Sale shows that when a request for credit is rejected, all the efforts, investment and resources that have been employed to get to the point where customer wants to buy will be lost. And losing a customer today may also mean losing potential future business / sales or may also give the firm bad reputation in the market / industry.

Hence, credit is extended and additional costs of doing business are incurred in order to acquire profitable sales that would otherwise be lost.

A customer request for credit represent a sale in progress and the credit practitioner should find a way of saying 'Yes' to profitable sales.

Securing Profitable Sales

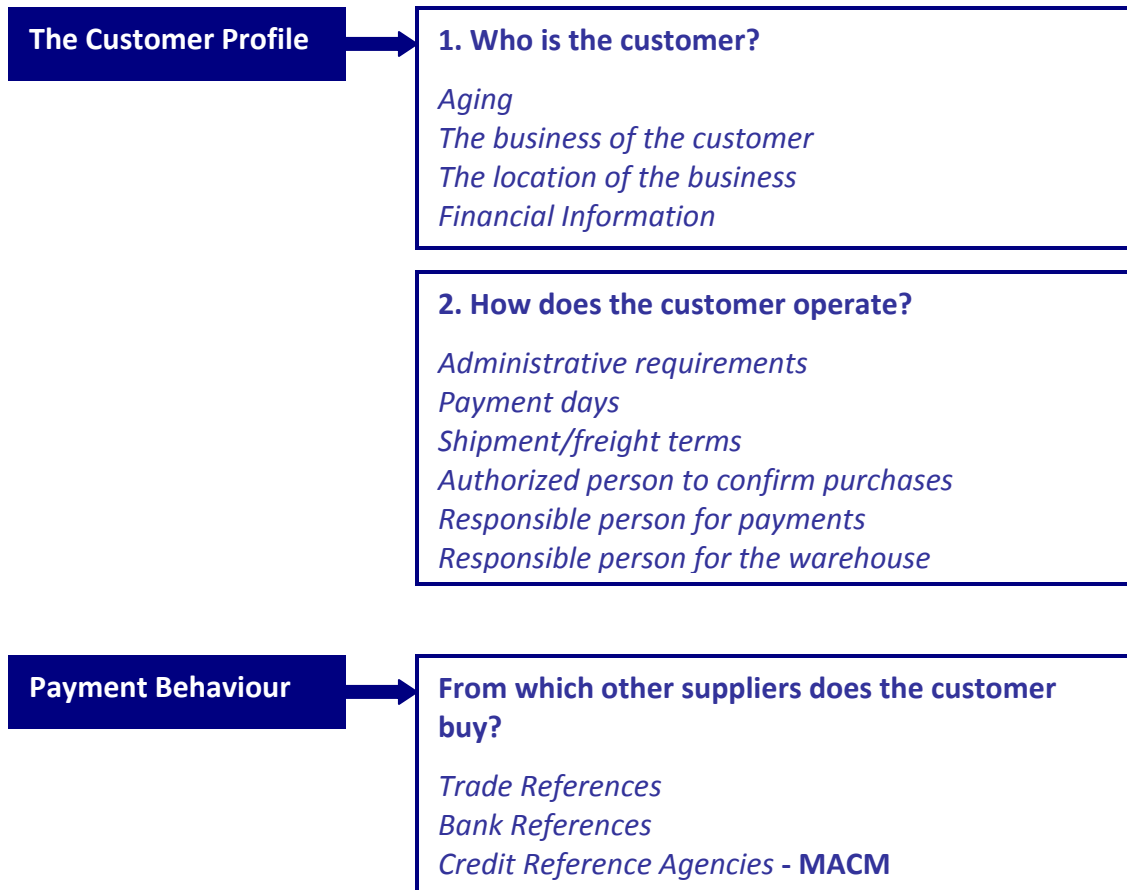
When a customer requests credit, the supplier should raise a Customer Information Form or a Credit Application Form, which should form the basis of the credit decision.

This Form should be completed in full by the customer and should consist of the basic details of the customer, references and conditions of the credit sale.

Requesting a signed Customer Information Form or Credit Agreement Form, specifying trading terms and conditions is not at all bureaucratic, intrusive or officious in any way, but it is only a matter of building long-term customer relationship whilst caring for the profitability of the business. Both the seller and the buyer would benefit from having a clear business agreement - it would prevent future disputes and enhance a sound business relationship, which would result in more profitable business for both parties.

Customer Information

The customer information applying for credit should consist of the following:



Determining the Credit Terms

There are no two business organisations alike. Every firm has its specific objectives and its level of risk averseness. However, having all the information required on customers, the credit practitioner will then be able to determine the credit terms in order to maximise profitable sales and manage the risk associated with credit.

But to determine the credit terms, the product value at time of sale should also be established.

If the profit margins are low, more cautious credit terms should be established. However, if the profit margins are high; the expiry date of the product is short; the turning inventory is slow; and the capacity of producing the product is high, then the credit terms can be relaxed.

This also applies to services. Services with high demand have high 'product value' and services with low demand have low 'product value'.

Notwithstanding, it all depends on the type of product, the industry and the economic factors of the market at any instance.

Sources of Information

The credit function should determine its specific information requirements to analyse the credit worthiness of the customer requesting credit and identify the most effective sources of information in terms of cost, accuracy and reliability.

Although there exist a number of external sources of information, it is suggested to make more use of the information deriving from the sales team.

The sales team is constantly out in the market. They know the customers well, very often on a personal basis. They also meet with other sales people, who are employed by the competitors and they talk to each other.

Thus, they exchange information about the market and the customers. The sales people are the ones that can sense the market in an effective manner. They are the right people that can help the credit practitioners to identify the most profitable customers, those customers who may be ideal to grant them credit.

The sales team can also provide information about early warning signs, which are critical to the credit function in order to take proactive actions and to monitor closely the

existing customers. Nonetheless, this requires synergy between the sales team and the credit practitioners.

Terms and Conditions of Credit Sales

If a business transaction lacks written credit terms and conditions, what evidence of the agreed credit terms would there be if any dispute arises in the future? It would be a case of the supplier's word against the customer's! These circumstances would result in harming the long-term business relationship and loss of business due to disputes between the two parties, if not also legal proceedings would be necessary, which would require more time and effort and obviously cost money.

Terms and conditions should therefore be considered as an important element in credit sales. They should include the payment period; interest and charges which may apply in case of late payments; discounts for early payments; and retention of title. Bank guarantees, personal guarantees and other liabilities may also be considered when the credit involves substantial amount of money or when the credit practitioner thinks it is best to managing the risk better.

Having the terms and conditions written on a piece of paper is not enough. They should be communicated and discussed with the directors or signatories of the company (or trader) applying for credit, and upon agreement they should be signed by both the supplier and the customer, indicating the persons' titles, date and place.

It may also be wise to send a copy of the Credit Agreement Form signed by both parties together with a Welcome Letter. This would ensure that the customer knows what has been mutually agreed and signed to at the onset of the business relationship.

Chapter 4

The Invoice

By Josef Busuttill

'Cash flow is the lifeblood of every business organisation' is a business mantra that has been repeated many times. The invoice is the document used by suppliers in order to get paid for the goods and services sold to customers. Therefore, the invoicing process deployed by the supplier has a direct effect on the cash flow of the business organisation.

This explains the reason why invoicing customers is a critical task of every organisation. Customers will not pay if they are not served with an invoice and consequently, suppliers will not get paid. Therefore, suppliers should give more attention to the invoicing process in order to ensure efficient cash inflow.

Lacking an efficient and accurate invoicing process would prompt complaints and disputes between the supplier and the customer. This happens because the supplier may not be well conscious of what an invoice is, should consist of, and when to send it to customers.

What is an invoice?

An invoice is simply a supplier's request for payment for the goods and/or services purchased by a customer.

The main and sole scope of an invoice is to facilitate payment.

Therefore, an invoice should be a straightforward document requesting payment from customers, without advertising clutters and, or any other unnecessary details and information written or printed on it.

Good credit management practices suggest that suppliers should strive to assist their customers to pay their dues on time by serving them with invoices that are simple to read and understand, describe accurately the products and services purchased by the customer, include all the necessary information and are served to the customer promptly.

Efficient Collection is all about timing

– the sooner you ask for money, the sooner you get paid.

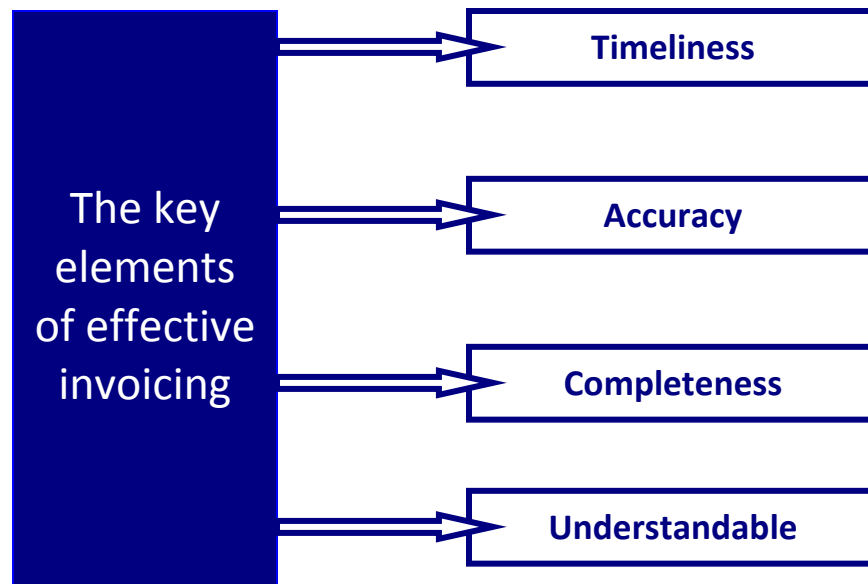


Fig 4.1 Source: Adapted from *The Best Kept Profit Secret*, Flood *et al.*, 2009.

Figure 4.1 shows that suppliers should strive to assist their customers pay their dues on time by serving them with invoices that are simple to read and understand, describe accurately the products and services purchased by the customer, include all the necessary information and are served to the customer promptly.

Figure 4.2 below illustrates the key features of an invoice and states that an invoice should be:

- *properly dated and addressed;*
- *Clear - providing description of goods and delivery address;*
- *Accurate - showing exact quantities, prices and any discounts;*
- *Complete - incorporating payment terms and conditions of sale;*
- *Informative - making reference to the conditions of sale. Example: interest and charges in case of late payment.*

What should an invoice consist of?

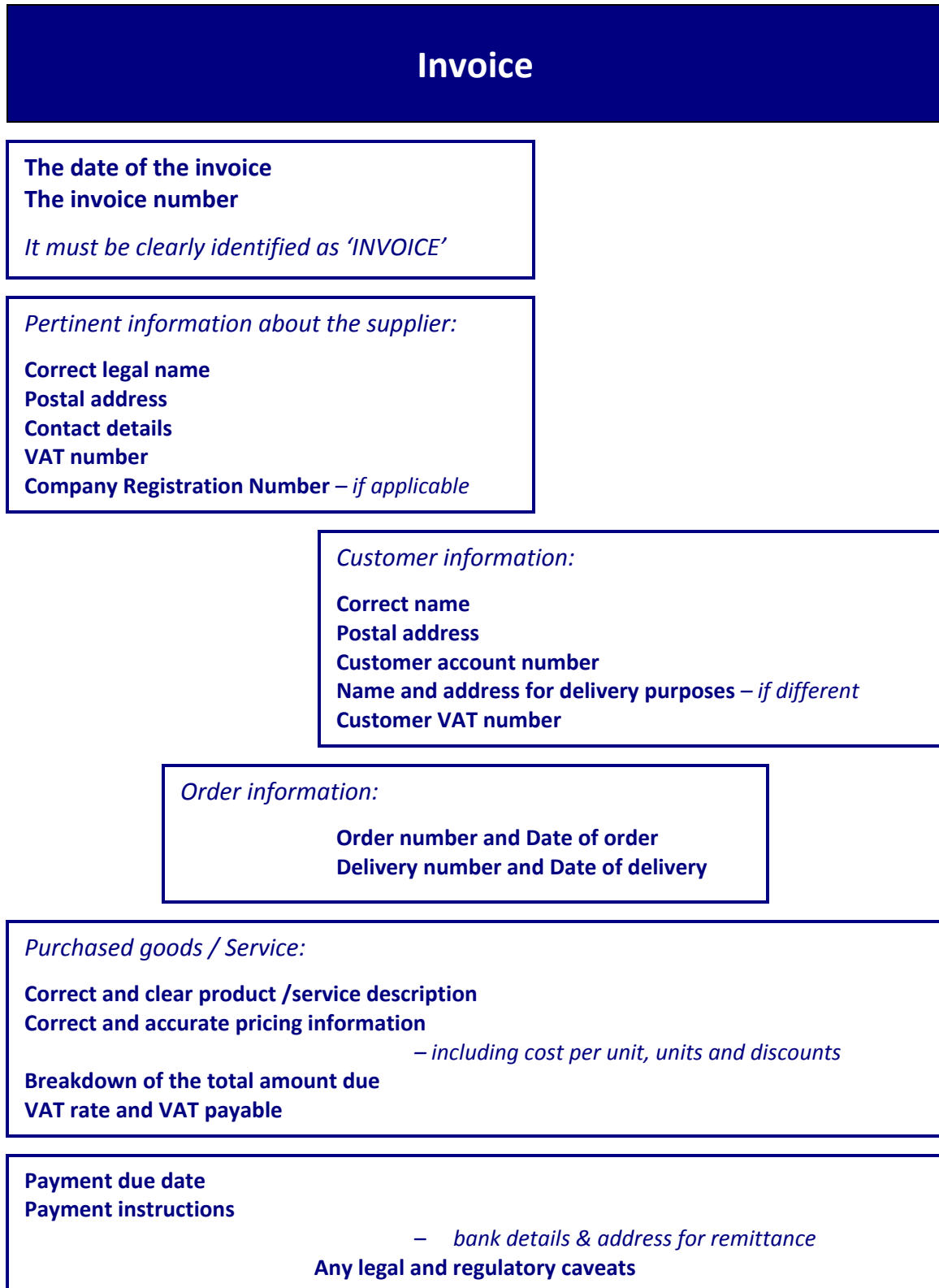


Fig 4.2 The Key features of an Invoice

References

Flood D., Jerrals G., Perez L.E., Sanchez A.W., Tyburski D., *The Best Kept Profit Secret: The Executive's Guide to Transforming a Cost Centre into a Profit Centre*, Profit Innercircle, 2009

Chapter 5

Managing Accounts Receivable

By Josef Busuttill

The primary objective of managing accounts receivable (A/R) should be to sustain long-term customer relationship in order to encourage the existing customers to make repeat purchase orders. Thus, maintaining competitive advantage in the market.

Selling to existing customers helps to keep the cost of doing business low. However, very often, this entails extending credit to existing customers which can be expensive to the supplier, but compared to the cost of finding and selling to new customers, the cost of extending credit to existing customers is often far less costly and less risky.

Sustaining long-term customer relationship by means of A/R management may not be the easiest task in today's competitive and hostile business environment, where cash flow is considered as one of the major problems in doing business. Therefore, business organisations should invest in their work force to train them in the skills necessary to manage A/R in a professional manner.

The Credit Practitioner

Firstly, one has to acknowledge that managing credit is an art in itself. This entails the person responsible for managing credit to be skilled and talented in the field of A/R Management like any other professional, working in other business functions or departments.

Secondly, the credit practitioner should have a sound understanding of managing credit. S/he should be able to act proactively and deploy good credit management practices by analysing and evaluating the financial ability of the customer prior to granting credit; assessing how much credit to allow within the constraints of the available finance; processing credit sales orders efficiently and issuing invoices promptly, monitoring the existing customers and equally important, collecting dues on time.

But to achieve best results, the credit practitioners should possess good interpersonal skills that complement numeracy and literacy. People employed in the credit function should be willing to meet customers and build long-term customer relationship; should be able to integrate with their colleagues and peers; should be able to motivate their

teams; should be IT literate; and above all, should strive to understand and meet customers' expectations, needs and culture which are changing rapidly.

Therefore, credit staff development and training are critical in order to protect this major liquid asset – A/R.

Categorising Existing Customers

It is essential to segment existing customers in terms of their payment behaviour. Categorising customers helps the credit practitioners to get to know the customers, understand clearly the customers' needs, attitudes and behaviour, while focus the limited resources when and where they are effective most.

There may be four categories of existing credit customers.

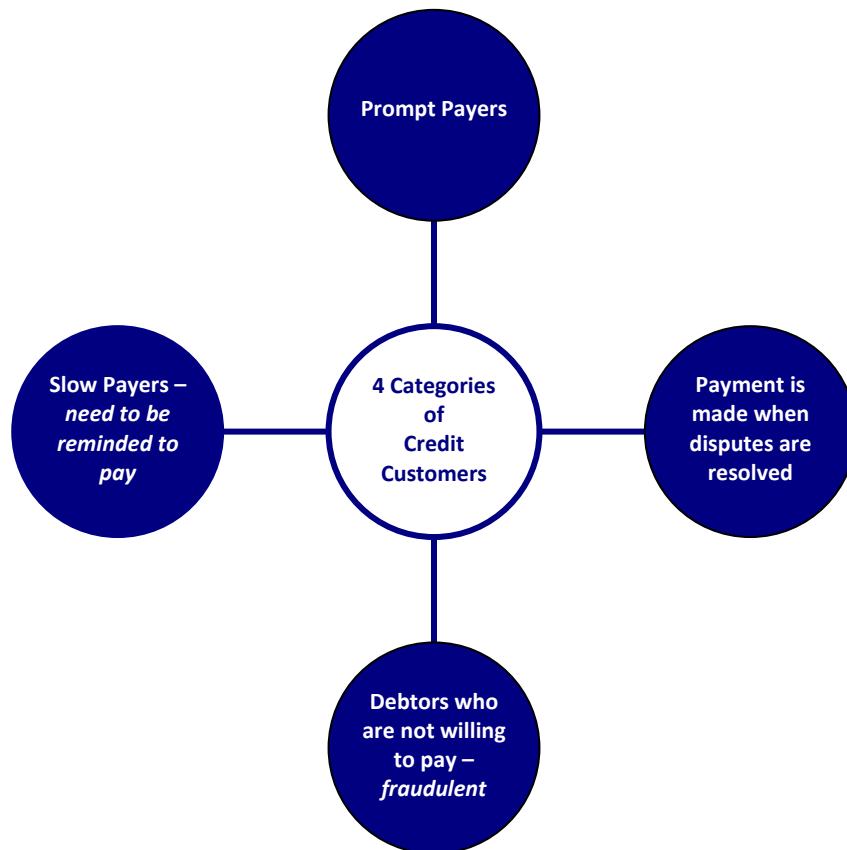


Fig 5.1 Credit Customers Categories

Figure 5.1 shows that there are credit customers who pay on time and some others who extend credit or pay late for a number of reasons.

The credit practitioners should strive to continue providing good customer service and sustain long-term customer relationship with prompt paying customers as these are the most profitable customers, while endeavour to establish the reason/s why other customers pay late.

If the credit practitioners lack to know the reason why customers are paying late, they would not be able to assist their customers and obviously would not get paid!

Managing Past-due Accounts Receivable

In simple terms, there are three types of late payers:

- 1. Those who pay only when reminded;***
- 2. Those who pay only when specific issues or circumstances are resolved;***
- 3. Those who are not cooperative, do not honour agreements, and may even go bust before they pay.***

It is the role of the credit practitioners to establish the reasons why their credit customers are paying late and categorise them according to their respective type. By so doing, they will be able to develop the necessary systems and processes that would help them assist their late paying customers and hence get paid or take proactive actions as deem fit.

Fig 5.2 explains in detail the three types of late paying customers and any proactive actions to take in order to sustain good customer relationship, sound cash flow and ensure long-term profit.

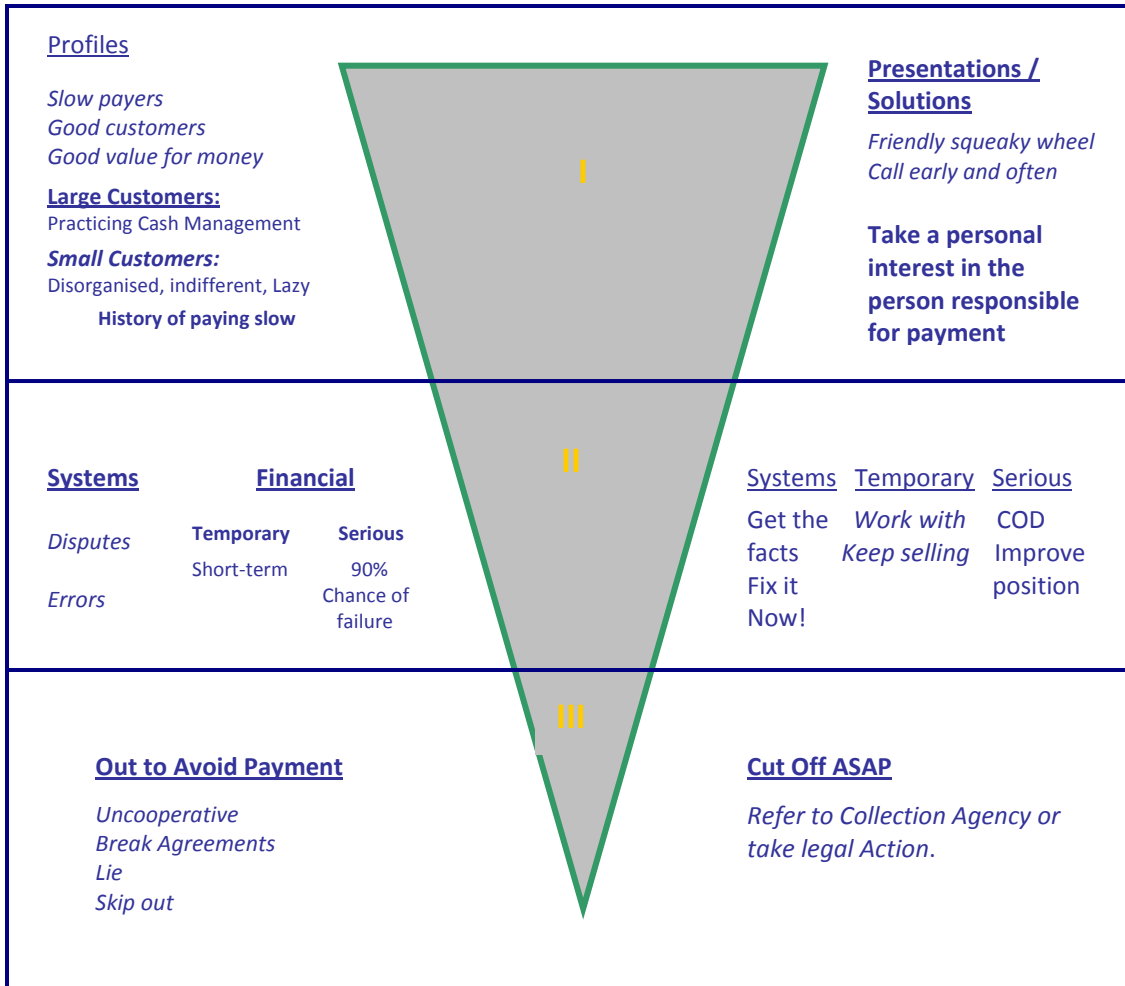


Fig 5.2 Source: Adapted from 'The B2B Inverted Pyramid Past Due Model'©, Abe WalkingBear Sanchez

Overdue customers falling under Type I are:

- a. Customers who may not be well organised or whose account payable function is slow moving.
- b. Customers who may be extending credit from their suppliers as a form of short-term financing.

Type I customers are profitable customers. It is advisable to build good rapport with the persons responsible of payments. Big firms falling under this type of customers may pay their suppliers late to secure sound cash flow of their business. Although this may sound to be unwarranted by suppliers, the latter should acknowledge that these customers are profitable and hence, it is recommended to keep them buying and paying as their contribution may be significant to the profitability of the supplying company.

Overdue customers falling under Type II are:

- a. Customers who don't pay due to disputes with their supplier.
- b. Customers who may not be able to pay by due date but can and will pay in the near future.
- c. Customers who cannot meet their liabilities and will eventually file for bankruptcies.

The credit practitioner should resolve promptly any disputes and misunderstanding with customers. Customers will not pay until disputes are resolved, and rightly so!

Other customers falling under this category may be suffering short-term cash flow difficulties. These customers should be identified and supported continuously. This should be considered by the suppliers as long-term investment in customers. Nevertheless, suppliers are to ensure that customers are not overtrading, which is the recipe of business failure.

Some customers may also have cash flow difficulties due to various reasons that would ultimately lead to business failures and bankruptcies. Some of these reasons may well include overtrading, lack of adequate resources, lack of proper management, and inability to change and meet market demands. In such scenarios, it is recommended to stop selling on credit and continue selling COD. Whenever possible, suppliers may obtain guarantees to secure payment.

Overdue customers falling under Type III are:

- a. Customers who try to avoid payment.
- b. Customers who may be operating fraudulently, with no intention of paying.

These are debtors and not customers. The credit practitioners should do their utmost to manage risk in order to avoid these type III customers. After taking any possible action to recoup money from these customers, it is suggested to take legal action (if such actions are justified) and, or refer them to collection agencies.

Type III customers should be referred to MACM so that other members would know about them and take profitable credit decisions. Exchanging information of these Type III customers would help the business community to stay away from selling on credit to these customers.

Conclusion

Bullivant (2010) contends that well-organised companies should have:

Characteristics of well-organised companies	Top management support for credit and collection procedures
	Data on customers – <i>customer’s details, type of customer, financial status, etc.</i>
	Good procedures for opening accounts, including payment terms
	Immediate contact with new customer to establish personal customer relationship
	Cultivation of key customers to ensure priority payment treatment
	Reliable data sources for fast, easy and cost effective access to credit information – <i>MACM online 24 X 7</i>
	Customer credit rating computerised systems
	Automated credit approvals and efficient processing of ‘OK’ transactions

Fig 5.3 Source: Adapted from Credit Management, Bullivant, 2010

In a nut shell, successful A/R management requires good customer relationship. All credit practitioners should keep in mind that there are other businesses striving to sell similar products and services to their same customers - and customers tend to buy from those with whom they have good business relationship. This also applies when it comes to the completion of the sale – *‘payments for goods and services’*. Past due customers prefer paying those suppliers with whom they have good rapport, so it is a good idea to build bridges with the person in charge of payments.

Once this business relationship is in place, it becomes easier to complete a sale by asking for payment, or establish the reason why payment has not been made as agreed, and overcoming any obstacles for payment would be less laborious and difficult.

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Flood, D., Jerralds G., Perez L.E., Sanchez A.W., Tyburski D., *The Best Kept Profit Secret: The Executive’s Guide to Transforming a Cost Centre into a Profit Centre*, Profit Innercircle, 2009

Chapter 6

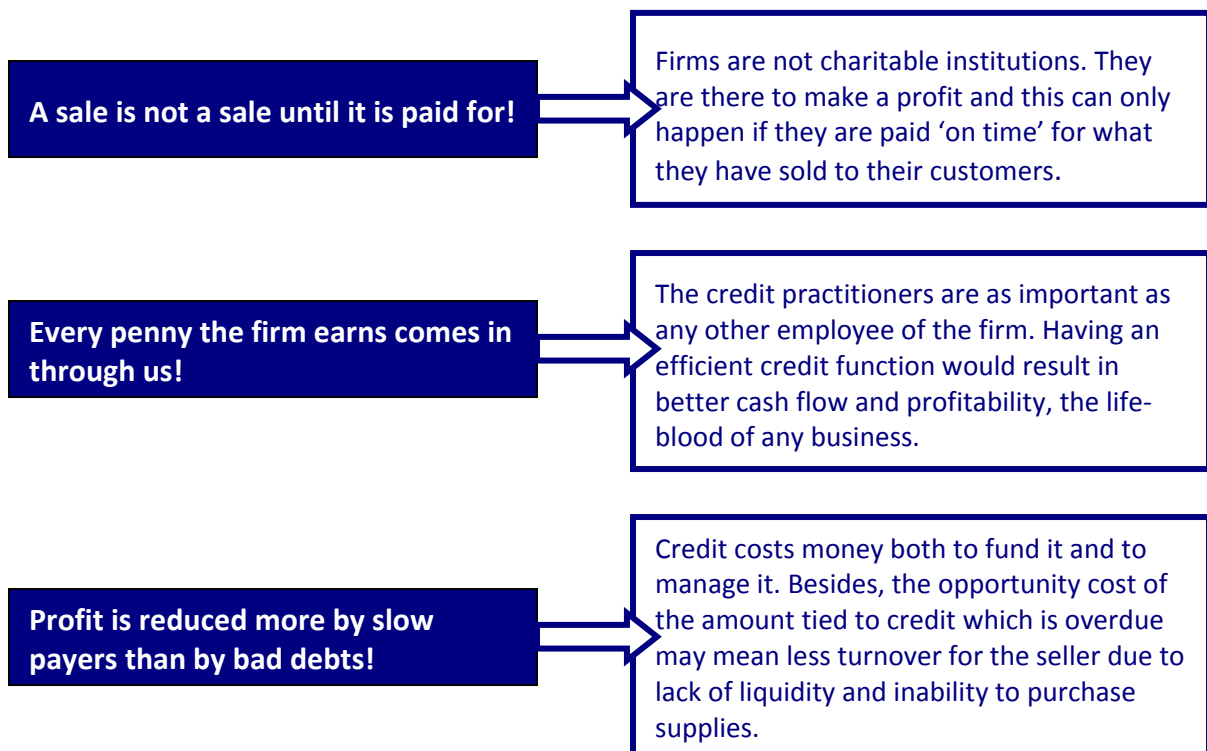
Managing Cash Flow Effectively

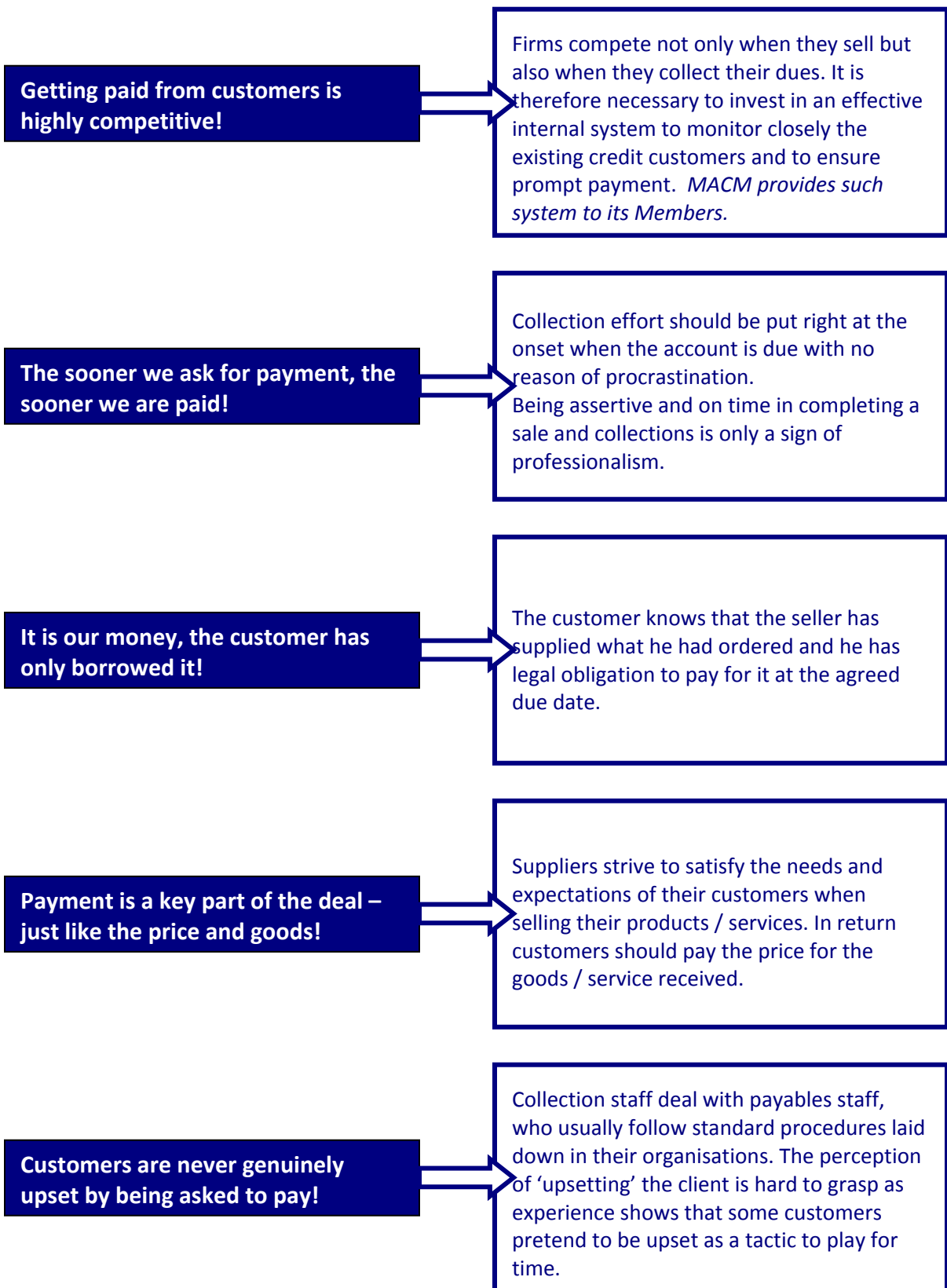
By Josef Busuttil

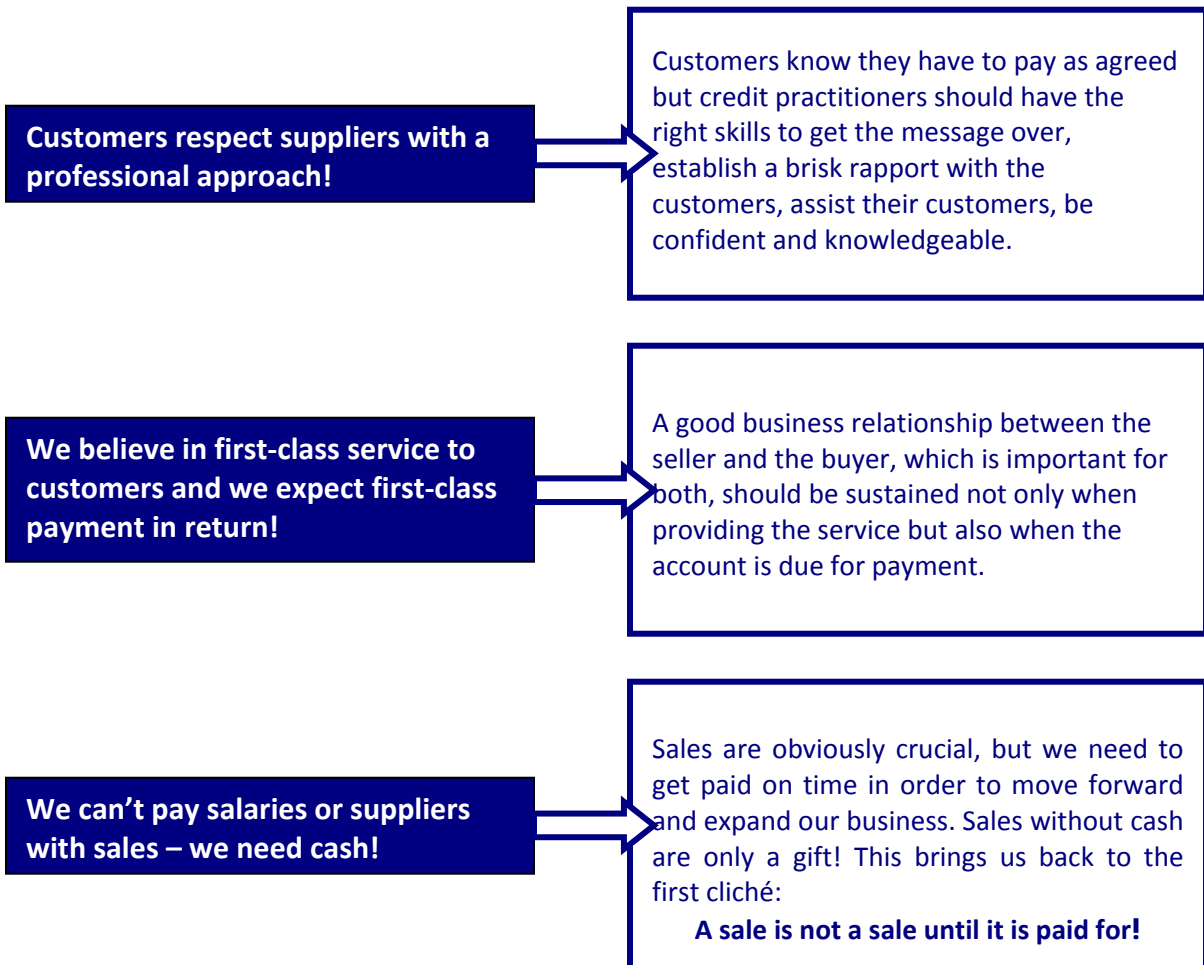
Getting paid from a customer is critical as it completes the sale that had been originally triggered by the sales team. But getting paid on time is not always possible. For many reasons, customers may delay payment and this delay in payment may affect negatively the cash flow and profit of the supplier.

To manage cash flow effectively, suppliers should develop and implement an internal system by which they will get paid from their customers, thus protecting their liquidity and profit. Nevertheless, this system requires skilled and trained staff, as they must possess positive attitude and behaviour when dealing with customers at this critical stage.

Bullivant (2010) refers to a number of clichés that drive the credit practitioners' philosophy and may help them to improve their attitudes and enhance their efficiency. Although these clichés may not be much appreciated by the sales team, they are nonetheless true:







Completing the sales by getting paid from customers requires special people with a committed attitude to succeed in spite of all the obstacles and excuses that they receive from customers. They have to be outgoing persuaders, not introverted methodical people who prefer accounting work.

Effective Methods to Complete the Sales and Manage Cash Flow

In chapter 5, it was elicited that categorising existing customers according to their payment behaviour is important as this exercise assists the credit practitioners to get to know their customers better (*Fig 5.1 refers*). Not knowing why the customer is paying late, the credit practitioner can never be successful to get paid from the customer and thus, completes the sale.

Therefore, the main objective of the credit practitioner trying to get paid from a customer is to ascertain why the account is in arrears.

Before looking at the actual methods used to get paid, which may include letters, phone calls, visits, etc., it is well worth considering the benefits of knowing your customer base and cultivating those accounts which will have major impact on collection performance.

In most businesses, about 20% of customers account for 80% of sales, and cash targets can only be achieved if the large accounts pay reliably on time. Constant contact with these customers is crucial and helps in the collection of monies.

Getting it right first time!

No one should expect to get paid on time if an organisation does not follow good credit management practices. Getting paid on time depends on how effective and efficient the internal processes and procedures are.

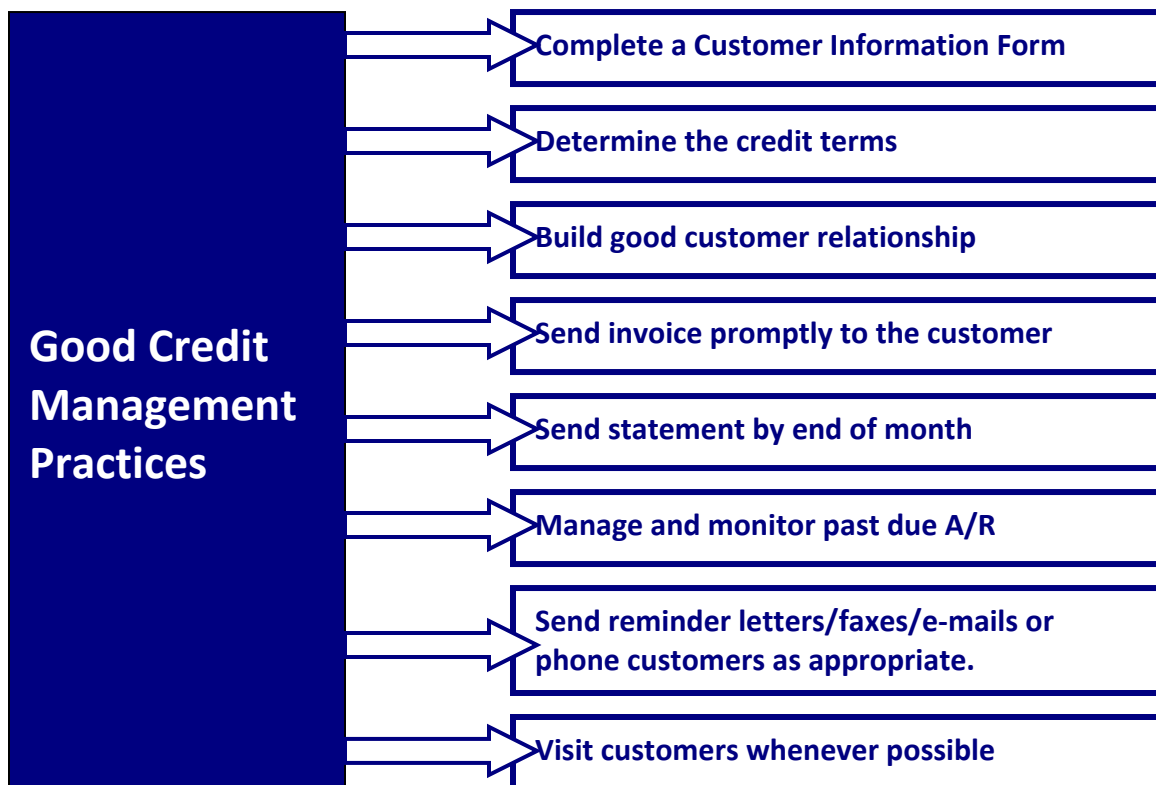


Fig 6.1 Good Credit Management Practices

The previous chapters have already addressed a number of good credit management practices. But it is practical to start with the sending of invoices to customers.

An Invoice

An Invoice should be a simple, effective request for payment document:

- *showing the customer's order number;*
- *showing clearly the date, reference and total;*
- *having a good layout for description of goods;*
- *showing the method of dispatch;*
- *showing clearly the payment terms;*
- *do not include advertising clutters;*
- *do not include technical product information.*

Monthly Statements

Bullivant (2010) contends that statements should be issued as quickly as possible after month-end closing. It should be addressed clearly to a named person and any amount overdue highlighted prominently. The monthly statements should:

- *have eye-catching appearance and layout;*
- *easy for customers to identify and match data;*
- *highlighting overdue items and amount prominently;*
- *encourage customers to return statements, or tear-off section, with their payment to make cash matching & posting much easier.*

Telephone Calls

Telephone calls can be effective only if the credit practitioner is:

Prepared – *The telephone call should be planned carefully;*

Persistent – *The caller must never be deflected;*

Prompt – *The caller must ring when s/he intends to;*

Urgent – *The customer feels that s/ he must pay today;*

Courteous – *Goodwill should be built and company's image enhanced ;*

Tactful – *Comments should be acknowledged;*

Businesslike – *The caller should be friendly but firm;*

Cooperative – *The caller should assist and help the customer;*

Repetitive – *The caller should keep mentioning the amount required.*

**It is advisable, never to associate the customer with the payment default
– the caller should always talk about the money owed!**

**And remember – getting paid may be the completion or the end of one
sale but should also be the start of another!**

Reminder Letters

Very often, letters are used to remind customers to pay when an amount is past due. However, not every letter is effective

- *address it to a named individual;*
- *sign it personally;*
- *show the sender's job title as one with authority;*
- *show telephone & e-mail;*
- *make sure it is accurate;*
- *keep it simple and easy to read;*
- *keep it to one page;*
- *the amount claimed should be prominent;*
- *show how the debt is made up;*
- *Write the letter in good English or Maltese (preferable both languages)*
- *keep the sales person informed of the collection letter.*

There are other methods that can be used to remind customers to pay and manage cash flow. These may include reminders sent by faxes, e-mails, SMSs, and also personal visits.

The sales people can also assist in the collection of dues. Although there may be arguments for and against involving the sales in cash collection, there may be instances when the sales team can be more effective than the credit practitioner, especially if the latter lacks good customer relationship or the credit function lacks adequate human resources.

Other methods that can be used to collect dues are direct debits, cash discounts, charging interest on late payment, stop supplies, and collection agencies. However, using these methods effectively depends on the industry, the product, the level of competition and the relationship with the customer.

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Chapter 7

Achieving and Sustaining Competitive Advantage

By Josef Busuttil

Trading in an environment where products and services are becoming more homogenous with little scope for differentiation, e-commerce and globalisation are making it more difficult to compete, customers are becoming more knowledgeable, and less loyal and in many industries supply is exceeding demand, it is critical to find ways by which a firm attracts more business.

The name of the game in today's business is to achieve and sustain competitive advantage.

But what is Competitive Advantage?

A good definition for Competitive Advantage is:

'The advantage of a firm over its competitors, gained by providing customers better value for money.'

What adds value to customers?

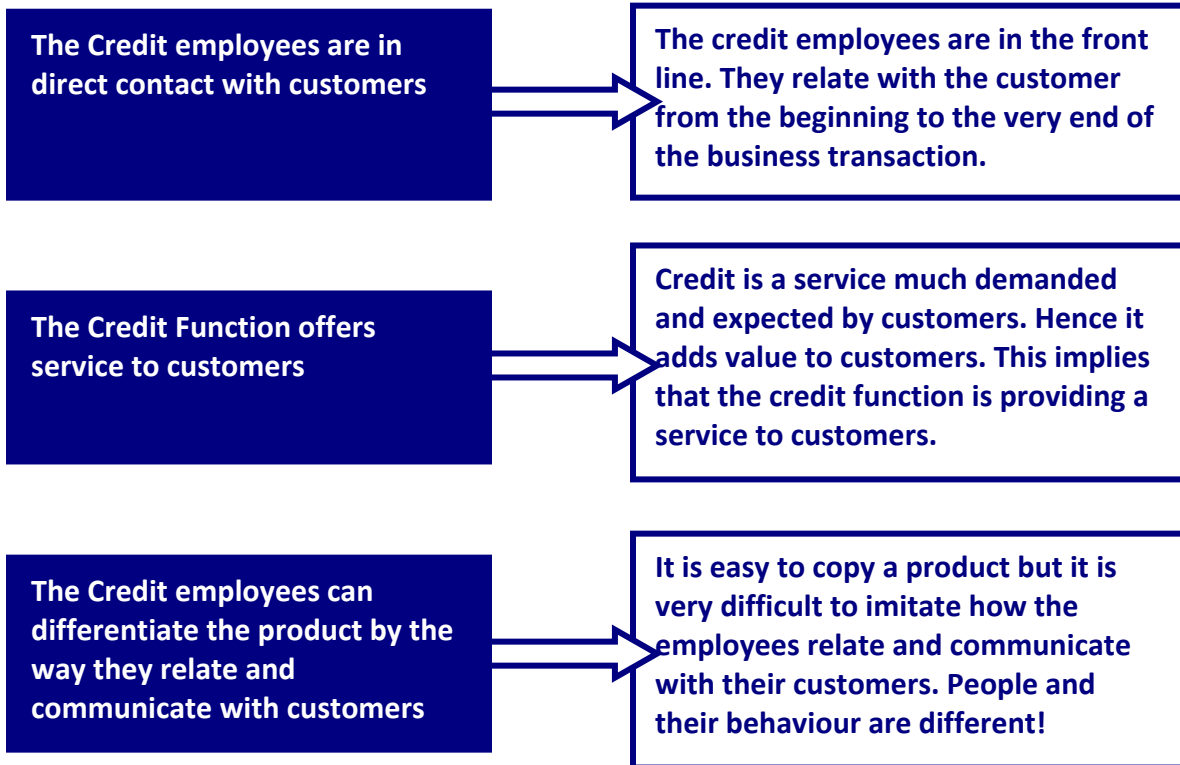
There are a number of factors that add value to customers. However, the main factors include:

- ***Good quality products***
- ***Branding – enhances customers' profile (perception)***
- ***Good customer service***
- ***Good Prices, discounts, credit terms***
- ***others factors depending on product / service***

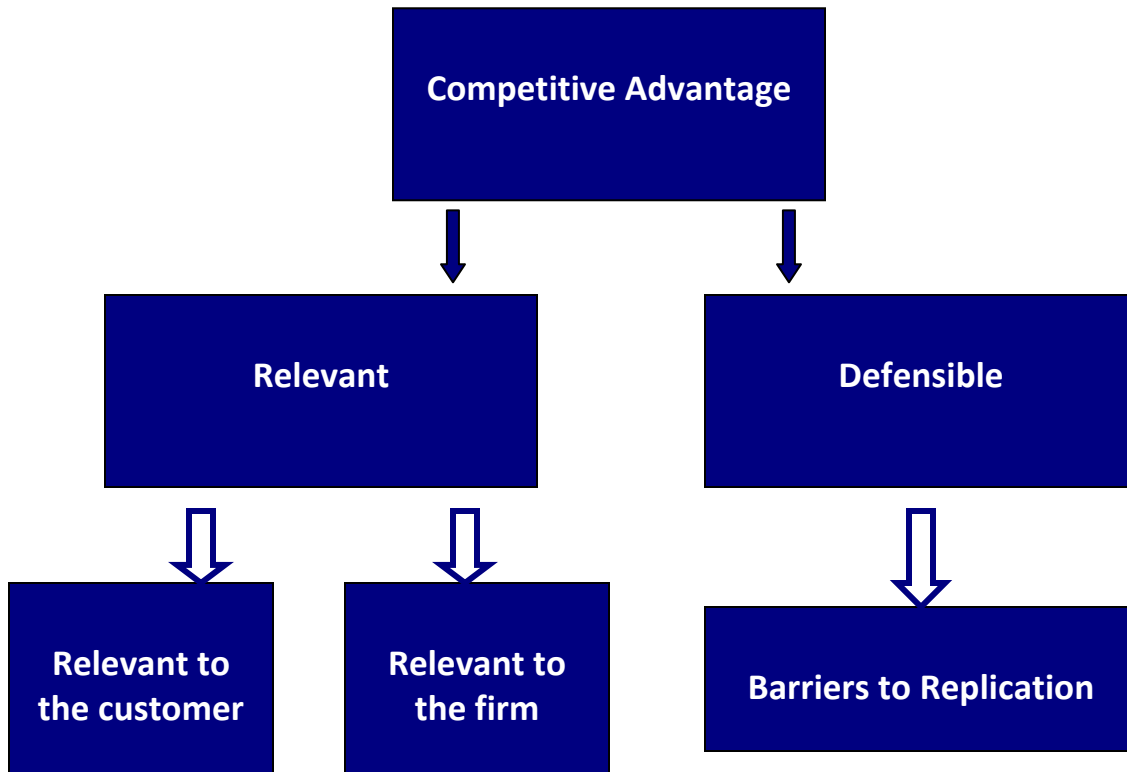
The list of factors, identifying the factors that add value to customers, illustrates that it is the role of every department or business function within a firm to try adding value to customers. This also includes the credit function.

The Role of the Credit Function

The Credit Function has a significant role to play in adding value to customers:



Achieving Competitive Advantage when granting and managing credit



The credit function should strive to perform its duties by being Relevant and Defensible.

1 a. Relevant to the customer by means of ***understanding and meeting customers' needs and expectations.***

1 b. Relevant to the firm by mans of ***being part of the firm's team to make decent profit and ensure sound cash flow.***

2. Defensible - ***A firm cannot sustain competitive advantage if it lacks barriers to replication because its success will simply be duplicated by competitors.***

The credit function is a people's function. The way people communicate and deal with each other is always different.

It is pretty easy for our competitors to replicate our products but it is almost impossible to imitate how to deliver the products to customers in terms of communication and customer service.

Nevertheless, the credit practitioners should be trained and skilled to be efficient and innovative:

- 1. They should be flexible to meet customers' needs and expectations.***
- 2. They should provide good customer service by which they help the firm to create a defensible image and reputation in the eyes of the customers.***

One has to keep in mind that customers have other suppliers who are granting them credit, and these suppliers are also striving not only to sell but to get paid from the same customers.

Therefore, a firm will only sell and get paid if it is preferred from its competitors by its customers – *if the firm has competitive advantage over the other suppliers!*

Chapter 8

Managing the Performance of the Credit Function

By Josef Busuttil

Measuring the performance of a department or a business function ensures constant and continuous improvement in efficiency and effectiveness. It is contended that people could only manage what they measure and therefore, it is critically important to measure what should be managed. This also applies to the credit function.

Why measuring the performance of the credit function?

The primary scope of measuring the performance of the credit function is to secure sound cash flow and long-term profit, whilst sustain long-term competitive advantage in the market in an effective and efficient manner.

- **Effective means doing the right job.**
- **Efficient means doing the job right**

Therefore, good performance measurement identifies problems before they become significant, hence corrective actions would be taken in a proactive manner to achieve the objectives set for the credit function.

Fig 7.1 illustrates the process of measuring the performance of the credit function effectively and efficiently.

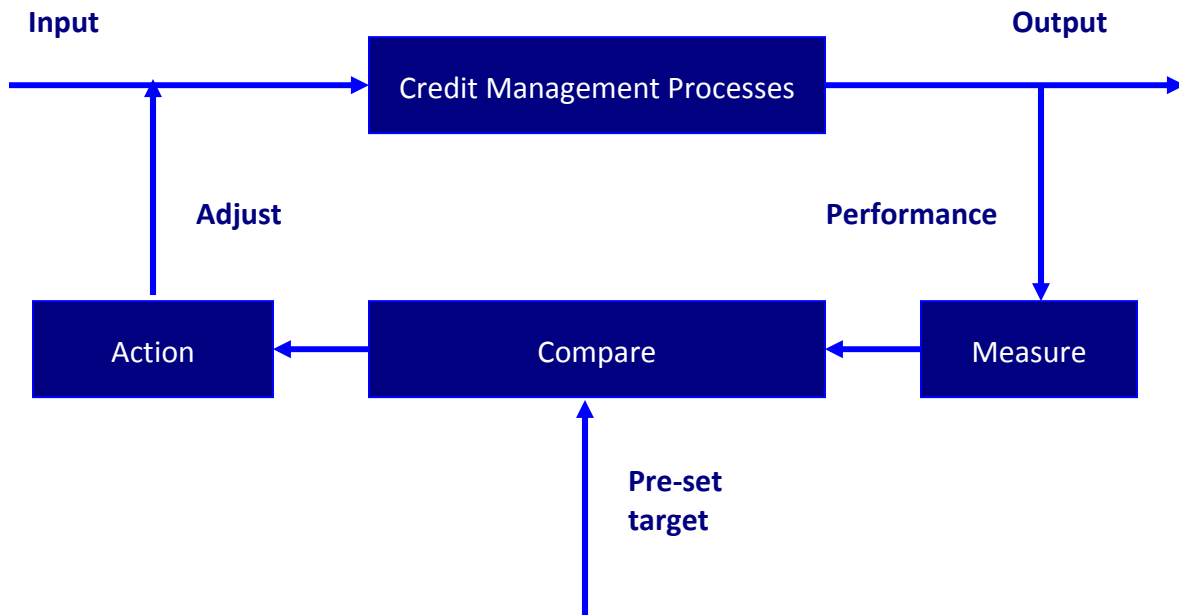


Fig 7.1 Proactive Performance Measurement, Adapted from: Drummond *et al.* (2000)

Fig 7.1 demonstrates that good performance measurement helps the credit practitioner to establish the three strategic steps:

1. *Where is the credit function now;*
2. *Where the credit function aspires to be;*
3. *How to get there.*

Unfortunately, many firms focus their performance measuring systems to establish where they are now, ignoring any future aspirations and actions. But it is clear that the business world is changing and sometimes, it is changing rapidly and this would entail planning future actions to achieve pre-set objectives.

What to measure?

The “Manage what is measured” concept has already been mentioned in the introduction of this Module. This implies identifying what should the credit function manage and hence measure.

Therefore, the credit function should focus to manage and hence measure its four major components:

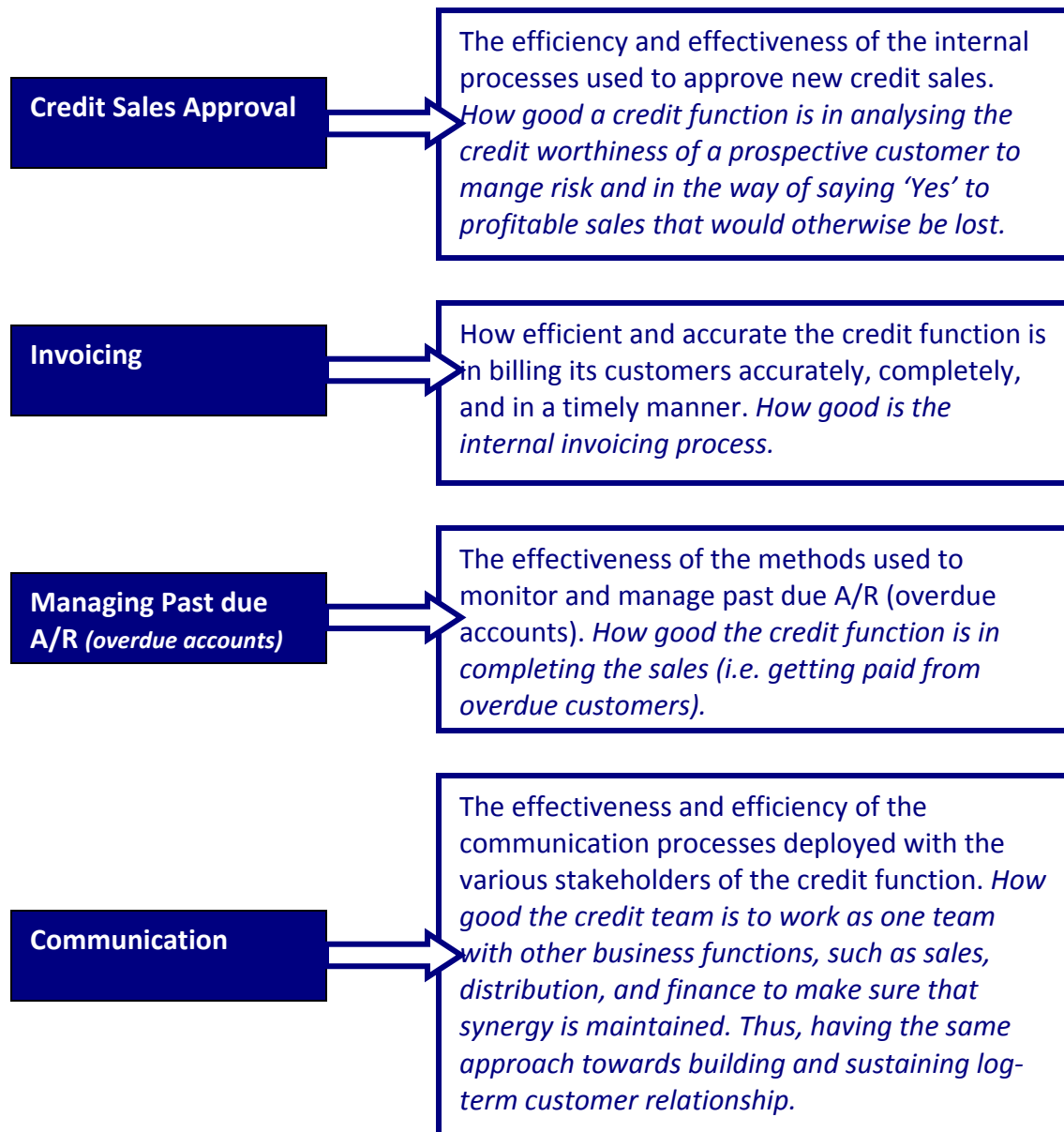


Fig 7.2 Measuring the four major components of the credit function

Measuring and managing the four major components of the credit function would ultimately contribute to achieve the corporate goals, objectives and strategy.

Methods used to Measure the Performance of the Credit Function

The traditional and most commonly used method is the DSO method. DSO stands for Days Sales Outstanding. The DSO figure represents the average time taken by credit customers in settling their invoices for the goods and services provided.

DSO is calculated as follows:

Trade Debtors x 365

Sales

Theunissen *et al.*, (2010) contend that there are indeed some critical elements to consider when using DSO to measure the performance of the credit function:

- Not specific - preventive as well as collection aspects are involved;
- Misleading in case of seasonal or evolving sales figures;
- Payment conditions and behavior of customers may vary with product group, geography, level of competition, etc.
- Does not offer a good insight into reasons of changes;
- Can be influenced by disputes;
- Does not consider the profitability of the customer relationship.

Another commonly used ratio, is the Bad Debts to Sales Ratio. This is calculated:

$$\text{Bad debt to sales} = \frac{\text{Bad debt}}{\text{Sales volume of the reference period}} \times 100$$

It is suggested to relate the bad debt to the sales volume of the period when it was invoiced, and not to the sales volume of the period when the bad debt was recognised. This ratio also has its limitations.

- It is not a proactive measuring tool;
- It takes into consideration old credit sales;
- It gives negative connotations to the credit function.

One reason, why this ratio may be valid is to learn from experience and to identify the reason for bad debt.

To measure the performance of the credit function in relation to Credit Sales Approval, the Approved Credit Sales Ratio may be used:

$$\text{Approved Credit \%} = \frac{\text{Approved Credit}}{\text{Total Number of Credit Applications}} \times 100$$

This ratio provides proof (or otherwise) that the credit function is not the function trying to prohibit sales but the function promoting profitable sales. When using this ratio, it is recommended to indicate the declined credit application forms and to point out the reason/s why the credit application forms were declined.

The traditional systems used to measure the performance of the credit function are often linked to financial data. But this data do not include other factors critical to the success of the credit function and the overall success of the business organisation, such as customer relationship, customer disputes, customer satisfaction, repeat credit sales and efficient service. Nonetheless, measuring the performance of the credit function should also focus on future performance in line with the corporate vision and strategy.

For this reason, Kaplan and Norton developed what they called the '**Balanced Scorecard**'.

The balanced scorecard considers four important perspectives:

- **Financial perspective:** corresponds to the traditional measures of corporate performance – *emphasis are very often on the shareholders' interest.*
- **Customer perspective:** relates to the relationship with customers – *good customer relationship is a key element for the future development of the firm.*
- **Internal processes:** concerns the key processes and procedures deployed by the credit function in its day-to-day duties – *this measures the effectiveness and efficiency of the business function.*
- **Learning and growth:** focuses on the future. The readiness of the employees to adapt to changes in order to meet the ever changing customers' needs and expectations - *This entails staff development and skills building.*

To develop a balanced scorecard by which the performance of the credit function will be measured, CSF – critical success factors should be defined for each and every dimension that requires to be measured.

Once the CSF are defined, the credit practitioner should establish the KPIs – Key Performance Indicators for each corresponding CSF.

One has to keep in mind that the defined CSFs for the Balanced Scorecard relate to the corporate scope and objectives. i.e. achieve the corporate strategies. Therefore, one should not stick strictly to the four perspectives as defined by Kaplan and Norton, as in some cases some perspectives may well be less important. Hence, defining the CSFs is the key element for an effective Balanced Scorecard.

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Chapter 9

Know Your Debtor

By Dr. Louis Bianchi B.A., LL.D.

Before proceeding to review the various judicial methods one can resort to, in order to obtain a judgement against one's debtor, we feel that it is necessary to elaborate to some extent on the process of credit management as a whole.

We have titled this article as "Know your Debtor" and this is exactly what we mean by this. Over the years, we have observed that many traders fail to have an insight into the person with whom they are trading and to whom they are affording credit facilities. Failure to have a proper insight into one's debtor can be very costly. We feel that it is absolutely essential that each and every trader knows who he is dealing with and to whom he is giving credit.

We cannot but emphasise that the trader should have the very basic information relating to the person he is affording credit. He should have not only his name, surname, ID card number (preferably a copy of the ID), address (both business and residential) if the debtor is going to be an individual, but also such details as to his bank and the exact nature of his business. Details of the cheques given by the debtor should also be kept as this will indicate to some extent how the debtor is meeting his obligations and how such payments are being effected. The same rules apply in the case of a corporate debtor. Details of how long he has been in business is also important. A copy of the abridged accounts of the company can be obtained in some cases from the Malta Financial Services Authority (MFSA). It is also important to verify whether the Debtor is filing his annual returns and other relevant documentation to MFSA as this will show the seriousness of his business.

Make sure you obtain the names of the person in his company responsible for receiving deliveries, as these will come in useful should you need to go to court. Make sure that your Delivery Notes are correct and duly signed by the person receiving the goods. It may also be useful to try to obtain names of other traders with whom your prospective debtor trades. You can also try to obtain some sort of credit reference from his Bankers. Ask the prospective trader if he objects to you contacting his Bankers and whether he is willing to give you written authorisation. If the prospective trader does not have a bank account, ask why, as in today's commercial world this is an unusual situation – be wary of traders who give you post dated cheques.

In Malta, unlike larger countries, it is relatively easy to obtain information on the person you intend doing business with; hence it is essential that whoever is giving credit facilities does his homework properly beforehand. Selling blindly to any individual, just for the sake of making a sale can be very costly indeed!

The facilities offered by the Malta Association of Credit Management's website and other internet websites offer a wealth of information and these should be accessed and information sought before granting credit facilities. Check to see that the prospective purchaser has any pending lawsuits in court. See whether or not any Court Warrants were issued against him. If you do not subscribe to any Credit Reference Agency your lawyer should help you in this regard..

Try to obtain from the person you are giving credit to, as much information as possible, this will help you recover your money quickly and efficiently. If you need to go to court this information will also help you and your lawyer. Be wary of prospective purchaser who is reluctant to freely give you information about himself. Do not be shy to ask questions, after all you are the one who is granting the credit facility.

Test the person you intend giving credit to, by starting off with small sales. Once you have establish a trading pattern with the debtor and he has started to pay regularly and on due date, proceed to increase your credit sales but always remain vigilant especially if payments start to be missed or lower amounts than those due are paid. Make sure you do not accept cheques from him which he has received from third parties and which he endorses in your favour. Such cheques only serve to complicate matters, especially if they are not honoured. Do not accept post dated cheques, as these only serve to delay further the problem of non payment and there is no guarantee that when they fall due they will be honoured by the debtor's bank.

If your debtor starts to miss payments and falls behind in his payments it is important that you cease giving him further credit facilities. You are to enquire with him why he has fallen behind and whether there are any problems with the goods or services provided by you. Whenever possible ensure that apart from speaking to him, you exchange correspondence as this may come in useful in court should you need to proceed against him. Be aware that in many cases, debtors who cannot honour their obligations will use every trick in the book to try to avoid and / or delay payment, and this is why it is extremely important that you keep proper and simple accounts. Just sending a monthly statement does not achieve much and it does not even interrupt prescription. If need be, provide your debtor with a detailed statement showing the amounts due by way of deliveries made by you and the amounts paid by him. Once you and your debtor have agreed that the amount claimed by you represents the correct amount get him to sign a statement to this effect.

If your debtor still has in his possession items which you delivered to him, but he has still not paid, you may consider taking these back. In this way you will reduce the amount due by him.

Only after you have failed to obtain payment or repossession from your debtor by approaching him and trying your best to get him to pay are you to contact your legal advisor.

The procedure which will normally be followed by your lawyer is that of sending a legal letter to your debtor requesting payment within a stipulated time. If payment is not effected your lawyer may then proceed to send a judicial letter or he or she will proceed with the appropriate judicial action to obtain a court judgement against your debtor. This may be accompanied with a precautionary court warrant against the debtor

There are a number of ways in which you can obtain a court judgement against your debtor the cost and the efficiency of which varies depending on the method you use.

We shall briefly review hereunder the various methods which can be used to collect the amount due to you.

1. Judicial letter in terms of Section 166a.
2. Judicial letter in terms of Section 253
3. Filing of a Talba in the Tribunal ghal Talbiet Zghar
4. Filing of a Rikors before the Magistrates Courts
5. Filing of a Rikors before the Civil Courts

Judicial letter in terms of Section 166a

This procedure is a relatively inexpensive procedure, but it has a number of disadvantages in that if you have difficulty in notifying your debtor you cannot opt for publication. What is more, if your debtor contests your claim, you will then have to file a lawsuit.

It is also to be noted that:-

Amount due must not exceed € 23293.73

Debt must be certain, liquid and due

Debtor may contest in whole or in part your claim within thirty (30) days from receipt of the judicial letter in which case you will have to file a lawsuit. . If the debtor does not contest the judicial letter within the stipulated time the judgement will be final and there will lie no appeal

After obtaining the judgement you may proceed with the executive warrants.

Judicial letter in terms of Section 253

This procedure which is relatively inexpensive can only be used for amount which are due in terms of Bills of Exchange (Kambjala) which have fallen due and have remained unpaid.

It is also to be noted:-

The amount that may be claimed in the judicial letter is unlimited
Together with this judicial letter you may file a precautionary warrant.
Debtor may contest your claim within twenty (20) days from receipt of the judicial letter for grave and valid reasons in which case you will have to file a lawsuit. If the debtor does not contest the judicial letter within the stipulated time the judgement will be final and there will lie no appeal.

If you fail to notify your debtor you can opt for publication

Filing of a Talba in the Tribunal ghal Talbiet Zghar

This procedure is relatively inexpensive and your claim is heard before the court. You may produce witness in support of your claim

Amount due must not exceed € 3493.50

The debtor may contest your claim

You can issue precautionary warrants to safeguard your credit

Both you and the Debtor may appeal the judgement on a point of law

Filing of a Rikors before the Magistrates Courts

The cost of filing the Rikors depends on the amount being claimed by you. The claim will be heard by a Magistrate and you will be allowed to produce witnesses in support of your claim

The amount due must be in excess of € 3493.50 and not more than € 11646.87

The Debtor may contest your claim

You can issue precautionary warrants to safeguard your credit

Both you and the Debtor may appeal the judgement on any grounds

Filing of a Rikors before the Civil Courts

The cost of filing the Rikors depends on the amount being claimed by you. The claim will be heard by a Judge and you will be allowed to produce witnesses in support of your claim

The amount due must be in excess of € 11646.87

The Debtor may contest your claim

You can issue precautionary warrants to safeguard your credit

Both you and the Debtor may appeal the judgement on any grounds

Once you have obtained your judgement and there has been no appeal, your lawyer can then proceed, in the absence of payment by the debtor after the judgement , with the appropriate warrant

The above proceedings are all measures which you can take against your debtor. Once you have obtained a successful judgment you can then proceed to issue the relevant executive warrants against the debtor for the collection of the amount due to you.

Chapter 10

Factoring: Guidelines to secure your sales and to improve your Cash flow

By Mediterranean Factoring, FIMBank p.l.c.

1. Introduction

In the current economic climate, cash flow is the top concern for any business. Factoring is a relatively simple and unique package of value-added services designed to provide an alternative financial solution that allows your business to be more competitive by improving your cash flow and securing your sales on open account terms.

One typical factoring offer may include all the following services:

- Immediate cash advance against receivables
- Collection of receivables and debtors' current accounts management;
- Credit Risk protection based on the positive investigation on the buyers leading to up to 100% protection against bad debts and protracted default.

Considering your specific needs, the factoring company (the Factor) will be able to set up the most adequate package of services and to structure tailor made solutions when addressing specific situations or requirements.

Depending on the situation and services involved, factoring can be classified in different types:

- **Non-Recourse or Recourse**, depending on whether or not the Factor assumes the credit risk (up to 100%);

client benefits

features	benefits
collection of receivables	reducing HR cost customised professional collection
credit risk protection	bad debt protection (up to 100%) non-recourse = off seller's B/S payment up to 180 days past due date
financing	up to 90% payment on documents no link to company's assets no collateral / security finance linked to volume of sales
credit management	debtor's pre-assessment debtor's on-going credit monitoring
open account terms	more competitive commercial terms buyer friendly

- **Domestic or International**, depending on whether or not the seller and the buyer are based in the same country;
- **Traditional or Reverse**, whether focused on the sales side, on the receivables, or on the purchase side (Supply Chain Finance, Confirming, ...);
- **Disclosed or Undisclosed**, depending on whether or not the factoring facility is disclosed to the buyer.

2. Contract Set Up

When setting up a factoring contract, the following criteria are assessed by the Factor:

- **Company Assessment** – this includes a review of the industry, market, buyers’ portfolio, invoicing and collection procedures, financials, ...
- **Terms of Payment** – factoring applies when terms of payment are on open account. Normally acceptable terms may go up to 150 days from the invoice date;
- **Dilution** – any non-cash reduction to a receivable balance (returns, discounts, rebates, ...)
- **Sales Turnover per Client and Global** – the sales turnover levels together with the terms of payment are crucial to determine the appropriate credit and funding limits for each buyer and to set-up the global funding limit.

Following such an assessment, the Factor prepares the factoring contract specifying these main conditions:

- **Credit or Funding Limits Approved** – this refers to the maximum amount of outstanding debts which a Factor is prepared to approve for credit cover protection or funding in respect to a specific buyer. This is based on the credit assessment of each buyer
- **Global Funding Limit** – this is the maximum total funding which a Factor is prepared to approve under the factoring contract
- **Percentage of Advancement** – this is a percentage of the face value of the receivables that the Factor will be able to fund (normally 80 -90%).

when factoring applies?

- **open account sales** [contractual relationship; up to 150 days credit terms]
- **continuous relationship**
- **clear / clean performance** [no sale return, no consignment, no counter sales, no performance claims]
- **clear sales title & enforceable receivables** [no legal constraints, clear ownership of the goods]
- **spread of buyers** [“not all eggs in the basket”]

- **Factoring Charges** – refers to the aggregate of the Factor’s remuneration for the services provided under the factoring contract:
 - a. **Factoring Commission** – the charge made by the Factor for administering the sales ledger, debt collection and credit insurance. This is a percentage of the total value of the invoices;
 - b. **Interests** – the finance cost calculated on the aggregated debit balances in the Funds in Use Account, generally over the daily balances and debited on the last day of each month;
 - c. **Other Fees** – these are additional fees, depending on the factoring facility structure (set up fee, renewal fee, buyers’ credit checking fees,..).

3. Contract Running

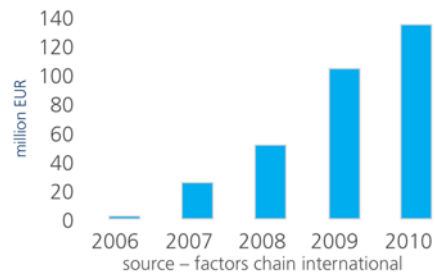
Once the factoring contract is issued, the following activities are carried out to commence the factoring process:

- **Account Opening** – as part of Know Your Customer procedures and due diligence, a bank account is opened and used by the Factor to credit your account based on the approved factoring contract;
- **Contract Signed** – once the contract is issued and signed by all parties, the facility is booked on the factoring system in accordance with the agreed conditions;
- **Account Manager** – a Factor official who acts as the primary business contact for your needs and to ensure that any issues are dealt with in an efficient manner;
- **Introductory Letters** – the letter is issued on your company’s letterhead to notify your clients/buyers that invoices have been assigned to the Factor and that therefore payments should be made directly to the Factor;
- **Assignments** – the assignment of the invoices resulting from the supply of the goods or services to the corporate buyers included on the factoring agreement. The main documents requested are the following:
 - a. **Assignment form** – this document is issued on your company’s letterhead and is signed as notification of assignment of receivables. It includes details of invoices such as the invoice number, the invoice date, credit terms, the invoice amount, as well the name and the code of the buyer;

b. Supporting Documentation – normally, invoice copies will be required, as well as delivery/transport documents which provide evidence of shipment and purchase orders.

- **Call Account** – this refers to your bank current account opened at the account opening stage and used by the Factor to disburse funds in accordance to the factoring contract;
- **Funds in Use Account:** this is a dedicated factoring account which is similar to an “overdraft account” under which interest is calculated on the daily balances of funds advanced under the factoring facility.

evolution of the maltese market



4. Monitoring & Reports

Once the factoring contract is running, you would normally be able to monitor your sales portfolio through a Factoring Web Access service. This is an online service that allows you to carry out the following at your convenience:

- View your factoring account details in real time
- Generate reports
- Upload invoices

Periodical meetings and reviews are conducted by the Factor together with you to monitor the progress of the factoring contract and in order to adjust it to any new circumstances or needs, thus enabling you to adapt the facility accordingly to the evolution of your business.

5. International Factoring

International factoring is normally handled on a Two-Factor System basis, with the Export Factor handling the exports through the assignments of the Sellers and the Import Factor handling the credit protection and the collections in the buyers’ countries, using its expertise and knowledge of the local buyers’ market.

Benefits to exporters:

- Increased sales in foreign markets by offering competitive terms of sale
- Pre-screening for credit qualifications of the buyers through specialists in each market
- Protection against credit losses on foreign buyers for up to 100%

- Accelerated cash flow through faster collections through specialists in each market
- Liquidity to boost working capital
- Enhanced borrowing potential and an opportunity to make use of supplier discounts

The world's factoring volume reached EUR1.284 billion in 2009, with EUR165 billion corresponding to cross-border business (FCI - Factors Chain International).

6. Improved Credit Protection

Trade credit insurance insures suppliers against the risk of non-payment of goods or services by their buyers. The insurance covers non-payment as a result of insolvency of the buyer or non-payment after an agreed period after the invoices' due date. Non-recourse factoring offers some advantages when compared with a normal credit insurance policy:

- Maximum Liability – normally does not exist;
- Credit Cover Percentage – up to 100%;
- Waiting Period – generally 120 days in export factoring;
- Price – Factor's economies of scale are shared for the benefit of all parties;
- Policy Management – you do not have to worry about the insurance policy management, its administrative burden and overhead costs.

7. Conclusion

The factoring market is growing fast and Malta's volumes are increasing year on year. There is still ample room to grow from current volumes on the domestic side, especially through progressive knowledge, education and understanding of the factoring product and its benefits by local entrepreneurs. Factoring can play an important role in putting at the forefront Malta's excellent business environment, EU membership, and strategic location for international trading. If one sees Malta as a potential hub for international business to and from Europe, on an open account basis, then factoring's prospects are much more interesting.