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Cash flow, debtors and Debt recovery made easy

YOUR **FUTURE** COMES **FIRST**

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Introduction

Every business no matter its size, type or phase in the business life-cycle needs to:

- carefully manage its cash flow on an ongoing basis;
- deal with debtors; and,
- from time to time contend with the issue of seeking to recover a debt and/or write off a bad debt.

In this eBook we cover what we think are some of the critical and practical issues to ensure your business can always maintain adequate cash flow and reduce debtors.

Maintaining a healthy level of debtors that pay within your standard terms and minimising bad debts (or those that have to be formally pursued) will improve cash flow and avoid the time and financial costs that come with having to chase debts.

In the event that your business is faced with an overdue debt we also outline the options available to attempt to recover the debt.

Contact us for comprehensive advice tailored to your circumstances

Cash Flow Management

Unless you are operating a retail business selling high volumes of low value goods in a 'cash on delivery' environment, you will no doubt be familiar with the challenges associated with getting paid in full, on time, all of the time. It is without doubt one of the hardest challenges in business.

Engaging your customers in an easy and efficient manner while ensuring that you get sufficient details from them and at the same time imparting the rules of doing business with you, is a very delicate balance.

Our tips at finding that balance include:

Know Your Customer

Obviously, it is important that you know who it is you are dealing with from a customer relationship management point of view. Understanding their needs and purchasing behaviours is important so that you can meet and exceed their needs. But too often businesses limit their "fact finding" of customers (beyond their purchasing needs), to a phone number, email address and the name of their contact. While this may be enough to communicate with a customer, those details alone do very little to protect you as the supplier.

It is imperative that you have the full and correct details of your customer for the purposes of invoicing and debtor management.

For all customers who are obtaining goods or services on credit, you should obtain the following information as an absolute minimum:

1. The full name of the legal entity you are doing business with.
2. The type of entity you are doing business with.
3. Australian Business Number (ABN) and where a company is involved the Australian Company Number (ACN).
4. Registered, trading and postal addresses.
5. Phone and email contact details.
6. Directors' and/or the authorised officer's names and contact details.
7. Where feasible a name, signature and date of the person who completed the above details.

Developing, implementing and routinely using forms (whether physical or electronic) that capture all of this data is a simple yet extremely effective way to ensure that you know the real identity of your customers.

We also strongly recommend that you go one step further and once you have obtained these details, you cross-check them. All too often we see situations where people have been given false information, such as companies that are deregistered, ABNs that don't exist or do not match the name of the business given and so forth. Consideration should also be given to ensuring that the person engaging your business on behalf of the customer actually has the authority to do so.

If you find that it is difficult to have a new customer provide you with these details or the details provided are inaccurate, that should raise concerns with you immediately. Caution should be exercised before doing any further business with that customer. If it is difficult to get these basic details from the customer, it is highly likely that it will be even more difficult to extract payment from them later on.

Have Someone Vouch for Your Customer

Having a trusting relationship with your customers is a very satisfying part of running a business. However, we all know that trust is something that is earned over time. If you will be supplying a new customer with significant goods/services on credit, it's a good idea to get somebody to vouch for that customer's trust worthiness.

There are multiple ways that a new customer can have someone vouch for their trust/credit worthiness, including but not limited to:

- an existing supplier of that business (preferably one which is clearly independent) providing a trade reference;
- a director of the business providing a personal guarantee;
- the business providing a Bank Guarantee or similar financial security; and,
- undertaking a credit check with a Credit Rating Authority.

If your business model is such that you are providing goods/services on credit you should carefully consider the value of having someone vouch for your new customer before their trading history with you can speak for itself. Knowing what your new customer's existing suppliers know about them, checking their credit rating and investigating their reliability as a good payer is vital to assessing whether or not you should be providing them with credit. In the absence of this information you are simply hoping that they will pay you. Given that past behaviour is often a reliable indicator of likely future behaviour, the importance of properly investigating a new customer to whom you are considering extending credit cannot be overstated.

If you are uncertain as to a new customer's credit worthiness, obtaining a personal guarantee or some other form of financial security helps to ensure that even if the customer doesn't pay, somebody else will.

Make it Hard to Owe You Money

All too often businesses that are struggling with cash flow overlook some of the simplest debt prevention tools. One of the easiest ways to immediately improve cash flow is to design (or simply decide upon), implement and routinely use good invoicing practices.

With the advent of simple, cost-effective and easy to use financial management software, it is easier than ever for any type of business to raise invoices quickly and to issue those invoices via multiple delivery methods. Invoicing customers on a frequent basis for smaller amounts (as opposed to invoicing infrequently for larger amounts) will encourage customers to pay and pay sooner. It is also likely to help you more readily identify difficult debtors early on.

An effective billing system should not only include invoicing frequently, but also proactively following up invoices which are not paid within your standard terms of payment. The previously mentioned financial management software programs will often come with a debtor management function that can automate follow-ups for invoices that remain outstanding after the expiry of set periods of time. Even if you cannot afford an accounting software package, you can easily create a set of reminders, overdue and final notice letters that you issue to your customers when invoices have been outstanding for set periods of time.

Don't be shy: if a customer was prepared to take your goods/services on credit knowing what your terms of payment were, you should not hold back in following up payment when those same customers have failed to pay you within your standard terms of payment. The fact of the matter is, the longer you take to follow-up an unpaid invoice, the less likely that it will be paid in full.

Particularly in circumstances where you have had to outlay cash for inventory, inputs or other service providers to enable you to supply the goods and/or services to your customer, consideration should be given to taking a deposit of at least the equivalent of your costs of manufacturing the goods or supplying the services. This way, even if you encounter difficulty in having your invoice paid, in full, you will not be totally out of pocket for the inputs associated with what it is that you have supplied your customer.

In this day and age, we find it amazing that some businesses limit the number of ways in which their customers can pay them! We are sure that you will know of some professional service providers that will only take payment by cheque or credit card, or retailers who will only accept cash and not eftpos! If you make it hard for your customers to pay you, it's difficult for you to then turn around and have a legitimate complaint regarding cash flow difficulties or high debtor days.

Make it as easy as possible for your customers to pay you. That means having multiple payment options and making sure that your customers know about them. This should at a minimum include eftpos, cash, cheque, electronic funds transfer, credit card and direct debit options. These days there are a plethora of mobile options that enable you to take payments at your premises or out on the road on various electronic devices and there are plenty of online payment portals available with very low fee structures (think PayPal, BPay, Afterpay and payment portals on your website). There are no commercially sound reasons not to use some or all of these options.

Make it easy as possible for your customers to pay you

Make it Enforceable

The previous practical elements of cash flow management should all be tied together through an appropriately worded contract otherwise commonly referred to as a set of Terms & Conditions. Such Terms & Conditions should at a minimum cover:

- what goods/services you are providing;
- how the price for the goods/services will be determined;
- whether a deposit is required and if so how much;
- what your payment terms are;
- the consequences of a default in payment (e.g. interest and/or recovery costs);
- the point at which delivery of the goods/services will be deemed to have occurred;
- the point at which title and risk in the goods/services passes to your customer;
- any claim of retention of title;
- terms regarding the registration of your security interest on the Personal Property Securities Register;
- whether orders can be cancelled, the manner in which they can be cancelled and the consequences of cancellation;
- matters relating to limitation of liability and warranty; and,
- the manner in which the Terms & Conditions can be accepted by your customer.

While it may seem like a lot of effort, if you do not have a set of written Terms & Conditions (a contract) that covers the supply of your goods and/or services, you immediately increase the likelihood that you will encounter disputes about the provision of your goods and/or services and/or arguments over your invoices.

Having documents in place which have been properly crafted by a professional and that are routinely issued to your customers immediately reduces the risk of disputes and/or delays in payment, and many of your customers will have made a conscious decision to do business with you under those terms. At worst you can seek to enforce those terms for the minority of customers who may not comply with them.

The additional benefit of having well-crafted engagement documents is that in the event that you need to progress to formal recovery, clear and concise Terms & Conditions will typically make the process quicker, cheaper and more likely to result in a positive outcome than would otherwise be the case. It will also enable you to pursue the matter with confidence.

Debtor Management

The word ‘debtor’ is commonly given a negative connotation. However, for businesses that supply goods/services on credit, it is a necessary part of the cycle of business that there will be a certain level of debtors at any given point in time. The issue of course for businesses in the context of cash flow management, is the health and age of those debtors. A common feature of businesses suffering issues with cash flow is that their debtor days (the average time that it takes for their customers to pay their invoices) are particularly high.

There are however some relatively simple practical steps that businesses can take to proactively manage their debtors.

Pick & Stick

Once you have gone to the effort to understand the practical elements of managing your customer engagement process and have put systems, procedures and tools in place to promote prompt and full payment, it is critical that you stick to this customer engagement process.

While many bad debt situations arise as a result of a failure to use the practical tools referred to in the earlier parts of this e-book, a scenario that we see far too often is where a business has a customer engagement process in place but for one reason or another deviates from it, leading to an increase in bad debts.

Being commercial and not emotive about your customer engagement and debtor management processes and pursuing unpaid invoices promptly, professionally and consistently will always improve cash flow and reduce debtors. Somehow, it seems that whenever you deviate from your customer engagement and debtor management processes there ends up being some form of complication, delay or adverse outcome with that particular customer or invoice.

If you experience a situation where there is unreasonable resistance from a potential customer to provide you with all of the information that you have requested, careful consideration should be given as to whether you do business with them at all. If a new customer wants you to indulge them with the provision of your goods/services on credit, the least they can do is provide you with the information you require and the completion of your engagement documents.

Further, if you start to sense that a debt is becoming a problem, then you are probably right. You should consider changing your engagement terms with the customer to COD or potentially ceasing further supply until the debtor has brought their payment up to date.

Who Owes You Money?

Without knowing who owes you money you can't possibly hope to follow them up or formally pursue them for payment.

Setting up a procedure where you routinely review your debtors both in terms of customer numbers, quantum and age will empower you to proactively follow them up. Many accounting software packages can produce automated reports and/or dashboard views that will give you a broad level health check on your debtors and also provide you with very particular information about each of your debtors.

Act!

Once you know who it is that owes you money outside of your standard terms, you need to act. You cannot expect customers to abide by your payment terms if you are not prepared to enforce them.

Whether that action is to use your (hopefully automated) written follow-ups, getting on the phone, sending a personalised email or sending a formal letter of demand, you won't get paid if you don't act. Depending on your business and business model it may be appropriate for the customer manager to get on the phone to contact the customer or alternatively the accounts department. The choice is obviously best made by you, however assertive and prompt action is likely to get the best result.

Take their Money

In a similar vein to our comments under the heading "Make it hard to owe you Money", make sure that you offer plenty of payment options for your customers. If someone wants to pay you, then take their money in whatever form it may come.

While not always optimal (compared to payment in full), consider accepting payment by way of instalments for slow or non-payers. If it is appropriate and suitable in the circumstances it is often preferable to enter into a formal payment arrangement with a customer where they can pay your outstanding invoice over a reasonable period of time (with or without interest at your discretion and based on your Terms & Conditions) rather than receiving no payment from the customer and then having to pursue the debt.

In our opinion, payment by way of instalments should be very carefully considered as a more favourable option than discounting the amount owed to secure payment.

When using instalment plans you can determine whether or not you wish to charge interest in return for the benefit of the customer being able to pay overtime. It is however very important that an agreement to accept payment via instalments over an extended term is agreed in writing. Not only does that help the payment plan become enforceable, it will also operate as an acknowledgement of the debt on the part of the customer and make it much harder for the customer to later deny that they owe you the outstanding sum.

In certain circumstances if cash flow demands it, you can also look at third party fee funding options that enable you to receive payment in full upfront but allows the customer to pay that invoice over time for a very low fee.

Toughen Up

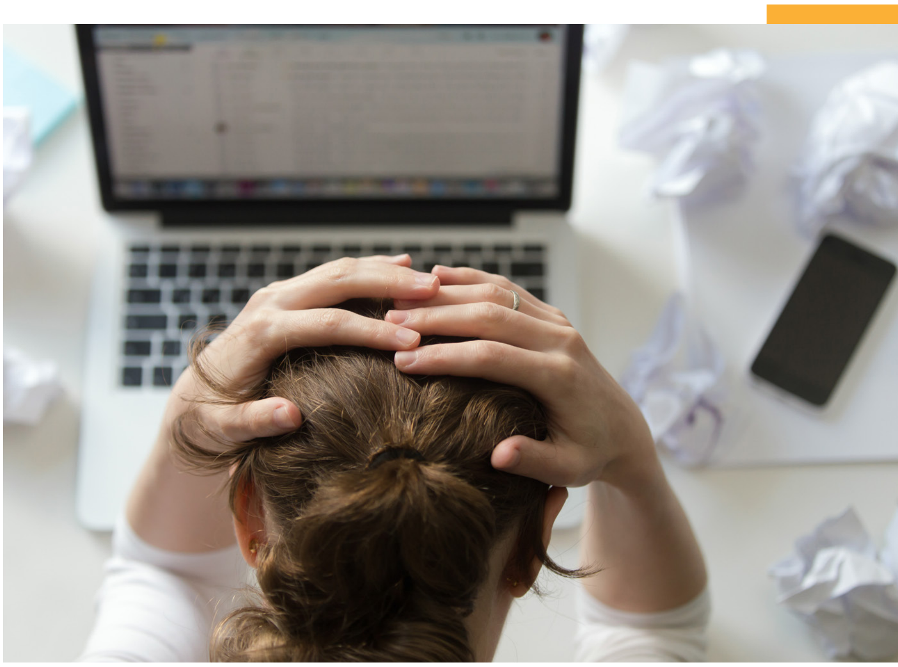
If you find yourself in the situation where none of your debtor management steps have worked and you have been unable to secure payment of your outstanding invoices, it's time to toughen up. You have incurred the time, effort and cost of putting your customer engagement and debtor management tools in place and you have taken on the risk of doing business with this particular customer on credit terms and they have not reciprocated, so there is no reason not to use all of the options available to you to secure payment of your invoices.

Offer plenty of payment options for your customers

Consider taking steps such as (*if your Terms & Conditions enable to you to do so):

- only operating on a COD basis and only after they have brought their other payments up to date;
- stop doing business with them;
- charge interest*;
- report a payment default to a Credit Rating Authority;
- utilise any financial security that they may have provided you such as a Bank Guarantee; and,
- attend on their premises and take back the goods that have not been paid for*.

if you have been unable to secure payment for your outstanding invoices it's time to toughen up



Formal Debt Recovery

If you are still owed money after you have taken the available 'Toughen Up' steps as set out above, the only remaining options available to you are:

1. do nothing and hope for payment;
2. write off the debt; or,
3. commence formal legal proceedings to pursue the payment.

The decision as to which of these approaches you may take will of course be based on the specific circumstances of your situation and a cost/benefit analysis of pursuing formal legal proceedings against the debtor.

Passive Recovery

If after considering the matter carefully you have determined that you do not wish to incur the time, effort and expense of pursuing formal legal proceedings, a passive recovery approach can be to report a payment default to a Credit Rating Authority.

The effect of such a report will be to hamper the debtor's ability to raise credit in the future. Typically, a financier will only provide finance in circumstances where there is a "clean" payment default history. Accordingly, if the debtor is applying for any form of credit (credit card, mobile phone, interest-free purchases, leases, or hire purchase, or more traditional finance) they may be forced to approach you to seek to have the default removed. Of course, you are well within your rights to refuse to remove the default until the debt has been paid in full. Most credit rating authorities will leave a payment default on file for a period of at least five years.

Active Recovery

If you determine that it is appropriate in all of the circumstances to commence formal legal proceedings it is advisable to obtain legal advice, preferably before you have commenced those proceedings.

Quite often, legal proceedings are resolved through settlement. Accordingly, just because you commence formal legal proceedings against a debtor, it is not guaranteed that the matter will run all the way through to hearing.

The general steps involved in pursuing an unpaid invoice through formal legal proceedings are as follows:

1. You file and serve a Statement of Claim which commences the court process;

2. The debtor has the option of requesting particulars of the Statement of Claim, that is, asking you to provide more detail of your claim; and,

3. The debtor must file a Defence either within 28 days of being served the Statement of Liquidated Claim or, if agreed, after the particulars have been provided. If the debtor does not file a Defence they may choose to ignore the claim or to admit the debt.

4. If a Defence is filed:

    a) Usually a pre-trial review is set down. A pre-trial review is an opportunity for the parties to try and resolve the matter;

    b) If you are unable to settle the matter it will proceed to a hearing, at which time you are given the opportunity to provide evidence and present submissions to the Court setting out your position. The Court will make a decision based on the evidence and submissions, and,

    c) You can continue to try and settle the matter at any stage prior to the close of the final hearing; If a Defence is not filed you ask the court to enter 'default judgment'.

Enforce Your Judgment

If you are able to obtain judgment against the debtor, there are a number of methods of enforcing the judgment through the court within which you obtained it, including:

1. Writ of Execution: The Sheriff attempts to seize goods, either as specified by you or that are generally held at the debtor's premises, which are later sold at auction to satisfy part or all of the debt.

2. Garnishee Order: An order will be made that monies from the debtor's bank account, their wages or other amounts owed to them by a third party is to be paid to you in satisfaction of part or all of the debt.

3. Examination: requires the person to provide various documents and information that provides a clear picture of the debtor's assets, debts, income and expenses. If they do not respond they can be served with an Examination Order requiring them to attend court to provide this information.

4. Instalments: the debtor may apply to pay the debt by instalments. Depending on the amount suggested for each instalment, the court can accept or reject that application. You have the ability to contest the amount, however the court will ultimately decide.

Creditor’s Statutory Demands

For debts owed by companies in excess of $2,000.00, a further way to attempt to recover the debt owed is to serve a Creditor’s Statutory Demand. Non-compliance with a Creditor’s Statutory Demand will establish that the debtor has committed an act of insolvency and can be the basis upon which proceedings to wind up the company can be commenced. Accordingly, this can be a quick way of recovering the monies owed to you, but it also comes with sizable risks to you.

A Creditor’s Statutory Demand can be served prior to commencing court proceedings, or as an enforcement option following judgment. We normally recommend the latter given the costs that can arise in connection with proceedings to set aside a Creditor’s Statutory Demand. We recommend that you obtain legal advice before serving a Creditor’s Statutory Demand on a debtor.

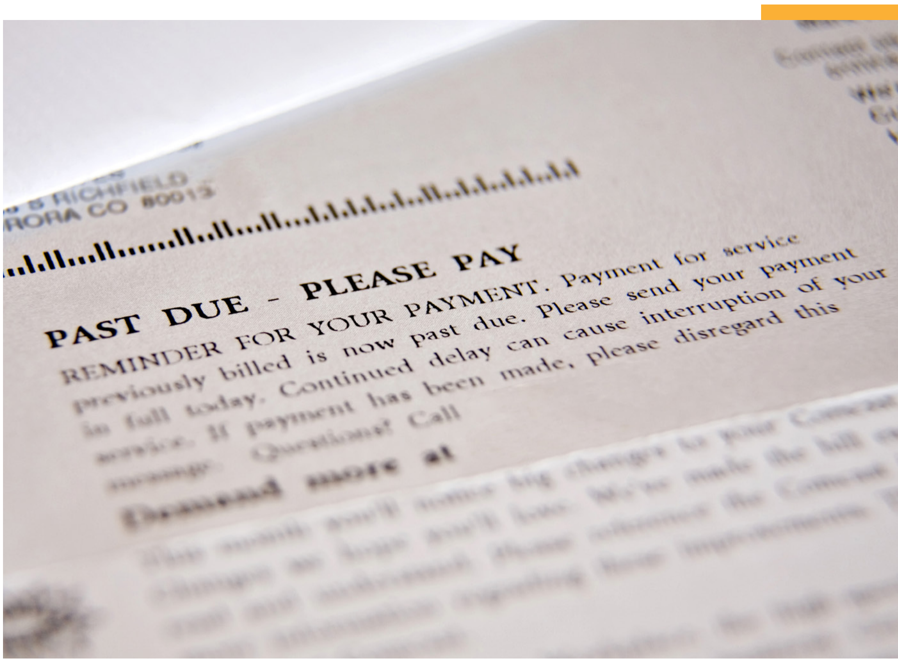
Bankruptcy Notices

For judgment debts of more than $5,000.00 owed by individuals, an effective method of enforcement can be the issuing of a Bankruptcy Notice.

Non-compliance with a Bankruptcy Notice will establish that the debtor has committed an act of bankruptcy. A Bankruptcy Notice is issued by the AFSA and states the total debt owing and may include a claim for interest.

If the debtor does not comply with the Bankruptcy Notice, you have the option to file and serve a Creditor’s Petition (“the Petition”). This is an application to a Court for an Order that the debtor be made bankrupt.

Non-compliance with a Creditor’s statutory demand will establish that the debtor has committed an act of insolvency



Upon Filing the Petition, a date for the hearing of the Petition will be set by the Court and noted on the Petition. The Petition process can be a very costly exercise and you need to consider your alternative options before taking this action.

The consequences of being bankrupt are serious and include:

1. Bankruptcy is not easy to undo;

2. The debtor's ability to borrow money or buy things on credit will be limited. The debtors name will be on a commercial credit reference record for seven years even if the debtor's bankruptcy has been discharged;

3. The debtor's name will be on the public record forever;

4. The debtor's assets including the debtor's house, shares, land and investments become the property of the trustee and can be sold;

5. The debtor may keep only limited items e.g. necessary household goods, a car up to a set value, normal superannuation, some tools of trade and personal injury compensation money;

6. The debtor's employment opportunities may be affected. For example, the debtor might be barred from work in the security industry, a job handling money and some professions, or being a licensed builder;

7. The debtor may find it difficult to rent, or to get electricity, water or the telephone connected without paying a bond;

8. The debtor will not be able to travel overseas without the permission of the debtor's trustee (or the Federal Court);

9. The debtor may be asked to hand their passport to the trustee;

10. The debtor cannot be a director of a company or hold certain public positions without permission;

11. Papers filed are open to public search; and,

12. Charges, fees and administrative costs will be paid from any assets realised in the debtor's bankruptcy.

If you would like to consider issuing a Bankruptcy Notice we recommend that you obtain comprehensive legal advice before doing so.

Why Coleman Greig?

At Coleman Greig we are proud of the reputation and respect we have earned as Greater Sydney's leading law firm.

The depth and breadth of expertise we offer, combined with our ability to pre-empt client needs and deliver individually tailored legal solutions, continue to position us at the forefront of cutting-edge legal services and ensure that we continually surpass client expectations.

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