Looking forward to 2013?

Josef Busuttil
Director General
MACM – Malta Association of Credit Management

One can develop and work on a strategy or a business plan any time, but a New Year looms ahead of us like a clean sheet of paper, upon which we have the power to deliberately compose our achievements and successes ahead of time.

We are in that time of the year when instinctively we look back and analyse what went wrong, why it went wrong and what should have been done. Business owners and executives meet their peers and set objectives and strategies for the coming year with the aspiration that next year will be a better one!

However, most business plans and objectives focus solely on turnover with little or no consideration about other important factors that a healthy business should secure. Very often, people in business do not realise that increasing sales may not necessary result in better profits. Not all sales are profitable sales!

Selling products and services in highly competitive and saturated markets is not at all easy. Products are becoming more homogenous than ever before, the product life cycles have been shortened, prices have been slashed to the bone, online shopping from all over the world has increased and will continue to increase, and the easiest differentiation strategy adopted by many businesses to increase their sales turnover has been that of selling on credit.

People in business contend that credit has become a commercial norm and customers themselves are nowadays expecting it. They are in fact requesting and bargaining with their suppliers for better credit terms and some businesses are seriously considering credit sales as a means to gain competitive advantage. So much so, that amid the political billboards seen all over the streets of Malta, one can easily be enticed by other colourful billboards promoting goods which could be purchased now and paid for later. Other 'buy now - pay later' adverts are also plentiful in the local newspapers, magazines and other media.

In actual fact, there is no harm in selling on credit. Credit is proved to be the oil that keeps the wheel turning in an economy, but firms selling on credit should have the necessary resources to achieve and sustain the desired profit margins and to secure sound cash flow at all times.

Therefore, if there are business people out there planning to increase their sales turnover by granting and extending credit to their customers, they should not merely grant and extend credit without focusing their resources on the four major components of the credit function. They should spell out clearly the appropriate policies that are necessary for such a strategy.

The four major components of the credit function:

Credit Sales Approval

The approval of credit sales should be the priority of the credit function and therefore, the resources necessary to carry out this activity must be adequately allocated. If adequate resources are deployed for the approval of credit sales, the result would be that of securing profitable sales that would otherwise been lost.

Proper customer information, or as it is most conveniently called the credit application form, should be used and based on the information collected from the customer and other reliable sources, suppliers should evaluate the credit worthiness of the prospective customer, keeping in mind to meeting the customers' needs and expectations while securing profitable sales. In other words - saying '***Yes'*** to profitable sales that would otherwise be lost should be the primary aim at this initial stage. MACM provides databases with pertinent data to perform this analysis process.

Invoicing / billing

Another critical activity is the issuing of invoices to customers. Invoicing is the second major component of the credit function.

An invoice is a request to a customer for payment, and no one should expect to get paid on time if invoices are not sent on time to the customer. Likewise, no one should expect to get paid if the invoice is not clear, complete and accurate.

On this last point, one should be aware that issuing invoices which are not clear, complete and accurate drives up the cost of doing business for both the supplier and the customer, because of the time wasted to reconcile and to revise the disputed invoice.

Past Due A/R Management

The third vital activity, and hence a major component of the credit function, is the management of past due accounts receivable (A/R) – *The overdue accounts*.

It is important to keep in mind that past due A/R management is not collections or enforcement of payment - it is simply part of ***the process of completing the sale***.

Although it depends on the industry and country, on average it is calculated that 25% of customers fail to pay on time for a number of reasons but less than 1% of the credit sales' value are in fact written off as bad debts. This implies that overdue accounts need to be managed more proficiently and effectively as they can be a means to gain more profitable business in the future. Reference is made to Type I and Type II customers of my last article. However, one should always be vigilant to take the necessary actions proactively in order to keep losses to a minimum.

Therefore, people working in the credit function should be trained in the skill of keeping credit customers current and buying, because repeat sales are the most profitable sales since they reduce administrative and marketing costs. Monitoring the existing credit customers using MACM monitoring service is imperative for the local businesses.

Communication

The fourth major component of the credit function is surely communication. In this context, communication is defined as:

a. Process monitoring;
b. Performance measurement;
c. Identifying areas of opportunity for improvement.

The credit function should adopt a set of monitoring and measurement tools to secure better profit, ensure sound cash flow and by which, areas of opportunity for improvement are identified. This may imply that the tools traditionally deployed to measure the effectiveness of the credit function may not necessary make much sense in today's commercial realities. Measuring tools that focus on better efficiency and customer satisfaction should be incorporated to assist sales and to encourage repeat custom.

Besides, during the course of approving credit customers and managing A/R, the credit function interacts with almost every aspect of the business. The credit function's role has to relate not only to customers but also to salespeople, finance, lawyers / attorneys, distribution, inventory, and other business units that collectively make a sale happen to the satisfaction of the customer.

Few executives and top managers realise that the credit function is therefore, perfectly positioned to have a birds' eye view of the whole business process. Hence, it can detect internal inefficiencies and identify areas of opportunity for improvement. People working at the credit functions should be consulted more often in this respect.

Whilst wishing the Maltese business community a merry Christmas and a prosperous new year, I reiterate and emphasise the need to focusing the resources on the four major components of the credit function if the business plans for 2013 are to increase the sales turnover by granting and extending credit to customers.