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The D word

Credit is drying up, Gordon Brown used the D word and SMEs are bearing the brunt of the worse economic downturn since World War II. David Thomson, Chief Executive Officer of Close Invoice Finance, offers some practical tips on survival and specifically, managing cash flow.

Not a day goes by without more bad news about the global downturn. While the Government makes ever more drastic attempts to kick start the economy, the harsh reality for many SMEs is that they are facing one of the toughest trading years on record.

But the slowdown is only one part of the story. This recession is unusual in that it has been caused by a crisis which has essentially seen banks stop lending – to each other, to businesses and to consumers. The combination of a lack of liquidity and plummeting sales means that business managers who don't have a sharp focus on managing cash will see their businesses fail. In the fourth quarter of 2008, insolvencies jumped by 51 per cent to 4,607* compulsory liquidations and creditor's voluntary liquidations (CVLs) in total in England and Wales, the highest level recorded in one quarter for five years. Some businesses fail because they are simply not viable but too many will fail because of poor cash flow management. The phrase "cash is king" may be a cliché but it has never been more true.

So what can you do about it? Assuming that everything possible is being done on the sales side, the cash position can be improved in two ways: by managing down late payment and by being smarter about accessing credit (in a low credit world).

LATE PAYMENT – THE SCOURGE OF THE SME

When it comes to payment terms, size most definitely matters. Large businesses have the power to extend suppliers' payment terms for the benefit of their own cash position. This trickles down through the economy, with terms extending at every level. Latest figures show that it takes on average 88 days for businesses to pay an invoice, with analysts predicting that this could rise to more than 100 days in 2009*. The direct impact is a shortage of funds to finance stock, staff, overheads and creditors. What's more, it means that businesses can struggle to service any short term debt. ▶

*Experian 2008



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In an attempt to contain and stop the spiralling impact of late payment on the SME sector, the government recently introduced a policy to speed up the payment of invoices to smaller businesses. The code, developed with the Institute of Credit Management, was launched by business secretary Lord Mandelson at a 'Prompt Payment' summit attended by companies including Asda, John Lewis Partnership and British Gas. It sought to establish clear policy in paying bills with the facility to raise concerns about late payers.

At present, however, the policies in place have done little to alleviate the disruption caused by late payment. A 10-day deadline for the settling of council's debts for example, had negative reception from councils who brandished the policy as an unrealistic expectation that would produce more red tape. If the Government can't persuade councils to comply, there seems little hope that big business will.

1. Tackle cash flow head on and acknowledge the problem

If businesses continuously experience excuses for non-payment, they need to tackle the problem head on. The main mistake companies make is that they act too late. Sometimes this is down to not knowing what to do but often it's simply the fact that late payment and bad debt becomes the norm – days become weeks and weeks become months. Late payment poses a serious threat to SMEs, and needs to be addressed in an equally serious and decisive manner.

2. Terms of trade should be crystal clear

At the order stage a business should ensure terms of trade are clear and accurately reflected on all relevant documentation, in particular invoices - verbal agreements are significantly harder to prove. In the euphoria of landing a new order or client, it's all too easy to forget to negotiate payment terms. If there is no agreed credit period, the law sets a default period of 30 days, but being transparent from the outset is far more effective.

3. Build a strong client relationship

Building a strong relationship is crucial in these difficult times and can help businesses better support clients and manage the risk of bad debt. Good communication is often all that is required to solve payment issues between debtor and creditor. As well as regular ongoing contact with the sales or service contact, try and establish a "friend" in the finance team. All things being equal, this should improve payment, but at the very least will ensure that you have as much information as possible about the state of your customer's business, so that you can plan accordingly.

Where late payment is unavoidable, always try to agree a payment plan and never forget to document what has been agreed.

4. Think carefully about charging interest in the early stages

Steps can be taken such as charging interest on late payments, although in our experience this can be counter-productive. Charging interest rarely encourages payment (unless debts are exceptionally overdue and the interest amount is considerable) and generally has a detrimental affect on your relationship with the client. ►

5. Know your tolerances and be decisive

Do not confuse having a good relationship with clients for being a pushover. Statements should be issued at the expiry of the payment term and then at regular intervals. If, following the introduction of a payment plan this is subsequently ignored, there needs to be a clear process for taking legal action.

6. Legal action

The first step in taking legal action (and often the most successful) is to issue a seven day 'threat of action' letter from a solicitor.

If payment is still not forthcoming, be sure to follow through threats of legal action as failure to do so will significantly dilute the seriousness of the situation in the eyes of the debtor. Your solicitor will suggest the best course of action, from making a small claim to pursuing the debt through the county court to issuing a winding up order. At this stage, we would advise exercising your right to add interest to the debt. Under the Late Payment of Commercial Debts (Interest) Act 1998, which applies to all contracts agreed after 7 August 2002, interest can be added to late debts at a rate of the Bank of England base rate plus eight percent.

A SMART APPROACH TO ACCESSING CREDIT

Access to credit has become increasingly difficult over the last two years. Banks are increasingly reluctant to lend and many companies find existing facilities are being reduced, withdrawn or priced out.

One of the few remaining sources of funds is therefore invoice finance, from independent companies such as Close Invoice Finance. The central premise of invoice finance is that it allows companies to raise cash quickly and easily against their sales ledger, affording businesses a greater degree of flexibility and control over their cash flow

Despite the deterioration of the credit profile of many businesses the fundamentals of factoring and invoice discounting haven't changed - we are interested in the integrity of debt not the company balance sheet or rate of growth. We therefore approach businesses in a very different way to traditional lenders who are focused on more obvious indicators of business success. Invoice finance can represent a lifeline to companies that have seen other forms of trade finance dry up.

There are essentially two types of invoice finance product. The first, invoice discounting simply provides finance against a percentage of the value of outstanding invoices. The facility is more often than not confidential and the client business retains control over invoicing and collection.

KILLING TWO BIRDS WITH ONE STONE

However, here at Close Invoice Finance we are actively encouraging our clients, where appropriate, to consider factoring as a means of addressing both debt collection (tackling late payment) and providing an injection of working capital into their business. Unlike invoice discounting, where clients 'own' the invoicing and collection processes, with factoring, we manage the whole debt collection process. Because we have a dedicated team of collection specialists we are not only very effective at managing late payment, but our clients are freed up to focus more effectively on running their businesses. ►

With **IDeal™**, our unique online invoice discounting product, the real time view of client accounts affords us an even more competitive approach to risk, which in turn releases higher levels of working capital against the invoice book.

Finally, if a “belt and braces” approach is called for, such as today’s crisis would suggest, we recommend that clients consider our bad debt protection product.

Although in the current market credit limits can be low, and at first sight perhaps not what the client hoped, the expertise and disciplines that come into force through our Bad Debt Protection facility – such as encouraging deposits, stage payments or pro forma terms for specific debtors or contracts causing us concern – can often prove to be life-saving in the long run, when their customer becomes the next surprise victim of the recession.

There is no doubt that 2009 is going to be tough, but approaching late payment head on and seeking alternative sources of credit than the traditional lenders, will go some way towards ensuring that solid businesses survive, and are well positioned to prosper as we go into the next cycle.

For further advice on how to deal with late payment or bad debt visit The Better Payment Practice Group (www.payontime.co.uk), an online resource that offers advice and answers questions on payment issues across all industries. Alternatively, contact the award-winning team at Close Invoice Finance on 0800 220257 or visit www.closeinvoice.co.uk. ●

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