Credit Management for SMEs

How to avoid late payments, boost cashflow and accelerate growth

A White Paper by Pegasus Software

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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.

Cashflow: a definition

Cashflow, 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 by BACS, small and medium-sized companies[1] are owed nearly £14bn as a result of late payments, a figure which has come down from a peak of £30.3bn in 2013, but still leaves SMEs exposed to high levels of risk. One in five SMEs said that if the amount they were owed was between £20,000 and £50,000, they would risk bankruptcy, and according to the Federation of Small Businesses 50,000 UK businesses are forced to close each year as a result of late payments.

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, threatening job creation and stifling innovation.

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. At the heart of the Government's Small Business, Enterprise and Employment Act is The Prompt Payment Code, which came into force in full in 2017, and aims to encourage best practice between organisations and their suppliers, and increase transparency around payment practices.

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), the code means that large British companies and large limited liability partnerships must report on their payment performance twice a year against clearly defined payment terms.

This includes publishing detailed statistics on the time it takes to pay invoices, as well as the proportion of invoices paid late and average time to pay. Relevant businesses must also describe their terms, dispute processes and supporting services such as e-invoicing.

The aim is that by exposing poor payment behaviour and highlighting best practice, the industry will be able to elevate standards and shrink the late payment problem. It also means that SMEs can use the information to make informed decisions on who to trade with and negotiate fairer terms.

But with 16% of companies reporting that they struggle to pay staff on time, the majority of firms spending almost four hours a week chasing late payments and 12% claiming to employ a dedicated role focused on the pursuit of debt according to BACS, it seems that the Code in isolation is by no means a silver bullet.

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 cashflow is crucial. It's amazing how many organisations don't create profit and cashflow 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.

[1] Any company which meets any two of the following three criteria: annual turnover above £36m, total balance sheet of more that £18 million or more than 250 employees

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.

10 tips for improved cash flow

1) Where possible, capitalise on financing options such as loans, to help mitigate against the impact of cashflow 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 in some cases it could actually impact the bottom line in a positive way.
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 cashflow 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 cashflow 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 £14bn 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.

Pegasus Software Orion House, Orion Way, Kettering NN15 6PE
T: 0800 919 704 **T**: +44 (0)1536 495000
F: +44 (0)1536 495001 **E**: info@pegasus.co.uk
www.pegasus.co.uk