Know your Debtor

the reference booklet
for the Maltese Creditor

Written and Complied by:

Mr. Josef Busuttil, Mr. Glen Bullivant, Dr. Rueben Balzan & Dr. Louis Bianchi

MACM Office Address: 86/2, Triq ta' Mellu
Mosta MST 3785
Malta

Tel. No. **21423638 / 9**
Fax. **21423640**

e-mail. **info@macm.org.mt**

website: **www.macm.org.mt**

Printed in Malta at Best Print Co. Ltd.

Foreword

At our last Annual General Conference in May 2007 many of our members expressed the wish that the Malta Association of Credit Management (MACM) produces guidelines which in simple terms would offer them a basic background into the various ways they should manage their credit facilities and also guide them in the various options available to them to collect monies due and which had remained unpaid.

With this in mind, Josef Busuttil, MACM's Director General, Mr Glen Bullivant, a leading Credit Consultant in the UK, Dr. Rueben Balzan and the undersigned set to work to produce this publication, which is intended as a guide to our members and the local business community and this insofar as it will give them a basic insight into how to manage better their cash flow whilst at the same time explaining the various legal methods which are available to them to collect monies due.

We should point out that the information stated in this publication is correct as at the time of going to press and it is therefore advisable that the reader consults with his own Legal Advisor at all times.

In our task to complete this publication we were fortunate to find the financial support of the Parliamentary Secretaries, Dr. Carmelo Mifsud Bonnici and Mr. Edwin Vassallo.

Dr. Louis Bianchi
MACM President

Table of Contents

Profile of the Malta Association of Credit Management 9

Chapter 1	**The Maltese Credit Environment** .... *Josef Busuttil*	13
Chapter 2	**Turnover, Cash Flow and our Competitive Market** .... *Josef Busuttil*	17
Chapter 3	**The effect of Overtrading Customers** .... *Josef Busuttil*	19
Chapter 4	**The Importance of Cash Flow** .... *Josef Busuttil*	21
Chapter 5	**Credit Policy** .... *Glen Bullivant*	24
Chapter 6	**Credit Knowledge Management** .... *Josef Busuttil*	29
Chapter 7	**Credit Terms and Conditions – Are they needed?** .... *Josef Busuttil*	32
Chapter 8	**Late Payment Directive** .... *Josef Busuttil*	35
Chapter 9	**The Sales and the Credit Departments** .... *Josef Busuttil*	37
Chapter 10	**Investing in the Skills and Competencies of the Workforce** .... *Josef Busuttil*	39
Chapter 11	**Know Your Debtor** .... *Dr. Louis Bianchi*	41
Chapter 12	**The Judicial System Tools** .... *Dr. Reuben Balzan*	46

Profiles

Dr. Reuben Balzan LL.D.

Dr. Reuben Balzan graduated in law from the University of Malta in 1993 and has since been acting as legal advisor to several businesses. He practises as a litigation lawyer and provides legal consultancy mainly in civil and commercial law, data protection and consumer matters.

Dr. Balzan is a Board member of the Malta Communications Authority. He sits on the Committee of the Chamber of Advocates and is a partner of the firm Balzan & Spiteri Bailey Advocates.

email: reuben@balzanlaw.com

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

Dr. Bianchi graduated in BA General from the University of Malta in 1969 and later continued his studies and graduated in Doctors of Law in 1973. In 1984, he attended Salzburg Seminar Session 232.

Dr. Bianchi has a wealth of experience in the credit management function and the local judicial system as he has been working in the Credit Control Department of Gasan Automotive division both as its legal advisor and manager since 1974.

Dr. Bianchi is the President of the Malta Association of Credit Management.

Profiles

Glen Bullivant FICM

Glen Bullivant is an independent credit management consultant who began his career in 1962 as a credit reporter and debt collector, riding around the city of Leeds on a red Vespa scooter (thus pre dating a well known celebrity chef by many years!).

He was a successful credit manager in industry from 1976 until setting up his own consultancy in 1993. He has held many honorary positions with the Institute of Credit Management including Treasurer, Vice Chairman and Chairman. He is currently one of the Institute's three Vice Presidents, Chairman of it's Technical Advisory Committee, and member of it's Education Committee and Examination Board. He is a part time college lecturer in Credit Management, and co author of *Credit Management Handbook* (Gower Press) and *Tolley's Effective Credit Control and Debt Recovery Handbook* (LexisNexis).

Glen Bullivant is a well known public speaker at conferences, seminars and dinners in both the UK and Europe.

Josef Busuttil MBA *(Henley)*, Dip. M MCIM, FICM, *Chartered Marketer*

Josef has been the Administrator of the Malta Association of Credit Management (MACM) since its establishment in June 2001. He was later appointed the Director General of MACM. Josef 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 November 2004 and in October 2006, Josef has been 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.

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 business seminars and conferences organised by different organisations both in Malta and overseas. He is a regular contributor of business articles to local and foreign business press.

The Malta Association of Credit Management

Profile

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 Friday, 15th June 2007, and in accordance with the Statute of MACM, the new officers and Council Members were elected 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. Antoine Galea, *BA (Hons) Accty., FIA, MIM, ABHA, MBA*
Deputy President, Education Affairs

The elected Council Members were:

Mr. Charles Arapa AICM
Mr. Gaetano Cordina
Mr. Mario Delicata, *B.Sc. (Hons)*
Mr. Joseph Dimech, *MICM (Grad)*
Mr. Joseph Falzon
Ms. Natalie Scerri, *MBA (Maastricht), BA (Hons) Acc, FIA, CPA, MIM*
Mr. Charles Xuereb B.A. (Hons) Accty, FIA, CPA, MIM

Mr. Geoffrey D. Borg B.A. (Hons), MBA(Warwick) is an 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, develop strategic plans, implementing strategies and managing and control activities. Sub-committees report to the Council of the Association.

Legal & Enforcement Sub-committee

Various meetings were held with politicians from both sides of the Maltese political sphere and with other relative 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, all these meetings turned 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.

Additionally, MACM is currently working on other areas of legislation:

- Dishonoured Cheques Regulation
- SEPA Project
- Judicial System

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 organizes a number of workshops, seminars and conferences to its members, as well as to the local business community at large. It also takes part in activities organized by other institutions both locally and abroad.

In addition, MACM has been accredited Teaching Centre for Malta by the Institute of Credit Management (UK) to offer education programmes leading to a Certificate / Diploma in Credit Management. Maltese students are now 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 hire 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 achieved high marks and have been awarded prizes from the ICM (UK). MACM Teaching Centre has also been awarded with a Certificate 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 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:

1. Minimising the risk associated with trade credit.
2. Avoiding bad debts

3. Being consistent in credit decisions.
4. Controlling of processes.
5. Monitoring Debtors on a daily basis.
6. Increasing performance.
7. Enhancing long-term customer relationship, thus improving customer retention.
8. Identifying financially solvent prospects, turning credit risk into credit rewards.
9. Maintaining sound cash flow
10. 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 professionals.

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). 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 in a meeting held in Ghent in November 2004 and was re-elected in for a further period of two years in a meeting held in Mestre, Venice, in November 2006.

Chapter 1

The Maltese Credit Environment

Trade credit is a business practice which involves supplying goods or services to businesses and allowing payment to be made at an agreed later date to enable the buyer to finance the purchase.

Introduction

Credit does not come for free. Granting or extending credit costs money to the supplier (creditor) or to the buyer, or to both. Credit is a service for which someone has to pay for. Paying for a purchase over a period of time is more expensive to the creditor than accepting cash on delivery.

The costs involved in granting credit are attributed to the process of granting and to the managing of credit in a profitable manner. This involves the analysis of the credit worthiness of the credit applicants, continuous monitoring of the debtors, due collection of payments on time, and in some cases the arduous task involved in the recovery of defaulting debtors. Additional cost elements reflect the opportunity cost of granting credit, which varies according to the credit period itself and to the cost incurred in late payment.

Since cash flow is the life-blood of every business and late payments have a negative effect on cash flow, firms employ various credit management policies and practices to prevent late payments and to manage effectively their debtors.

The changing Maltese credit environment

Going through the history of the local credit environment, attitudes to debt, both consumer and trade, have changed dramatically over the years. For many generations, buying something now and pay for it later was considered taboo by the majority of our ancestors. Today, it is difficult to imagine not having those goods we want now but could only have them in couple of years' time when we had saved up enough money to buy them.

Presently, our economy is very much governed by credit and its availability. It is commonly believed that, as a society, we are biting off more than we can chew and we are living beyond our means. Some also argue that some belt-tightening is required.

This scenario is causing a slowing down of payments by customers in the local business environment, dishonoured cheques being drawn, and a number of bankruptcies in all sectors of our economy.

Despite the fact that this commercial scenario triggered the business community to invest more efforts in the credit management function, late payment is still one of the major difficulties for many local firms, as it is causing them liquidity problems.

The local competitive environment; banks; management philosophy of traders, and economic factors have all contributed to change the Maltese mentality and their behaviour pertaining to credit.

Fig 1. Factors effecting the Local Credit Environment

Competition

Owing to the small size of the Maltese economy, all sectors are highly competitive and fragmented. The business environment is characterised by a large number of retailers and suppliers, trying to push their products and services to maintain their market share or to win new business.

Products and services provided by various businesses can be described as homogenous with low or no differentiation features. Very often, the selling crux lies in credit terms, the interest-free credit on offer, and the once in a life-time buy 'now' and pay later offers, promoted prominently on the outlets' windows.

Local Banks

Having strong influence in our economy, banks promotions are having an effect on the local consumers' perception and attitude towards credit and loans. Banks are allocating substantial budgets to promote various types of loans, ranging from credit card facilities to loan financing of houses, businesses, education, cars, yachts and even for holidays.

They are using effective clichés to encourage individuals to borrow for their needs and also for leisure. Being sales-driven and target-oriented organisations, banks are trying to match credit terms and interest rates offered by their rivals to win more customers.

Management Philosophy

Being small to medium organisations, local businesses are mostly managed and directed by their owners who have great influence on the internal culture and management styles of their firms.

In order to balance the relatively small economic sectoral revenue against the high overhead costs associated with the economic expansion of the 90's, business owners were constrained to enter various sectors of the economy, sometimes completely unrelated to their core business. This had a negative effect on the local credit environment as firms became more sales-oriented and used credit as a competing selling tool to increase sales, sometimes irrespective of the risk associated with credit.

Economic Factors

In theory, the impact of credit on the economy is positive, only if credit is granted in a responsible manner. Responsible credit makes useful contribution to the living standards and the wellbeing of a society.

However, the economic expansion of the early 90's, although it has led to higher inflation and lower unemployment, has created a 'feel-good' factor in our economy. This has transformed borrowing into an acceptable and necessary practice for many local consumers and traders alike.

The Maltese economy has then experienced low interest rates, during the recent economic slow-down. Such low interest rates encouraged consumers to borrow even more. However, debtors should now be careful as interest rates are again rising and this would mean that the credit environment in general can only become worse. Rescheduled programmes of existing loans with higher repayments are already being sent by the financial institutions.

Nonetheless, the rising house prices have also contributed to more demand for personal loans. We live in a society where we want to own the property we live in, rather than renting it. This has led to an increase in loan terms, opened up more credit facilities and loans for longer period of time.

Motives to granting and extending trade credit

In a research conducted among MACM Members, it resulted that organisations grant and extend credit to their business clients for a number of reasons. The leading motives of the local sellers to grant trade credit were found to be common to all industries under research.

Leading motives were found to be common to all respondents:

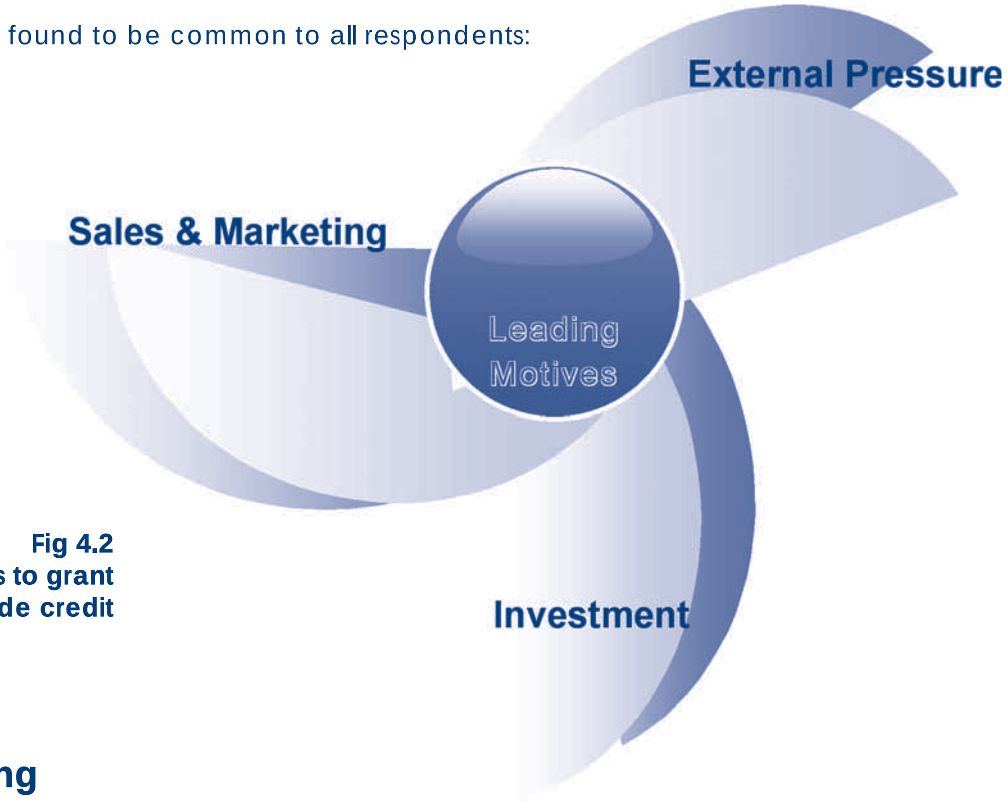

Fig 4.2
Leading Motives to grant and extend trade credit

Sales & Marketing

Business people argue that credit supports sales and it is used as a tool to gain competitive advantage. Local suppliers negotiate favourable credit terms with their clients to secure new sales orders, thus maintaining high sales volumes.

Additionally, since Malta is a relatively small market, local suppliers of imported goods are committed with their foreign principals (manufacturers) to sell a determined volume in order to secure better prices. To achieve high sales targets, these suppliers have to extend credit to their clients in order to finance the sale transactions.

In the FMCG sector, extending credit helps to introduce new brands and product lines in the market, since retailers will be more encouraged to buy new brands or to put new product lines on their shelves if credit terms and limits are extended. This would help new products to sell, since new product lines will be visible at retail outlets by the consumers.

It was also contended that food stuff brands are substitutes for each other with very low differentiation features. Therefore, extending credit would help the supplier and its brands to be listed and be included in the system of the retail outlets. This argument also holds true for the local providers of trailers and haulage as well as the printers. Such services are homogenous in terms of quality and timing and the tool used to differentiate these services is by offering better prices and extending credit terms.

Other suppliers also argue that credit is granted and extended in order to hinder sales of the competitors' brands through a means of crowding out the competitors. Selling in quantity to a retailer would mean that the retailer takes long to resell these products and therefore will not be able to stock other brands.

Moreover, suppliers claim that trade credit is related to the price structure and the sales order. The larger the order, the better price the retailer would get from the supplier. Therefore, larger retailers buy in bulk to get better prices and finance the purchase by requesting more credit. This means that trade credit may be used to price discriminate.

In certain sectors, such as the IT sector, credit is widely used as an advertising tool when dealing with both business and consumer clients. IT Solutions providers are offering easy payment schemes and interest free loans over a period of 18 to 36 months to their clients when purchasing hardware and software packages.

External Pressure

Research shows that one of the major motives to extend credit is due to external pressure coming from the competition. Sellers are competing on trade credit terms to attract more sales and are trying to satisfy the demand for credit of their clients. Due to our competitive market, sellers try to match their competitors' credit terms or else they will loose sales and market share.

Pressure to extend credit is also being exerted on the sellers from larger clients. Stronger clients may be using their strength to exert pressure on the sellers to get better deals pertaining to prices and credit terms.

Investment

Research showed that a key factor to succeed in the local competitive market is to build and maintain loyalty and long-term business relationship with clients.

Suppliers argue that extending trade credit to clients, hence financing their working capital, helps to build and maintain a loyal customer-base and keep out competitors from taking their market share. They added that trade credit is therefore deemed to be an effective strategy to maintain long-term business relationship with the clients.

Chapter 2

Turnover, Cash Flow and our Competitive Market

Today's businesses are in competition both to sell their products or services, as well as to collect payments from their customers.

With the increasing competition faced daily by businesses both locally and from new international entrants, companies are forced to seek growth either from their existing markets or possibly try to target new markets through export or diversification. Very often they strive to increase their sales turnover in a short period of time by reducing their prices down to the very 'bone' to attract more customers. And the more their turnover increases, the more they continue trying to sell. This macho attitude will often lead businesses away from their true objectives of profitability and shareholder's wealth.

If a business wants to survive in a competitive market, it needs to plan how to grow or maintain the same market share profitably. *Price,* is not the only element by which competitive advantage can be gained. Products or services on offer can be differentiated in various ways keeping the price unchanged or even premium prices charged through quality improvements or competitive credit terms, while still enticing demand.

There is always a limit by how much prices can be slashed and lack of awareness of a product's true cost can be disastrous for a company. The airline industry in general has suffered from companies slashing costs until they arrived to a point where the variable cost of operating a flight was higher than the revenue being attained, let alone making a contribution to the huge overheads that airlines have. The supermarket industry is another typical example. The same applies to the PC market. Companies are undercutting competitors in price at the expense of their long-term profitability.

Sustainable business growth comes only from increased profitability. An unplanned rapid increase in the sales turnover is often at the expense of profit, which eventually could lead to business failure.

Growing sales without proper financial planning is the perfect recipe for disaster. Therefore, business expansion needs to be planned and controlled, and above all this needs regular cash flow to sustain it. If cash inflow lags behind the cash outflow, the operating business will be in a state of cash shortfall, and this cash shortfall is very much related to turnover. Thus, unless this shortfall is anticipated and budgeted for, the business will run out of working capital and will not be able to meet its bills, pay interest charges, and more significantly pay wages.

Therefore, management should forecast both the profitability and the cash flow effects arising from changes in the sales turnover, productivity and costs. Business expansion can only be based on a solid business plan, taking into consideration various factors such as the available capacity and the capabilities of the business. Additionally, one should always keep in mind that every business has its limited resources, which also need to be identified.

Fundamental questions

So, the first step to plan for growth is to ask three fundamental questions: *"where are we now?", "where do we want to be?", and "How are we going to get there?"*

These questions should be answered in the context of the wider business environment, offering constraints and external forces beyond the control of the business.

Prior to any decision to expand the operations of a business, the commercial viability and the market demand should be analysed: *What is the available capacity and what are the capabilities of the business? Can the business expansion be managed by the available resources? Is there enough capital to meet the required and the future ongoing costs? What is the use of expanding a business operation in a saturated market? What is the scope of opening a new retail outlet where one or more outlets selling homogenous products or services already exist down the same road or in the vicinity?*

Given the size of our Island, we find over-saturated market segments in various sectors of the Maltese economy. This commercial situation often results in cash short fall, and the easiest way to solve this predicted constraint is by requesting more credit facilities from the trade suppliers to be able to meet the amounts due in the short-term.

It goes without saying that creditors should keep their eyes open to such situations and extend credit only to those clients who really are credit worthy and are able to honour their commitments.

Creditors should primarily analyse the cash flow of the credit applicants since cash flow management is the life-blood of the business and the main indicator of business health. Moreover, it is becoming more important to be informed about how the clients' cash flow is managed because if credit is extended to, or a credit facility is granted to a client who is not credit worthy, may have negative repercussions.

The Malta Association of Credit Management (MACM) was primarily established in Malta to foster and facilitate the exchange of credit information, while promoting honest and fair dealings in credit transactions. Amongst other activities, MACM members share mutual goals and credit problems, and by meeting with their peers in an Industry Credit Group they receive advance notice of problematic accounts and follow the payment patterns of common customers. Timely information regarding 'warning signs' may enable credit decisions to be taken more wisely, saving the trade creditor both time and money.

Chapter 3

The effect of overtrading customers

It could be argued that in Malta, trade creditors often, though unintentionally, are instrumental in permitting their debtors to become distressed.

Trade creditors coming from all sectors of the Maltese economy are being faced with an ever increasing number of distressed clients who are insolvent or have cash flow problems. In some cases these customers are considering closing down their business. On the other hand, credit seeking new customers are emerging on the market, posing uncertainty both with their lack of experience in a new market environment, and in their managerial skills required to run their businesses profitably.

From past experience, Maltese trade creditors know that stocking a new reseller's outlet without a prior binding agreement with the respective owner/s specifying the terms and conditions of sale is no longer viable, and therefore unacceptable.

No trade agreements, lax credit analysis, and poor collection follow-up, all contribute to bad business habits of many of their clients. Unfortunately, these bad credit habits became acceptable in the local commercial trade, and sometimes are also being mistaken as a divine right or normal trade practice. To name but a few of these bad habits: credit is being considered as an undeniable right by the trade clients; often it is the trade client who tries to dictate and determine the credit terms; personal and trade guarantees are taboos in a credit relationship; post-dated cheques are still being issued and widely accepted; and late payments supported with all kind of excuses are normal practice. All of these malpractices foster distress.

What contributes to business distress?

In my opinion, the three common reasons that are contributing to business distress in the local market are:

- Under-capitalisation of businesses which consequently rely on their banks' and trade creditors' capital to pull them through. A lot of shell companies with Lm500 (€1,165) authorised share capital and Lm100 (€233) paid capital try to hide behind the limited liability that a company offers.

- Poorly managed businesses, which in some cases inefficiency and / or fraud may be the primary causes of distress. This is often a result of lack of management or business training.

- Overtrading, occurring when the business's turnover increases faster than its cash profits, so that eventually it becomes unable to obtain the extra capital required to finance the expansion, thus having huge cash flow problems.

However, the external environment of the business may also effect the profitability and the sustainability of its operation. Intense competition may lead to unsustainable price wars which would surely effect the profits of any business in the longer term. An economic recession would also affect the cash flow of some businesses, especially those which are weaker. The Supermarket sector and the Catering industry in Malta can be said to be classic examples.

Notwithstanding, businesses do not fail suddenly, they can often be seen moving down a well-defined path of failure. The first noticeable phase of distress is the structure of the top management team of the business. A lack in the management skills and market knowledge of the executive team is a symptom of decline in the operation of the business. This situation triggers problems in the planning of sales, stocks, cash flow, financial control systems and costing forecasts.

As a consequence of the first phase, the business in distress allows the proportion of non-equity finance (normally trade creditors) compared with equity finance to increase by taking up larger loans, overdraft extension, and more trade credit until it reaches the saturation point when, should its trading profits dip downwards for any reason, it will not be able to honour the debts and the interest incurred. It usually happens that if a business reaches this phase, it will try to hide the facts, by delaying Profit and Loss Accounts and the financial figures from outsiders, even from the creditors of the same business, many a time including their bankers. So, all creditors should watch these patterns and any changes in the operations of their clients, so that if any abnormalities are noticed, immediate action would be taken.

In order to help avoid the increase in number of distressed clients, trade creditors should try to change their present trading practices which are doing harm to their own businesses' finances as well as to our economy.

Financing Business Growth

A growing business needs to finance and control its growth. The bigger the business, the more cash it needs to oil the wheels, and that cash has to come from somewhere. Very often, many businesses initialise their operations with limited resources, and start chasing volume sales without considering the consequences of it: effect on profitability, cash flow control, assets needed to fully satisfy the demands, impact on employees and their relative wage bills, and above all the adequate resources and expertise required to manage and control the business operations effectively and efficiently.

Under-resourced, growing businesses tend to finance their unsustainable growth by requesting more credit from their suppliers, and demanding higher limits on their overdraft facilities. Therefore, all the creditors, including the banks should be more cautious of these commercial scenarios, and should have all the information pertaining to credit to help them assess the real credit worthiness of these traders and their respective risk exposure when granting or extending credit facilities.

Therefore, it is important that trade creditors will know how much money their clients owe their bank/s, and with the same argument, the banks will know how much trade credit is granted to these traders and if they are honouring their due payments on time. Any guarantees or securities held should also be revealed, so that every creditor will know the exact net-worth of the debtor or credit applicant. *What is the scope of asking for a guarantee from a debtor or a credit applicant, if the net-worth value is less than the credit amount being applied for, or even worse, granted.*

Hence, better collaboration between all the creditors in the market would help to minimise the risk associated with credit by exchanging factual credit information, thus getting to know the true net worth value of the debtors, and the ever changing credit worthiness of every debtor on an ongoing process. Information about the debtors' payment history, trends in the debtors' industry, changes in the overall economy, and changes in demand for the debtors' products and services should also be exchanged to develop a holistic understanding of the opportunities or threats facing these traders.

Only with such exchange of credit information can credit managers or bank managers make an informed decision about granting / extending credit to their clients to the benefit of these same clients, the economy at large and their own credit company or institution.

Chapter 4

The Importance of Cash Flow

Find ways to defend your cash flow - Poor cash flow can be the death of an otherwise healthy business!

Cash flow and profitability are often misunderstood and confused – these two terms have totally different meanings. Most people think or associate poor cash flow with an organisation experiencing declining sales. But poor cash flow can happen to a business with sales bursting through the roof. Bankruptcies in the supermarket sector in Malta are good example - sales turnover was high, yet some big supermarket chains were unable to pay their debts amounting to millions of liri, to the detriment of their stakeholders including the creditors and their employees.

To make it simple, cash flow refers to the ability to pay the bills on time and on a regular basis, whilst profitability is the net difference between the total amount a business earns and all the costs involved to run the business.

In order to achieve profits, most businesses have to produce and deliver goods or services to their customers before they collect payment. Provided that these businesses have enough cash reserves to pay their suppliers, salaries, rent, taxes, bills and other costs, and the payments received are greater than the total cost of sales, then the business is said to be profitable. Additionally, one has to keep in mind that cash flow is not just the cash inflows and outflows, but is also dependent on the timing of these cash movements.

Therefore, unless the business has the cash reserves to meet all the costs regularly and on time, it will be unable to deliver its side of the bargain, receive payments, and make a profit. Irrespective of the profit potential, unless the business has adequate cash flow to operate, it will not trade effectively.

It is unfortunate that in Malta many businesses act as the bankers to their customers to an extent that they may be limiting themselves to develop further - due to lack of adequate cash flow, or may be even sacrificing their resources to collect dues from their customers rather than maximising their resource utilisation in other profitable business activities.

To realise the real cost of late payments, just imagine what will be the effect on the business if all the money owed for over 30 days was in the business' bank account!

The Malta Association of Credit Management (MACM) provides early warning signs and indication of the payment performance of various traders coming from different sectors of the Maltese economy, thus, helping its members – Maltese trade creditors – to identify potential pitfalls in prospective and existing customers.

Trade credit improves customer long-term relationship, and can also be used intelligently to gain competitive advantage, but it should be properly and professionally managed.

Unfortunately, our competitive market and trade culture do not help proper cash flow management. The small size, fragmented and generally saturated Maltese market tends to force suppliers to oversell

- to gain a bigger share of the market - and sometimes suppliers go beyond their means when granting credit to their customers. More often than not, trade credit is still being done verbally with no documented credit terms and conditions, let alone signed credit agreements.

This culture should definitely be changed. The trade creditor should be more proactive and professional when granting credit, to the benefit of the business organisation itself which would then reflect on the wider economy it operates in.

It should be understood by everyone involved that trade credit is not a right of the customer, but should be given only to those customers who are committed to honour the trade credit terms and conditions. Trade creditors should never allow their clients to dictate credit amounts and terms by threatening of doing business with the competitor, but should strictly adhere to the Credit Policy of the organisation.

Effective cash management implies accuracy, completeness, authorisation whenever needed, disclosure and a well reporting system of all cash movements within the organisation. Management can only forecast, plan and implement business activities if its cash flow is controlled, monitored, and forecasted.

What needs to be done?

There are three basic steps to follow:

1. Write an adequate organisation credit policy
2. Develop an internal credit control system
3. Invest in a credit management information system.

A documented credit policy should help all the employees of the organisation, including the sales people, to understand better the objectives of the credit department. Writing an effective Credit Policy should entail a thorough analysis and evaluation of the organisation's capabilities, including all its assets and competencies. This must take account of the financial exposure that the organisation can endure, the skills and controls available to the organisation, the human resources required, and the amount of working capital available by the business to invest in its customers / debtors.

Next comes the internal credit control system. What is the average payment period of the debtors? Is the information about the credit applicant complete? Is there enough information on which the credit decision is taken? Are the late payers easily defined and properly segmented to act upon effectively and efficiently? What methods and techniques are best to communicate with the late paying customers? *May be a successful method used with one customer is not so effective with another!* Who will be responsible for the credit management within the organisation? Are there adequate resources? These are some of the never-ending list of questions which a trade creditor should answer before developing an efficient credit control system.

Finally, a trade creditor should invest in a reliable information system. No organisation lives in a vacuum. A trade creditor needs information both from internal and external to the organisation. This system should be capable to provide continuous information about what is going on in the market, alerting the credit manager of any payment default or any other 'warning signs', at a very early stage. Thus, helping the credit manager to analyse the credit applicant, and to monitor the debtors on a daily basis.

The most significant early 'warning signs', which the system should provide and cater for are:

a) History of dishonouring cheques issued by the debtor or credit applicant,
b) Customer changing his banker,
c) Changes in the payment pattern of the debtor or the credit applicant,
d) Recent history of late paying,
e) Low stock levels,
f) Overtrading,
g) Lack of filing of accounts as required by the Registrar of Companies, if we are dealing with a company.
h) And rumors in the industry, etc…

In other words, the Credit Management Information System should trigger and guide the credit manager to act proactively whist keeping the costs as low as possible.

MACM serves as an effective and efficient credit management information system to its members, and provides relevant data and information which the credit managers need in order to act proactively.

Factual credit information regarding defaulting debtors is lawfully exchanged between the members of the Association on a daily basis to ensure that the information provided is always up-to-date and relevant.

The exchange of credit information between the MACM members is based on trust, co-operation, and reciprocity, with the primary aim being that to develop a positive credit environment in the Maltese business arena, thus combating fraud, and minimising credit risk at the least possible cost to its members.

Being a member of MACM, the credit manager has also the opportunity to meet and discuss current credit management issues with his or her peer group during the Credit Industry Group Meetings organised periodically by the Association.

Credit defaulters and fraudsters are common clients to the suppliers coming from the same industry or market, and an effective way to be informed of any early 'warning signs' in the market is forming part of a credit industry group or association.

Chapter 5

Credit Policy

Credit – necessary for business growth, but carrying both risk and cost

The granting of trade credit is a powerful selling aid, and is a fundamental foundation upon which all trading relationships are built. Both seller and buyer gain advantage from credit facilities, but the risk of slow or non payment is borne by the seller – risk in the form of non payment, and cost in the form of the interest expense incurred from the date of the sale to receipt of the funds.

The demand for trade credit requires:

- a sound operating procedure to cope with continuous sales volumes;
- capital to fund the waiting time (between sale and cash receipt) with a worthwhile return on the investment; and
- regulation and enforcement, informally or by law, of credit agreements.

In effect, this means having a Credit Policy.

Why is a credit policy needed?

Every function of a business plays a part in the life of a sale and equally in the death of a sale, and therefore the debtors' asset. It is created when a customer is prospected for business, or when products or services are advertised, since expense begins then. This expense has to be recouped by a sale, which, by definition, must be fully paid on time. Anything less reduces the intended margin. Thus:

- the selling operation;
- the order processing system;
- the manufacturing or procurement action;
- the costing and pricing basis;
- the conditions of sale; and
- the customer service efficiency,

all contribute together with the company's credit control, sales ledger and cash collection departments.

A credit policy is necessary to show the company's intended way of doing business and avoids confusion and potential misunderstanding. The need for company policies in respect of health and safety, smoking, employment etc., are well founded and accepted as both normal and necessary, and this should apply equally to the credit operation. Successful companies have long set down their preferred operational approaches to the credit function and how it fits into the organisation:

- involve all relevant functional heads in shaping the business for the future;
- clarify 'best practice' and iron out inconsistencies in procedures;
- define job responsibilities and objectives;
- avoid internecine disputes and save valuable management time;
- plug any 'profit leaks' caused by chaotic attitudes and procedures;
- ensure that all operations comply with the corporate focus on net profit; and
- ensure that all operations comply with the law of the land.

All businesses can benefit from the experience of well-established firms by taking a look at how they do things and by developing their own operating policies.

Instigating a credit policy

A credit policy should start at the highest level, be agreed at all levels, and be inclusive of all those areas of the business operation which leads to satisfying customer requirements. Every employee in the business should know:

- what the credit terms are;
- how and why they have been arrived at; and
- how, why and when they are implemented.

A director or senior manager is delegated by the Board of Directors to produce a brief outline of collective policy, process and procedures required to manage the debtors' asset efficiently. Producing and/or updating the policy document motivates and requires functional heads in sales, production and customer service, etc. to involve all staff and delegate responsibility. It invariably clarifies areas where staff may have been unclear about authority, responsibility and seniority in certain situations. When a credit policy has been decided, it should be signed by the Board of Directors and issued to all departments to show its importance to the cash flow and profitability of the company.

The production and implementation of a credit policy document is an excellent opportunity for sales and credit to get together to decide and define responsibility for solving customer problems. The credit manager should bring sales staff together and explain key points such as:

- credit approval of new customers;
- observance of credit ratings and credit terms;
- joint visits to major customers; and
- action to recover seriously at risk debts, etc.

The credit manager and the sales manager may still have fundamental differences of opinion from time to time in respect of the rights or wrongs of credit facilities for an individual customer. There may be good marketing reasons for trading with a customer, not always in accord with credit best practice as seen by the credit manager. For this reason, an important feature of a credit policy is the establishment of an arbitrator, usually the Managing Director or CEO. When two sides cannot agree, the arbitrator decides and has the final authoritative say. The decision can be accepted by both sides and no blame (or reward) is attached to the consequences. In such circumstances, the policy would require such decisions to be officially recorded.

Considerations when developing a credit policy

The credit policy cannot be produced in isolation, without any reference to outside influences or circumstances. Much has to be taken into account when developing a credit policy, including:

- the seller's strength in the market;
- the capital needed to finance seller's sales;
- the credit terms which the seller gets from his own suppliers;
- the range of customers (types and sizes);
- available net profit margins;
- any special arrangements, including longer terms and/or installments;
- competitive pressures – i.e. 'what the others are doing';
- the type and nature of the goods supplied – for example, the shorter the life of the goods, the shorter the credit period should be (a buyer may lose interest in paying if the goods or services are long gone);
- the customer's creditworthiness;
- the buyer's own cash cycle – if a buyer is retailing for cash, a seller's terms can be short but if his business process last for a long time, credit may be much longer;
- seasonal sales may be greater at specific times of the year;
- incentives to boost sales may include extra credit facilities; and
- the existence of any security for the credit exposure.

Contents of a credit policy

Credit policy documents can be one-page statements of intent or major volumes in a bound set of corporate guidelines. Whatever the format, **it should ALWAYS be issued by top management** and show a date for review with interim updates as circumstances dictate. Useful contents would be:

- a simple statement of the company's business aims;
- a list of the company's types of customers, and their business sectors;
- the full conditions of sale, as issued to customers;
- the conditions of sale which affect credit management, for example;
    - the range of payment terms;
    - cash discount rules;
    - scope for special terms, prepayments, installments, extensions, etc
    - penalty interest, and
    - reservation of title;
- bad debt levels and method of reserves or provisions;
- DSO (days sales outstanding) calculation and uses;
- methods of assessing customers, explaining credit ratings and risk codes;
- order referrals and stop list, actions and circulation;
- follow-up methods for various kinds of accounts;
- legal action and use of other third parties to collect;
- use of external services, e.g. credit reference agencies and credit insurance;
- staff responsibilities and authority levels;
- interaction with other departments and their responsibilities to achieve objectives; and
- the arbitration process.

Where the company is engaged in international business, there should be a separate part of the policy document devoted to export processes and policies.

Practical stages in operating a credit policy

The elements of a well-structured approach to credit management include:

- the credit policy;
- objectives;
- procedures; and
- an organisation chart, which clearly indicates authority and responsibility, levels.

It also lays out the financial measurement process from the initial budget to monthly reports of actual results compared to that budget, as follows;

- a credit policy statement, including:
    - the part that credit plays in overall sales and financial objectives, and
    - the responsibilities of various job-holders
- annual and monthly objectives showing:
    - criteria (e.g. DSO, overdues, bad debts, etc.), and
    - ratios and percentages:
- annual budgets for monthly debtors and credit department costs;
- organisation chart to show credit jobs and their connections to other functions;
- procedures for credit assessment and collections; and
- credit manager's monthly report showing:
    - debtors results and variance from budget, with reasons, and
    - credit department costs and explanation of variances from budget.

Additional notes

The policy should be adaptable to changes in circumstances, both internal and external. Credit terms remain the heart of the contract between seller and buyer and establish the moment in time when the transaction will be completed. The nature of both business and product dictates that from time to time variations from standard terms will take place – such variations from normal terms are carefully negotiated, documented and enforced.

All business is done on the *seller's* conditions of sale, and the payment terms must be integral to those conditions. As one of the legally binding sales conditions, credit terms, once established, must not be regarded by the buyer as flexible. It is important that the credit terms are clearly stated at the order taking stage and subsequently enforced, just as other contract details are. Standard credit terms are not inviolate at all times, but *agreed* terms are part of the negotiated and enforceable contract.

Monthly, or weekly, reporting illustrates the effectiveness of the credit policy and its adherents. Trade credit terms are invariably expressed in days, so the reporting of outstandings in terms of days is the usual key performance indicator. The credit policy should stipulate how reporting should take place, but it should always incorporate the four key elements of:

- days sales outstanding (DSO);
- overdues as a percentage of total debtors;
- age of overdues within the total overdue; and
- disputed debts.

Summary and conclusion

All companies extending and managing trade credit should establish a credit policy which provides the framework for making consistent and well informed credit and collection decisions which are compatible with the company's strategic objectives and the goals of the credit function. The credit policy is a document that specifies the course of action for granting credit and recurring credit activities. The credit policy has to be understood by, and communicated to, all relevant parties, particularly credit staff, sales staff and customers.

Credit policies need to be reviewed and monitored on a regular basis to take account of changing market conditions, company strategy, competition, and financial needs. A carefully documented credit policy is a fundamental requirement of sound credit management practice, and should serve at least the following purpose:

- to define the objectives of credit extension in the context of corporate strategy and organisation structure
- to define the authority and responsibilities for credit granting, establishing and varying terms and the timing of collection actions
- to provide documented procedures in relation to the above that can be communicated to all staff
- to specify training policy for credit staff
- to specify performance targets and monitoring activities for credit staff
- to reinforce "one company – one customer" culture throughout the organisation

The credit policy of a company should be developed in accord with the strategic, marketing, financial and organisational context of the business and be designed to contribute to the achievement of corporate objectives. The corporate strategy can include trade credit management not just in terms of its contribution to collection and cash flow but as a means of generating sales and profits, and of investing in customers by building relationships.

The management of trade credit can help build stable and long term relationships with customers, generate information about the customer and their requirements and facilitate different customer strategies in terms of credit granting, credit terms and customer service. The objective is to generate growing but profitable sales.

Chapter 6

Credit Knowledge Management

Creditors are becoming more vigilant and are seeking reliable and professional aids and credit information management systems to help them assess and monitor the credit worthiness of their clients applying for credit.

Following a number of payment defaults faced by the Maltese business community, more awareness of the need to manage information pertaining to credit has been created.

The Maltese business community is in fact experiencing a revolution in the way credit is being granted to the respective clients. Rightly, creditors are becoming more vigilant and are seeking reliable and professional aids and credit information management systems to help them assess the credit worthiness of their clients applying for credit.

But creditors should also understand the importance of reviewing their existing debtors on an ongoing process, because the level of success of a credit department depends solely on its efficiency in collecting debts in a timely and consistent manner to keep the cash flow of the business healthy.

The only way a credit department can achieve this success is through developing and implementing an efficient and effective credit information management system which best satisfies the needs of the particular organisation. Credit managers need to know *WHEN, HOW and WHAT* actions may need to be taken at any instance, to the benefit of their own organisations and to maintain sound business relationship with their clients.

The credit information management system, however, should be reliable, accurate, relevant to what it is needed, and provide up-to-date information which should trigger and help credit mangers to act proactively.

There is also the element of the costs associated with adopting a system. The cost of its implementation and its maintenance should be justified appropriately.

Since credit should be granted only to clients who are creditworthy and those who are committed to honour their obligations, the information management system should provide pertinent information by which the credit manager can identify the risks associated with the particular credit.

Additionally, the credit manager should review the debtors' list on an ongoing process to convert credit into cash on a timely basis, and to reduce the risk of delinquency and bad debts. So, the system should be capable to provide continuous information about what is going on in the market, and to alert the credit manager of any payment default or 'warning signs' at a very early stage. *Thus enable the creditor to act proactively!*

The list below, by no means complete, indicates the most significant 'warning signs', which the system should look and cater for:

i) History of dishonouring cheques issued by the debtor or credit applicant,
j) Customer changing his banker,
k) Changes in the payment pattern of the debtor or credit applicant,
l) Recent history of late paying,
m) Low stock levels,
n) Overtrading,
o) Lack of filing of accounts as required by the Registrar of Companies, if applicable.
p) Rumours in the industry, etc…

Nevertheless, one of the best sources of information should be the sales team. The salespeople are well positioned to spot any changes in the market, or even any downturns in the customers' businesses. Therefore, sales people should be strongly encouraged to be on the alert for any emerging credit problems.

To fully appreciate the potential within the sales force, it is necessary to communicate with them on a regular basis and consider them also as an important source of information for the credit department. Adequate training is inevitable, but the optimum would be to integrate the sales operations within the overall organisational objectives and values, including that of the credit department. Motivation and involvement should help the sales people to contribute, co-operate and adapt to any changing circumstances.

Another effective internal source of information is the credit application form. A document which should be used by the creditor upon every request for credit. The credit Application Form should be used as a base for collecting all the information essential to the organisation before granting credit, and to communicate clearly and contractually any terms and conditions with the credit applicant.

Information found in the credit application form may also be needed to proceed legally should the debtor repeatedly fail to settle outstanding amounts or lack to adhere to the terms and conditions agreed to. The legal process is long and costly and moreso when the details that one could have easily obtained at the outset are not forthcoming either from the organisation's credit department or sales people.

To complement the internal information, other external sources of information should also be considered. The Registrar of Companies is one of the most valuable sources. Information on every registered company in Malta is available online from this Authority at a fee. The credit manager can evaluate the track record of the Company applying for credit, last date accounts were filed, who the directors are, its share capital, the profitability of the company, its assets and liabilities, etc… Lack of information or a serious delay in filing of accounts normally reflects a poor or deteriorating performance on the company being investigated.

The Public Registry may be another useful source of information. Tangible form of security or guarantee against credit needs to be verified. What is the scope of asking for a personal guarantee from a credit applicant if all the assets are hypothecated. Creditors should ensure the value or the real worth of a guarantee.

The Law Courts are another source of information to the credit department. A very efficient and effective web site is maintained by the Court Registry providing valuable information such as court judgements (http://www.justice.gov.mt). However, the credit manager should keep in mind that court judgements and other relative court information are not exactly early 'warning signs' referred to earlier on, and thus, may not always serve as a tool to act proactively. Usually, court cases are the last resort possible to recoup dues, and are only initiated after various defaults in payments are experienced by the creditors. Moreover, court judgement takes time from when it is filed by the plaintiff, and in the meantime, the defendant may still be trading and may still be defaulting other trade suppliers in the market!

Amongst other services, the Malta Association of Credit Management provides the service of daily information sharing between peer groups at the least possible cost to its members based on trust, co-operation, and reciprocity with the primary aim being that to develop a healthy credit environment in the Maltese business arena.

MACM serves as an effective and efficient credit management information system to its members, and provides relevant and pertinent data and information which the credit managers need to act proactively. Credit information regarding defaulting debtors is lawfully exchanged between the members of the Association on a daily basis to ensure that the information provided is always up-to-date and relevant. Being a member of this Association, the credit manager has also the opportunity to meet and discuss credit issues with his peer group during the Credit Industry Group Meetings organised periodically by the Association. Thus, his / her decision making will be more effective, less risky and technically more profitable to his company.

Credit defaulters and fraudsters are common clients to the suppliers coming from the same industry or market, and the best way to be informed of any early ‘warning signs’ is undoubtfully by forming part of a credit industry group. This system has been proved successful in various countries and it is also leaving positive results within the Maltese business community through MACM membership.

The credit department does more than just crunch numbers and make collection calls. The credit department is becoming a more integrated business unit within the business organisation. It determines the level of cash flow of the organisation, and to an extent, the profitability of the whole organisation especially in Malta where credit facilities were easily granted. Credit decisions will be taken more wisely and professionally when the internal and external business environmental factors are taken into consideration. The only way to make effective, profitable and competitive credit decisions, as well as to reduce risks associated to credit is by basing these decisions on accurate and timely information.

Chapter 7

Credit Terms and Conditions – Are they needed?

"Customers might be offended when asked to sign such agreement and would move to another competing supplier – hence loosing sales!"

It is surprising to note that many suppliers and trade creditors in Malta do not use a trading agreement when selling their products or services to their customers, nor a credit application form prior to granting trade credit. *Why.....?*

Some businessmen argue that these contracts or agreements complicate matters; it is bureaucratic; others say they have no time for such formalities, or these contracts were never used before and *".....a simple invoice should suffice!";* but the shocking argument is that "customers might be offended when asked to sign such agreement and would move to another competing supplier – hence loosing sales!".

But has anyone ever walked up to a bank asking for a bank loan on the only basis of a repayment promise?

From my past experience as a bank employee, a thorough evaluation of the risks involved, and a detailed analysis of the creditworthiness of the client applying for a bank loan or an overdraft facility was the normal banking practice. Besides, a Bank loan application had to be supported with a detailed business history of the applicant, a business plan for the future operations of the business, set of audited financial statements, an adequate collateral to the satisfaction of the bank, an obligation for first general hypothec on assets, a life assurance policy, and the never-ending list of requirements continued.

But aren't the banks in competition with each other? If one bank refuses an application for a bank loan, the applicant would certainly go to another bank across the road – and all the banks know it! Notwithstanding, the banks are there to sell their services and make their profits as any organisation in any other industry or sector of the economy!

It is all about Culture

My personal perception, however, is that the required list by the banks supporting a bank loan application is widely accepted by the communities as the normal banking procedure. But why should the trade credit applicants and existing trade debtors hesitate to provide information pertaining to credit sales to their suppliers when they are requestd to do so, whilst at the same time willing to collaborate and provide whatever information their bankers request? Why should there be the perception that a bank loan differs from trade credit? Aren't they the same in principle?

The whole issue circles around our trading culture, which was inherited from the former Maltese business people who used to trade with each other solely on mutual trust and personal integrity. But one should keep in mind that unfortunately, the trading environment has changed, together with the people doing business in today's markets!

Nobody wants to lose sales – but, it is not accepted, in today's modern economy, that businesses adopting a credit policy in order to ensure that all their customers adhere to written terms and conditions suffer from loss in business.

Admittedly, it may happen that some potential customers do not take the option of credit when asked to provide pertinent information, but surely this is not loosing sales! In such circumstances the trade creditor would be protecting and saving its resources for other potential customers who are more *'profitable'*, and with whom long-term business relationship makes more commercial sense.

Requesting a signed contract or agreement, specifying trading terms and conditions is not at all being bureaucratic, intrusive or officious in any way, but it is only a matter of caring for the long-term profitability of the business. And customers would accept it if well communicated with them. After all, both the seller and the buyer would benefit from having a clear business agreement - it would prevent future disputes and enhance long-term business relationship, which would result in more profitable business for both parties.

If a business transaction lacks written credit terms and conditions, what evidence of the agreed credit limit and credit terms would there be if any dispute arises in the future? It would be a case of the supplier's word against that of the customer! It is due to these circumstances that long-term business relationship and loss of business through disputes between the two parties may be harmed, 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 and the credit limit; Interest and charges which may apply due to late payments; discounts for early payments; retention of title; and the issues of a bank guarantee, personal guarantee and other liabilities should be considered especially when the debtor is a limited liability company, or the credit involves a substantial sum of money.

Other disclaimers may include:

- Permission to snap-check with the applicant's bankers and other trade references from time to time;
- Submitting of audited financial statements when deemed necessary;
- A statement that no verbal agreements or modifications will be accepted or effective;
- Statement that the fees and costs to collect past due accounts will be added on the defaulted account;
- Interest charges on late payment (EU Late Payment Directive);
- Credit facilities are not transferable and may be withdrawn unilaterally, and that any change of ownership must be notified in writing otherwise the original applicant/s will remain liable for all balances due up to the date of notification.

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 trade creditor and the customer, indicating the persons' titles, date and place.

It may also be wise to print the terms and conditions of sale or credit on the reverse of the invoices and statements. This would ensure that the customers know what has been signed and mutually agreed at the onset of the business relationship.

Thanks to the expertise of the Members of the Malta Association of Credit Management, and to the professional working relationship and collaboration between them, MACM has developed a master copy of a credit application form which includes a set of general terms and conditions. The business community can adapt these credit terms and conditions to meet the specific needs and expectations of their particular industry or sector. Relevant legal aspects, recently introduced in Malta, are also found in the recommended credit application form by MACM.

It has always been the objective of MACM to continue introducing business concepts of how credit management should be carried out in today's commercial world, and to develop tools which would help credit managers perform their duties in a professional and profitable manner.

Copy of this document can be made available from the Secretariat of MACM upon request.

Chapter 8

Late Payment Directive

A published leaflet of the Directorate-General for Enterprise of the European Commission on late payment revealed that in Europe, one out of four insolvencies is due to late payment, leading to a loss of 450,000 jobs each year.

Late payment in commercial transactions is considered as one of the main concerns of the Maltese business community. Some companies, across all sectors of the Maltese economy, are facing liquidity problems, which are evidently seen and remarked in their audited accounts. We also see a great deal of bartering going on with building developers exchanging property as payment to sub-contractors. Some other companies complain that as a result of late payment, they are unable to restructure appropriately in order to face the new challenges and opportunities of today's market demands. However, similar difficulties are also found across the European Union.

A published leaflet of the Directorate-General for Enterprise of the European Commission on late payment revealed that in Europe, one out of four insolvencies is due to late payment, leading to a loss of 450,000 jobs each year! The payment delays in commercial transactions across the EU are quantified at EUR 90 billion a year (around Lm40 billion per year) and they account for EUR 10.8 billion in terms of lost interest. In addition, outstanding debts worth EUR 23.6 billion are lost every year through insolvencies caused by late payment.

In 2004, Intrum Justitia, Europe's leading provider of credit management services, carried out a survey in 22 European countries involving more than 9,000 companies. This survey, shows that the majority of the participant companies are strongly concerned about the consequences of late payments. The same report states that payment uncertainty was cited as the most significant obstacle to trade. The classic obstacle of 'customs duties and taxes' and 'administrative obstacles' were considerably less significant in trade within Europe.

An analysis of the local credit scenario gives very similar results. Court cases filed in our Law Courts, indicate the magnitude of this problem in the local market.

By the Legal Notice 233 of 2005, the EU Directive 2000/35/EC has been transposed into the Maltese Law and shall apply to all contracts signed after the 1st of May 2004.

This Directive applies to all commercial transactions including all the transactions carried out between undertakings or between undertakings and the public authorities. The Government, the Local Councils and other public bodies are therefore included whenever a public procurement contract is signed with the private sector.

Although this Directive does not harmonise the payment period across the Member States, it defines a fixed reference period of 30 days commencing from the date of receipt of the invoice or from the date of receipt of the goods.

It also imposes a penalty interest, which starts automatically in the event of payment delay at an interest rate of 7% above the set Central Bank rate.

This penalty interest rate should help to discourage enterprises from paying each other late, since it would be more expensive to delay payment than use one's own banking facilities.

The same Directive allows the seller to retain title of goods until payment is completed, however this should be explicitly agreed between parties before delivery.

Moreover, the Law addresses the compensation for all the costs associated with the recovery of the debt. Article 26C (5) states that *"unless the debtor is not responsible for the delay, the creditor shall be entitled to claim reasonable compensation from the debtor for all relevant recovery costs incurred through the latter's late payment."*

Surprisingly, I make reference to Article 5 of the EU Directive 2000/35/EC, where it is stated that Member States must ensure that an enforceable title (court order or judgement) for unchallenged claims would be obtained within ninety days from when the legal proceedings are instituted in court, irrespective of the amount. Although this Article should help speeding up the payment recovery, it was completely left out when the Directive was transposed into the Maltese Law. In Malta, we do have a fast track to get a court order – by filing Judicial letter (166A) but restricted to certain amounts.

By the implementation of this Directive, the interests of the Maltese trade creditors are, in a way, protected against fraudulent debtors. However, the trade suppliers should be aware of the benefits that this Directive provides, and in my opinion, they should apply its provisions when selling to their customers on credit to their own benefit.

Local suppliers selling in the EU market also benefit from this Directive since all Members States have to implement it, thus no different legislation exists in the EU market.

Notwithstanding, the honest debtors should not be effected by this Directive, and should neither affect the business relationship between the trade creditors and their debtors provided that the debtors honour their commitments on time and as agreed in the contract between the parties concerned.

Chapter 9

The Sales and the Credit Departments

The sales department triggers and makes the sale, and the credit department completes the process by agreeing competitive credit terms with the client.

In a previous chapter, it was argued that the Maltese business scenario is marred by a late payment culture, defaults in credit facilities, bartering, mismanagement of finance and cash flow, late or non-filing of financial documents and a number of dishonoured cheques are being drawn.

This slow payment and non-payment culture is seriously hindering the cash flow of many local businesses leading to more distressed firms and even bankruptcies. This creates a ripple effect because "Businesses that are not paid on time may find it hard to pay on time themselves".

Being aware of this commercial scenario, every creditor should take a proactive approach in the market to help avoid any financial losses as has been experienced in the local supermarkets sector some six years ago.

One way of being proactive is by motivating all the staff, especially the front line sales people, who are in direct contact with the clients, in order to give the necessary ongoing feedback to the credit department. Close ties between the sales and the credit department are essential in today's market turbulence, because besides being inexpensive it is also an effective way of maximising profitable sales and reducing the risks associated with credit.

Notwithstanding, some credit departments are sometimes criticised for having a poor working relationship with the sales department. This is much more evident in larger organisations where stringent decisions taken by the credit manager effect directly the operations of another manager or sales rep in the sales department whose primary aims are to maintain good customer relationship, increase sales and reach the targets set.

Synergy between the two departments is important. It has to be mutually understood that both departments are vital for the success of any business organisation. The sales department triggers and makes the sale, and the credit department completes the process by agreeing competitive credit terms with the client, thus securing long-term customer-relationship, and realising payments and profits from the sales department's efforts. Where internal conflicts between the Credit and the Sales departments exists, internal politics are inevitable and may take time to resolve. However, if both departments understand each other's role and objectives, a more co-ordinated approach should be possible, and this co-operation is important to enhance the effectiveness and efficiency of the operational activities of both the credit and the sales department alike.

More often than not, the decision about which supplier is awarded a purchase order is much about the relationship between the buyer and the salesperson rather than about the supplier's name, terms and conditions of the sale, and the quality of the supplier's product. This close relationship can be beneficial to the credit manager both to understand better the needs of the clients, as well as to know the ongoing financial position of the clients. Any early visible decline in the business of a client can be easily noted by the salesperson and this would be an opportune time for the credit manager to meet this client.

- Salespeople are therefore the proper intermediaries between the credit manager and the client, but they should not as a rule serve as mediators or much less as arbitrators in a credit dispute with the client. Hence, the role of salespeople and sales clerks should be given more weight by the employers. Recruiting the right people, and ongoing sales training should be seriously considered.

- Co-operation between the two departments is not impossible to achieve if the right personnel are employed and professionally trained. Differences in opinion may only be about how a particular order or account should be handled, and very often both parties have their own good reasons for coming to their own particular conclusions. The secret of better relationship lies in developing and implementing an internal programme consisting of the following activities:

- Sales personnel should be given the necessary training to help them understand and appreciate the role of the credit department within the organisation, and the risks involved in granting credit and collecting debts.

- Encourage the salespeople to make use of the credit application form whenever they are asked for a credit facility, both from their existing client base and from the new applicants. The credit application form is the basis of the credit facility and should contain all the relevant information about the applicant, which is needed to assess the creditworthiness of the applicant, and to serve as a contractual basis between the creditor and the applicant.

Provide the salespeople with credit information, including the credit limits set by the credit department and the late paying accounts, without violating confidentiality. This information should be given to highlight any defaulting clients and thus help to justify any actions taken against these debtors by the credit department.

The credit manager should attend the sales meetings organised by the sales department. This should help the credit manager to understand better any emerging credit needs in the market, and thus enhance the co-operation between the two departments. Any trade offs should be discussed between the two departments, leading to more balanced decisions with the aim to satisfy the needs of the customers profitably for the benefit of the organisation.

The credit department should respond promptly to all enquiries from the sales department, and the sales department should in turn accept any decisions taken in respect of any existing account or credit applicant.

Using the resources available within the organisation is the most effective and efficient way to act proactively against any wrongful trading which may exist in the market.

No organisation should rely or depend solely on the remedies provided by the legal framework or by any other institution which exist in this country because their effectiveness is common knowledge. Therefore, precautions should be constantly taken, and every credit facility should be assessed for its creditworthiness at the onset and monitored throughout accordingly in order to keep any negative financial surprise to a minimum.

Chapter 10

Investing in the skills and competencies of the work force

The effective way to achieve such business rewards is by combining the work force's experience with education.

Trade credit has become an important element to gain competitive advantage in today's dynamic business environment. Consequently, people employed at the credit department have an important role to play:

'Aiming to achieve high volume of profitable sales with possibly no or few bad debts and a sound cash flow management, while building a long-term business relationship with their clients.'

The effective way to achieve such business rewards is by combining the work force's experience with education. In other words by investing in the skills and competences of the work force.

Many Maltese companies entrust one of their key assets, *'debtors'*, very often in the hands of inexperienced or unqualified personnel, and the Malta Association of Credit Management (MACM) has felt the need to introduce in Malta accredited qualifications for people working in the field of credit management in order to develop the right skills and qualities that could also be applied to other managerial roles: *The ICM (UK) qualifications.*

The ICM qualifications:

The Institute of Credit Management (ICM) education scheme has been established for over 20 years and the syllabus is reviewed annually to ensure its relevance to the credit function.

The ICM has long believed in the value of an all round grounding in credit management and the education syllabus for students studying for the ICM qualifications is designed to give the best possible foundation upon which to build a career in credit management.

The strength of the syllabus lies in both the strong base upon which to base a career, and in the opening it can give to those who have hitherto only had exposure to trade or consumer or export. In other words, by studying to achieve the ICM qualifications, the aspiring credit manager can look to broaden his or her horizons in all sectors of the economy be it in the service or product related industries.

Why the ICM qualifications?

MACM has always been active to introduce a recognised, hands-on education programme for students and credit practitioners in Malta, and the ICM qualifications of the UK meet the MACM's objectives. Founded in 1939, the ICM is the largest professional credit management organisation in

Europe with 9,000 members and students, and is the centre of expertise in the United Kingdom for all matters relating to credit Management.

The ICM is also an accredited awarding body offering nationally recognised qualifications in credit management. In carrying out this role, the Institute establishes and maintains credit related learning syllabi, organises and quality controls every aspect of the examination process, and accredits centres that deliver ICM qualifications.

The Syllabus:

The ICM Certificate in Credit Management

The Certificate in Credit Management comprises Introductory Credit Management, Accounting, Business Law and Business Environment. Each of these four compulsory units is assessed separately, and develops in the student a basic understanding of credit management across the full range of credit environments, fundamental accounting principles and some broad understanding of the legal context and structures in which businesses operate, together with the national and international context of today's global economies.

Success in these units, coupled with the development of good management practices readily equips the credit manager with the basic tools to do the job effectively and efficiently.

The ICM Diploma in Credit Management

The successful candidate in the Certificate may then proceed to achieve the more demanding Diploma in Credit Management. Comprising as it does Advanced Credit Management, Credit Management Law, Legal Proceedings and Insolvency and a Practical Credit Management Project, the diploma is the definitive credit management qualification. The qualification for successful Certificate and Diploma candidates is much sought after, and is the model for credit management schemes in a number of countries.

It is hard work, but the end result pays great dividends both in status and reward, and should be viewed by both employer and employee as an investment in the future.

It is an investment to be strongly recommended.

In Malta, part-time courses are run by the Malta Association of Credit Management in the evening. Courses commence every October at MACM Training Centre in Mosta. MACM Training Centre is the only accredited study centre for Malta. Highly qualified tutors deliver lectures. Examinations are held in January and June at the University of Malta.

Registration:

Through MACM, Maltese students can now be able to study and sit for the ICM examinations in Malta. Students will need to register through MACM for membership with the ICM.

On the successful completion of the ICM Certificate in Credit Management, one is eligible to become an Associate of the Institute and to use the designatory letters AICM (Cert).

Completion of the Certificate and Diploma in Credit Management entitles to become a Graduate of the Institute and use the designatory letters MICM (Grad).

Chapter 11

Know your Debtor

Before proceeding to review the various 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 publication "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. We feel that not only is this useful, but it is 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, Identity Card number, 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. The same rules apply in the case of a corporate debtor. Details of how long he has been in business is also important.

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.

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 no pending lawsuits in court. See whether or not any Court Warrants were issued against him. If you are dealing with a corporate body try and obtain copies of the trader's accounts from the Registrar of Companies. See that his Annual Returns are up to date. All this will help you form a better picture of the person you will be offering credit facilities to.

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

Not just good looks...
Value
Convenience
& Timeless Taste
Extra Orange Flavour
No Sugar
Kinnie
zest
EXTRA ORANGE FLAVOUR
Less than one calorie per 100ml
No sugar
Kinnie®
zest
www.kinniezest.com

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 endorse 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 judgment 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 judgment against your debtor the cost and the efficiency of which varies depending on the method you use.

We shall review hereunder the various methods which can be used.

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 and also if you do notify your debtor, and he contests your claim, you will then have to file a lawsuit. It is also to be noted that:-

Amount due must not exceed Lm10,000.00 (€23,293)
Debt must be certain, liquid and due
Debtor may contest 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
You may not file precautionary 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 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 Lm1500.00 (€3,494)
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 Lm1500 (€3,494) and not more than Lm5000.00 (€11,647)
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 Lm5000.00 (€11,647)
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

Chapter 12

The Judicial System Tools

Precautionary Warrants

The Creditor might find himself in a situation where he has not yet obtained an executive title (which might take some time if the Debtor is contesting the Creditor’s claim) and is concerned that the Debtor might dispose of his assets or take any other action which might prejudice his rights. In this case the Creditor may request the Court to issue precautionary warrants. This will effectively safeguard the Creditor’s interest by seizing property belonging to the Debtor, which property is deposited in Court or kept under the custody of a third party, until the Creditor’s claim is properly determined and converted into an executive title. Once issued, precautionary warrants shall remain in force until the Creditor obtains an executive title, or until they are rescinded by the Court. Once the Creditor obtains an executive title, then a precautionary warrant become an executive warrant.

Since the precautionary warrant is used even though the Creditor’s claim has not been confirmed by means of an executive title, it must therefore be used prudently. In fact the law requires that applications for precautionary warrants must be confirmed on oath by the Creditor. If the Court feels that a Creditor’s application for a precautionary warrant is abusive, then he can be found liable for damages.

Precautionary warrants are usually issued concurrently with the commencement of legal action. At any rate, once a precautionary warrant has been issued the Creditor must bring forward his legal action against the Debtor within a specific time period. Failure to do so will entitle the Debtor to request the Court to remove the precautionary warrant and may expose the Creditor to an action for damages.

Notwithstanding that a Creditor has filed a precautionary warrant in accordance with all the provisions of the law, the Debtor may still request the Court to remove the precautionary warrant in certain situations. One such case would be when the Debtor is in a position to lodge a deposit or other equivalent security in Court to safeguard the Creditor’s claim. The removal of the warrant is also possible when the Debtor can show that the amount being claimed by the Creditor is *prima facie* unjustified or excessive.

The Debtor may also request the Court to condemn the Creditor to pay him a penalty between Lm500 (€1,165) and Lm3000 (€6,988) if he can prove that the Creditor failed to bring the action within the time prescribed by law following the filing of application for the precautionary warrant. Furthermore, the Creditor can also be condemned to pay such penalty if he fails to show that the warrant had to be issued or that within the fifteen days prior to the application for the warrant, he had called upon the Debtor to pay the debt or to provide a sufficient security. The Debtor may also request the payment of the penalty if he can prove that the Creditor’s claim is malicious, frivolous or vexatious, or if the circumstances of the Debtor are such as not to give rise to any reasonable doubt as to his solvency and his financial ability to meet the Creditor’s claims. It is therefore clear that while precautionary warrants are useful tools which will ensure that the Creditor’s rights are not prejudiced by the Debtor’s actions, they must be used prudently and responsibly.

Types of Precautionary and Executive Warrants:

Warrant of Description

This warrant is a precautionary warrant and is therefore used to secure a right over a movable thing until the Creditor has obtained an executive title. The court executing officer will execute this warrant by describing the item specified in the warrant in detail stating the relevant details such as the number and quality of the item. Once the court executing officer has done this, the item shall remain in the custody of the person in whose possession it is found and that person shall be responsible for its safe keeping. This warrant is useful to record the condition, quantity and location of items belonging to the Debtor (whether they are in his possession or in the possession of a third party) thus ensuring that they are not disposed of to the detriment of the Creditor's rights.

Warrants of seizure

Warrants of seizure can be both precautionary as well as executive. This warrant is a Court order issued upon the application of the Creditor whereby the executive officer seizes the Debtor's property for the eventual judicial sale by auction (see below), so that the Creditor can be paid from the proceeds of such sale. There are various types of warrants of seizure:

- *Warrant of Seizure of Movable Property*
  This is used to seize movable property from the possession of the Debtor, which property can range from normal household items to money, jewellery and articles of precious metal or intrinsic value. The objects seized may be put under the care and responsibility of a third party known as the consignatary. Not everybody can be appointed consignatary (for example close relatives and employees are not accepted), and the consignatary is responsible for their safekeeping.

- *Warrant of Seizure of Immovable Property*
  This is a Court order for the seizure of immovable property belonging to the Debtor. Once property is seized, the Court will appoint an expert to appraise the property and fix a date and time for the judicial sale by auction. The Court may accept an appraisement filed by the Debtor himself, after hearing any objections which the Creditor might have to such an appointment. The appraisement shall consist of a valuation of the property together with a detailed description including the existence of any legal burdens, leases and other third party rights over the property in question.

- *Warrant of Seizure of a Commercial Going Concern*
  The law defines a Going Concern as "any kind of commercial enterprise conducting a business activity and including machinery, apparatus, goods, corporal and incorporeal rights, both movable and immovable property, licences, copyright and goodwill". A warrant of seizure issued on a commercial going concern will therefore seize all the above including both the movable and the immovable property of the going concern. Prior to authorising the sale of the seized going concern, the Court will appoint an expert to draw up a report on the going concern which report must include the assets and liabilities, and whether given the amount of debts which the going concern has, it should be put under administration rather than sold. If the going concern is put under administration, then the appointed administrator will be responsible to manage it until the debt is paid. Such administrator shall have the right to sell and carry on trade in the going concern's day-to-day business, subject to obtaining the necessary authorisation from the Court in the case of decisions of an extraordinary nature.

Judicial Sale by Auction

Once the Debtor's property has been seized by means of one of the warrants of seizure, the Creditor will want to sell the seized property by an auction which is carried out under the authority of the Court. The auction is advertised in one English language and one Maltese language newspaper. Both the Debtor and the Creditor may, at their expense, advertise the auction in any newspaper of the choice or broadcast over any medium. When the property seized is being sold by judicial sale by auction, the Creditor may bid *animo compensandi*, which means that he may purchase the seized property himself on account of the money owed to him. If the property is purchased at a price higher than the amount owed to him, then he is obliged to deposit in Court the surplus amount.

Garnishee Order

This is a Court order issued to third parties who might be in possession of money or movable property belonging to the Debtor. These orders are typically served on commercial banks but may in fact be served on any person who might be in possession of the Debtor's money or movable property. Upon receipt of the garnishee order, the third party has a maximum of 21 days to deposit in Court any money or movable property in his possession. If the third party fails to do so within the mentioned time limit, he shall be responsible towards the Creditor for damages and interest, and may also be liable to arrest. The law prohibits the issuing of a garnishee order in certain instances such as on salaries, wages, social benefit or pension (only the first Lm300 (€699) per month are protected). The Garnishee Order can be both a precautionary and an executive warrant.

Warrant of Prohibitory Injunction

This is a precautionary warrant which may be used to ensure that a Debtor does not transfer his property to third parties while the Creditor obtains an executive title. As the name suggests, this warrant takes the form of a Court order prohibiting the Debtor from transferring such property. This warrant may be used only where the debt is not less than Lm5000 (€11,647) and can be used on both immovable and movable property. If used to prohibit the transfer of immovable property, then the warrant must be served on the Director of the Public Registry. This will ensure that anyone purchasing the Debtor's property will become aware of the existence of this warrant once the searches are carried out by the Notary, unless of course the warrant has been done in the last minute well after the Notary had already carried out the searches. At any rate, any transfer of immovable property done after the service of the warrant to the Public Registry shall be null.

This warrant may also be used to prohibit the sale or transfer of shares which the Debtor might hold in a commercial partnership. The warrant must be served on the Registrar of Companies and any transfer of shares done after such date shall also be null.