

Get ready for the Credit Crunch!

By Josef Busuttil
Director General
Malta Association of Credit Management
e-mail: jbusuttil@macm.org.mt
www.macm.org.mt

We have been hearing news about the international credit crunch for the last six months. International household branded companies and banks went bust. Millions of people were made redundant, others worked for reduced hours or were forced to take long leave without pay.

Governments used people's money to help big companies recover from their dire finances or rather their cash flow, if this was of any aid. Head of states met to discuss the way forward for their countries' well being. The effect of it all is that this crisis has left the consumer with less spending power and psychologically cautious. Therefore, demands for products and services decreased considerably.

Although the effect on our banks has been minimal, thanks to their competent management and the diligent local regulator, our country may be effected when it comes to exports.

People are not spending and consequentially, foreign companies are not making regular or the usual amount of purchasing orders from the Maltese companies. Additionally, our tourist industry may also be effected, as less people may be willing to travel. Our five-star hotel industry has already been feeling this lack of demand. They are arguing that foreign companies are less willing to pay for overseas conferences. One should keep in mind that one Euro less spent by tourists in our country would have a negative impact on the Maltese circular flow of income as the injection of money from abroad would be reduced. As a result, the economy at large would be effected.

This economic crisis has also led foreign banks and companies to rationalise their credit facilities. This may also impact Maltese banks and businesses as the latter would not find foreign financial assistance as they used to obtain from their principals in the past.

Credit is like a chain – one ring attached to another, and it has a domino effect. If the local suppliers lack adequate cash flow due to credit rationing, they would not be able to grant credit to their customers.

The light at the end of the tunnel to this situation may well be that to reorganising the credit management processes and procedures in order to minimise costs – in other words to being more effective and efficient in the granting and managing of credit. However, this may entail a change in mentality.

In a study that I had conducted within the Maltese business community, it resulted that:

- The majority of the newly established businesses do not make use of information available from credit agencies, such as the Malta Association of Credit Management (MACM) or purchase credit rating reports before granting credit to their trade customers. Nevertheless, this is practiced by the major and well established companies;
- The majority of local businesses tend to sell their products and services on credit without using proper Credit Application Form, stating clearly the conditions of sale and credit terms. This would easily result in misunderstanding or misinterpreting of the conditions of sale;
- More often than not, small companies grant credit based solely on the gut feeling of the business owner/s. No proper credit worthiness analysis is being performed to minimise the risk associated with credit;
- Some business owners do not have the necessary knowledge and business acumen that is required to manage the business in a profitable manner;
- The absolute majority of local businesses do not have a written credit policy and they argue that their A/R depend on the economy and has nothing to do with the internal procedures;
- Receivables depend on one person and it is effected by the person's commitment to manage and control A/R;
- The general perception of local businesses is that customers may be offended if they are asked to pay on time.

The result of my study is consistent with a research undertaken by Grablowsky in 1976 among family-owned businesses, a business scenario similar to the Maltese business community. Grablowsky has identified similar mismanagement practices in Accounts Receivables management.

In view of this result, the Malta Association of Credit Management has developed a Credit Management Wallchart to help businesses adopt an effective and efficient procedure and '*modus operandi*' to manage their credit.

The Credit Management Wallchart, which has been distributed to all the Members of MACM, serves as a tool to strike a balance between the importance of credit as an effective customer service with the risks associated with credit.

If businesses follow the procedures and processes suggested in the Credit Management Wallchart, they would benefit from gaining and maintaining long-term customer relationship, whilst protecting their cash flow. Following the Wallchart's processes, which are defined and designed in a clear and concise manner, businesses would also improve their quality of service provided to their customers. Thus, building and sustaining loyal customer-base.

In such an economic scenario, businesses need to invest in their customers in order to encourage repeat purchases and secure 'profitable' sales. Businesses should keep in mind that having a loyal customer base would help in the collection of dues, since they would benefit from competitive advantage both when selling their products and services as well as when collecting payments from their customers.

The Credit Management Wallchart is available from the Secretariat of the Malta Association of Credit Management. Tel. 21423638 / 9