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## **The credit function and its value for businesses**

### **When was MACM established and what is the 'credit' function?**

The Malta Association of Credit Management (MACM) is this year celebrating its 10 anniversary. It was officially established in June 2001 with the main scope being that to provide a central national organisation for the promotion and protection of all credit interest pertaining to Maltese businesses.

Credit is involved when a firm sells its products or services and agrees with the customer to get paid at a later date. Therefore, credit can be described as the oil that keeps the wheel turning for businesses and the economy at large.

The rationale behind granting credit can vary according to the industry, product type, the level of competition in the market, customers' demands and marketing objectives of the firm granting credit.

In principle, firms grant credit to allow their business customers the required time to add value to the products and to promote and sell the goods to the next customer in the supply chain. In the business-to-consumer transactions, firms grant credit to individuals who may not have enough money to pay for their purchase now but are able and willing to pay by instalments or as agreed with the seller.

Therefore, granting credit can be seen as a form of investment in the customer. And like any other investment, it involves risks and costs money. This implies that firms granting credit should protect their investment by minimising the risks and cost involved in credit. Hence, the credit function is one of the most sensitive departments of a business organisation, as it is the responsibility of the credit function to ensure that customers honour their payment agreements and thus, protect the cash flow of the firm, which is the lifeblood of a business organisation.

## **What are the main achievements of MACM during the past 10 years?**

To answer this question, one has to know the main objectives of MACM, which are threefold and complimentary to each other:

1. Lobbying with various stakeholders for a better credit environment in Malta.
2. Promoting good credit management practices with the local business community by means of educational events, such as lectures, seminars, workshops and conferences.
3. Providing relevant tools and up-to-date information to MACM members by which they will be able to analyse the credit worthiness of their prospective customers, as well as, to monitor and manage their existing credit customers efficiently and proactively at a cost-effective manner.

Since its establishment, MACM embarked on a number of lobbying activities, addressing various matters pertaining to the local credit scene. To name but a few, MACM was successfully involved in various fronts such as improving the number of dishonoured cheques in the local market; promoting the introduction of specific legislation, such as The Company Recovery Procedure, The Late Payment in Commercial Transactions Directive, The Consumer Credit Directive, and the efficiency of the local judicial system.

As regards to the promotion of good credit management practices in Malta, MACM organises a number of events every month. The primary aim of these events is to educate the credit practitioners employed by local businesses. These events help to provide best strategies and tactics that would assist businesses to ensure sound cash flow and secure long-term profit.

MACM is also the accredited training centre of the Institute of Credit Management (ICM) of the UK. It provides lectures leading to recognised Diplomas in Credit Management to local students who work or would like to pursue a career in the field of credit management.

To compliment the above activities, MACM was the pioneer in Malta to provide the Maltese business community with the required tools and up-to-date databases of information that would assist local creditors to take profitable credit decisions. Thanks to today's technology, MACM members avail themselves of comprehensive credit reports on every entity registered in Malta. MACM collects information both from its members by means of exchange of information and also from other sources on a daily basis to ensure that its members are well informed and equipped to minimise credit risks and costs and to turn these risks into credit rewards and better profit.

MACM is also the distributor of Graydon International for the Maltese market. Therefore, through the MACM Secretariat, a Maltese firm can request a Credit Rating Report on any company registered anywhere in the World.

### **To what extent is the credit function between companies utilised?**

Customers are demanding and expecting their suppliers to grant them credit. Statistics show that 80 to 90 per cent of business-to-business transactions involve payment at a later date and the agreed credit terms are often extended.

The wider use of credit is also remarkably noticed when examining the accounts of businesses. On average, the "Debtors" account amounts to 40 per cent of the assets of a

company.

Creditors argue that in B2B transactions, customers are giving great importance to the credit terms offered when negotiating business deals. This implies that more businesses are using credit as a marketing tool to gain competitive advantage in order to boost sales and increase market share.

### **How has the credit crunch affected company's credit?**

Following the credit crunch, credit has been rationed all over the world. Banks are being more vigilant and rigorous when lending money to their customers and credit insurance companies have increased their rates considerably. This means that credit has become more expensive.

Maltese companies have also been affected. Local importers are finding their foreign principals (exporting companies) less willing to grant them credit and many complain that they are being requested for upfront payment. This may create financial pressure on the local trade creditors as the latter cannot rely on the credit once obtained from their foreign exporters to finance the credit they grant themselves to their customers in Malta.

Nevertheless, from what I have experienced during the past two years, meeting with business people all over the world, I come to the conclusion that Malta, as a country, has

managed the credit crunch well as compared to other economies. Having good regulatory authorities helped much in those difficult times.

### **Have the benefits of the credit function been recognised by Maltese companies?**

The people involved in the management of credit are far from just being responsible to crunch numbers. These people can be of great benefit to their respective firms as they are the ones who are in direct contact with the customers from the beginning till the very end of the business transactions.

I always contend that the credit function should be considered as a sales function. The credit people know their customers well and they can be instrumental in enhancing the profile of the firm and in building long-term customer relationship, which would in turn help to gain and maintain competitive advantage in the market. Hence, increasing repeat sales which

should enhance the synergy between the sales and credit teams, and not the other way round.

Yet, the credit function is still seen by a number of CEOs and business owners as the ugly stepchild of the finance department, the necessary evil function. If the credit practitioners are well skilled, it is the department that can bring in significant benefits to the firm.

My suggestion to the Maltese business owners and CEOs is to involve more the credit team in the business strategies and decisions. They can add value to the business. They are able to distinguish between "sales" and "profitable sales". One has to keep in mind that a firm can have notable revenues but still suffers from sound cash flow and long-term profit due to late payment and bad debts.

### **What are the problems which local companies experience in terms of credit?**

One of the main concerns of local

businesses is late payment. Some industries are worse than others.

MACM compiles data and issues industry DSO figures on a quarterly basis for its

members.

The DSO figure represents the average time taken by customers (trade debtors) in settling their invoices due to their suppliers. It is a tool widely used by businesses around the world to measure the performance of the credit management function.

MACM publishes the DSO figures so that its members will be able to benchmark their DSO figure with that of their own industry. In Malta, the DSO figures vary considerably from 36 days for the Agriculture Supplies to 250 days for the Industrial Equipment Industry. This shows that businesses operating in certain industries are much more exposed to late payment and should therefore strive to change their working processes and habits.

Late payment causes cash flow problems to firms, especially to SMEs which are more vulnerable, leading to bankruptcies, loss of jobs, financial uncertainties to businesses and discourages entrepreneurs to invest. Thus, restricting the economic growth which is much vital to an economy like our country's, which is a small market economy depending heavily on the private sector's initiatives.

### **Are there 'tools' which companies can utilise to improve their credit?**

Definitely the tools exist to help companies to improve their credit practices and decisions. Nevertheless, one has to keep in mind the cost of these tools and balance well the cost and the rewards emanating from these tools.

Being a not-for-profit organisation, with no commercial objectives, MACM

provides a number of valuable credit tools and pertinent information to its members, which are considered not only indispensable by the local credit practitioners but also very cost-effective.

As already pointed out, good credit management practice is critically important. From time to time MACM issues tips and publishes literature to members to help them improve their credit management processes and procedures. Recently, MACM published a Credit Management Wall Chart which is a step by step guide to manage credit profitably. The Credit Management Wall Chart is available from the secretariat of MACM.

MACM also provides sample copies of various credit documents including a credit application form, invoice, monthly statement, part-payment receipt, collection letters, stop supplies letter, and others with specific wording referring to local legislation and other caveats to ensure better effectiveness.

Members also have access to a Credit Scoring Tool which rates a company according to its financial data.

At MACM, we believe that credit management is all about being proactive. Therefore, MACM runs a system by which credit information regarding defaulting debtors is exchanged between the members of the association on a daily basis to ensure that the information provided is always up-to-date and relevant. MACM also provides factual information related to the law courts proceedings. These include judicial letters, law suits, and court warrants related to the local commercial scene.

Therefore, through the MACM website – [www.macm.org.mt](http://www.macm.org.mt), members have unlimited access (they do not pay per use) to information pertaining to credit provided by MACM.

In addition, MACM provides a system by which members are able to monitor their existing accounts (credit customers) on a daily basis. The MACM system automatically informs its members if it receives any news on any particular customer.

Being a member of MACM, the credit manager will also have the opportunity to meet and discuss credit issues with his peer group during the number of meetings and events organised periodically by the association.

MACM strives to continue providing innovative tools and services by which its members would ensure sound cash flow and it is currently busy working on other services which are new to Malta and which will be launched in the near future.

The association ensures that every business is able to make use of its services, irrespective of its size and industry the business operates in. All the MACM systems are developed with the needs of the local business community in mind and the association offers these systems at a low cost to ensure that every business organisation will be able to make use of these systems.

The aim of MACM is not to make a profit out of its unique services and products but to improve the Maltese credit environment to the benefit of the Maltese economy at large.

### **Is the importance of training and courses widespread enough in Malta? What courses are available?**

More and more businesses are investing in their credit employees. MACM organises a number of training courses throughout the year and the demand for these credit management courses is increasing.

Although the short training courses help the credit practitioners to improve their day-to-day processes and procedures, the proper training can only be holistically gained by obtaining the ICM(UK) Diploma in Credit Management.

The ICM Diplomas are reviewed annually to ensure their relevance to the credit function in today's business environment.

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 properly 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 credit. In other words, the aspiring credit manager can look to broaden his or her horizons by studying to achieve the ICM qualifications.

There are two ICM Diploma Levels. On the successful completion of the ICM Diploma – Level 3, one will be eligible to become an Associate of the Institute and to use the designatory letters AICM.

Completion of the Diploma in Credit Management Level 5 entitles the graduate to become a Graduate of the Institute and use the designatory letters MICM (Grad).

Being a lecturer myself, I acknowledge that it is hard work, and no one would ever consider entering the study process lightly. But the end result pays great dividends, both in status and reward, and should be viewed by the employers and employees as an investment in the future. It is an investment that MACM strongly recommends.

In Malta, part-time evening courses, are being offered by MACM. A number of Maltese students have already taken this opportunity and are enjoying the benefits that these qualifications provided. Employers are also benefiting from the skills and knowledge of their credit staff who are qualified in this specific management field.

### **Is the local legislation adequate to sustain the credit function?**

The necessary legislation is there. EU Directives have been transposed to local legislation, the Maltese Judicial System has been enhanced. However, the Maltese business community lacks the awareness and the knowledge of how to apply such legislation to protect themselves and to sustain the credit function. In addition, the enforcement of court judgements is far from being satisfactory.

In a research conducted by MACM, it was revealed that the business community lacks the knowledge and the details of legislation pertaining to credit. They do not know how to apply The Late Payment Legislation in Commercial Transactions and they also lack to know the implications of the Consumer Credit Directive. Following this survey, MACM has organised a number of seminars for its members to explain the implications of these two pieces of legislation. Other similar seminars will also be organised in the near future.

By the Legal Notice 233 of 2005, the EU Directive 2000/35/EC has been transposed into the Maltese Law.

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 imposes a penalty interest, which starts automatically in the event of payment delay at an interest rate of seven per cent above the ECB Intervention 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.

Moreover, this Law addresses the compensation for all the costs associated with the recovery of the debt. It 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".

Having legislation in place is one thing, but enforcing it is another. Efficiency in obtaining judgments is indeed important, and the judicial letter system, more commonly known as 166A, has helped tremendously. But the creditor is also very interested in having a truly effective legal means to enforce a judgment or executive title and recoup the money that he is owed. The problem in Malta lies in the enforcement of a judgment.

I always question: What is the scope of obtaining a court judgment if the debtor still refuses to pay? What actions are being taken to enforce court judgments, in reality?

I also criticise the Court Marshall System, which is both cumbersome and ineffective.

A self financed private system, administered in a professional and ethical manner should change the current situation at the Law Courts, which is currently not helping much the businesses who are owed money and have an executive title in hand.