

Can they, or can't they, pay?

Sovereign Credit Management explores the importance of assessing customers' creditworthiness and how credit reporting protects sales ledger value and helps identify sales opportunities.

In a poll of 659 businesses carried out on www.payontime.co.uk in April 2005 (website of the Better Payment Practice Campaign) it was found that two fifths of businesses fail to check the creditworthiness of new customers. This is a staggering figure considering the nature of our late payment culture, and the levels of bad debt that businesses are currently experiencing in the UK. This late payment/bad debt culture has become significantly prominent in the telecoms sector since the deregulation of BT and the increase in competition in the telecoms market, with customers now able to switch suppliers ever more easily and so run away from their debts.

On average consumers spend around £300 per year on fixed telephony (landlines and call charges), and spend a similar amount in the mobile sector. The level of spend by businesses in these areas is often many times greater than that of individual consumers, especially if you also look at the level of spend on telephony systems, which can amount to many thousands of pounds. With the exception of pre-pay mobile phone tariffs, nearly all of these transactions are offered on credit.

It is our belief that credit should not be an automatic right. As an individual, would you lend money to someone if you knew you weren't going to get paid back? The chances are that you wouldn't, so why do 63% of businesses offer credit without finding out what the likelihood of getting paid for their goods or services is? What we need to remember here is that a sale is not a sale until the goods have actually been paid for, so if you find that a potential customer is not creditworthy (able to pay), what advantage do you gain by taking their order?

With basic consumer credit reports being priced as low as £1.70 each and business credit reports starting at £2.50 each, the total cost of a credit check on the average customer can amount to as little as 0.5% of the total spend of each customer over the course of a year. Compare this with the fact that, on average, businesses' bad debt provisions are somewhere between 2% and 7%, we can see that checking a customer's creditworthiness at the time of the order can be a much cheaper option in the long run.

In some instances, customer accounts may only generate small revenues over the course of a year, so it may not be considered financially viable to run a credit check on them. This is totally acceptable. As a general rule, we would advise that businesses credit check the top 80% of accounts (working by account value), with at least the top 30% of the sales ledger being checked using more comprehensive credit reports.

It's not just at the outset of a customer relationship that a customer's creditworthiness should be checked. Checks on customers should also be run throughout the working relationship. This can be done by monitoring payment trends using in-house data, and also by placing customers on credit monitoring services. Often these monitoring services are free, and generally, placing a customer on a monitoring list can be done automatically after an initial credit report on them has been purchased.

The first benefit of placing customers on a credit monitoring list is that you can highlight when a customer's credit circumstances diminish, as and when their credit problems occur. This allows the collections activity on this customer to be stepped up immediately so as to reduce the risk of payment default. The flip side to this is that the monitoring service can also highlight an improvement in a customer's creditworthiness. This information can then be used to fuel future sales activity. After all, it's cheaper to retain and grow customer accounts than it is to get new ones, so it makes sense to target those customers that have a greater capacity to pay for goods and services.

The greater level of diligence that we as businesses show in assessing the creditworthiness of our customers, the stronger the performance of our businesses will be. What we must always remember is that if we make a credit decision, such as to put a credit limit in place, or not to grant credit, we must stick with that decision so as to protect our business interests. In order to make credit decisions work, it is vitally important that all credit information is communicated clearly amongst the credit and sales teams, after all, the sales team needs to know which customers they are allowed to sell to, and which they are not.

CHECKLIST FOR CREDIT CHECKING YOUR CUSTOMERS:

* Some credit checking services use data that can be several months old (particularly those on disk). Ensure that you only use up-to-date data when assessing the creditworthiness of your new and existing clients so that you can highlight changes in their credit circumstances as and when the changes occur. Monitoring services are particularly good for this.

* Use online credit checking facilities. This will allow you to make instant credit decisions, and will avoid holding up the sales process.

* Have access to data from more than one credit agency. The quality of credit information available can vary significantly between credit agencies.

* Credit check the top 80% of accounts on your sales ledger (by account value), with the comprehensive checks carried out on at least the top 30% of accounts.

* Communicate creditworthiness between the credit and sales departments regularly. This can be done either through a credit control system, or simply through setting up a credit control spreadsheet that is emailed amongst departments.

* Let your customers know that you are using credit checking services prior to them placing an order. This may dissuade non-creditworthy customers from approaching you for your services in the first instance.

* Stick to agreed credit limits! You have made your credit decisions for a reason.

Sovereign Credit Management provides online access to several credit reporting databases and can advise you as to which services are best to use for your industry sector. For free advice on how to manage your credit reporting processes, call Sovereign on 01403 755 755 or email info@sovcredit.co.uk