Protecting our largest liquid asset

by Josef Busuttil

Trade credit is the largest source of business financing and many economists contend that trade credit is the economic fuel driving the worldwide economy. This hypothesis has been evidently proved and confirmed by many businesses that are finding it difficult to get the usual credit terms from their suppliers due to the current international economic and financial turmoil.

Today's commercial environment is not at all rosy for the international business community. Unemployment is a major concern for many governments, hefty austerity measures are being introduced in a number of countries that were once considered as tiger economies, and big household names had to close their doors to business. This situation has led to less demand for goods and services by customers and harsher competition for businesses.

With businesses competing intensely to maintain their market share, trade credit has recently become inevitable and even more important as it encourages customers to buy. However, this is a big challenge for businesses because while they are offering better credit terms to increase sales, trade credit and loans have been rationed by the major financial institutions across the globe, leaving a number of businesses suffering poor cash flow.

A survey conducted by the Credit Management Research Centre, at Leeds University Business School, reveals that in the UK, more than 80 per cent of daily trade transactions are on credit terms and as a component of the money supply, business-to-business credit exceeds the primary money supply (M1).

In Malta, the trade credit scenario is not much different. Trade Credit has evolved to become an integral part of our day-to-day business. For most local companies, accounts receivable or as we commonly refer to "debtors", represent the largest liquid asset on their balance sheet, and habitually we are in danger of taking it for granted.

In real fact, very few invoices are actually being paid on due date or before and in some industries, accounts are overdue by more than 180 days. It is clear that late payment is a critical problem across all sizes and types of suppliers in Malta.

Furthermore, trade credit is being considered by businesses as a means to generate more sales and better credit terms are being offered and extended to gain and sustain competitive advantage in the market. Some businesses argue that they would lose sales if they were less flexible on credit terms.

But if credit is so vital in doing business in today's hostile environment, how can the suppliers manage their past-due accounts, protect their cash flow and minimise the risk associated with trade credit?

Firstly, one has to acknowledge that managing credit is an art in itself. This entails the person responsible for managing credit to be skilled and adequately trained like any other professional working in other business functions or departments.

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

But to achieve best results, the credit controller should possess good interpersonal skills that complement numeracy and literacy. People employed in the credit function should be willing to meet with customers and build long-term customer relationship; should be able to integrate with his colleagues and peers; should be a leader and able to motivate his/her team; should be IT literate; and above all, should strive to understand and meet customers' expectations, needs and culture.

My question is, how can one be effective in collections if he/she does not know the customer, let alone the reason behind the customer paying late?

The job of the credit staff is far from crunching numbers and mitigating risk. In today's commercial scenario, the credit controller should be the one who writes, communicates, implements and manages an effective credit policy that is in line with the current commercial scenario while meeting the different expectations of the stakeholders of the business, including the profit element at the end of the day.

Hence, credit staff development and training are key in order to protect this major liquid asset. In view of the current hostile commercial scenario, MACM provides the necessary credit management training to the local business community. In-house credit management training, ensuring better focus on specific industry needs, is also being offered. MACM training programmes complement well with the MACM Credit Management Information System available to all MACM members.

Having the most pertinent credit information and credit tools together with skilled personnel is the recipe to take profitable credit decisions that protects cash flow, maintains market share and ensures long-term profit.

Mr Busuttil is the director general of the Malta Association of Credit Management, a not-for-profit organisation, providing a central national organisation for the promotion and protection of all credit interest pertaining to Maltese businesses. The MACM represents the credit profession across all economic sectors and is the distributor of Graydon International Credit Reports in Malta.