

https://dspace.org/

The Credit Control Decision

Brett, Jonathan K

2015-01-12
http://hdl.handle.net/10539/16444

Downloaded from a DSpace repository. https://dspace.org/

THE CREDIT CONTROL DECISION

JONATHAN K. BRETT

A RESEARCH REPORT SUBMITTED TO THE FACULTY OF COMMERCE UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF COMMERCE

JOHANNESBURG 1985

THE CREDIT CONTROL DECISION

J.K. BRETT

ABSTRACT

This research report examines the current practice of granting and controlling credit within the Republic of South Africa.

Companies today are experiencing liquidity problems largely because of high interest rates and the effects of high rates of inflation. A high investment in debtors can cause or compound liquidity problems. Uncollectable or bad debts may even cause a company to go into liquidation. Sound credit management is vital for the successful survival of any business.

This research report identifies the factors considered before credit is granted to a prospective customer, the responsibility for the credit control decision, the overall performance of the debtors department, and methods used to enforce the credit control decision.

Questionnaires were sent to 100 South African public companies or their subsidiaries to determine their credit practices. These companies are considered successful and thus have or should have successful credit practices. Answers to the questionnaire were analysed and where possible compared to results obtained from similar surveys abroad.

The research findings show that most of the companies surveyed have tight credit control procedures and have developed practices to ensure that their bad debts remain within acceptable limits.

Successful credit management is an ongoing procedure beginning from the credit sale to the payment of the debt. In order for it to be effective it must be guided by policy, nourished by information, facilitated by structure, monitored with precision, and supported by all concerned[10].

DECLARATION

I declare that this research report is my own, unaided work. It is being submitted for the degree of Master of Commerce in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in any other university.

Jonathan K. Brett
Johannesburg 1985

ACKNOWLEDGEMENTS

I wish to express my gratitude to all those who assisted me in the preprration of this research report, especially;

The various people throughout South Africa who responded to the survey, without whom this research would not have been possible.

Professor Mike Pratt for the guidance, constructive criticism and encouragement given to me.

Mrs Dot Roets for her excellent typing and layout.

Kessel Feinstein for their encouragement and support, both material and otherwise.

CONTENTS

			Page
CHAPTER 1			
1.	Introduction		
	1.1	Purpose of report	1
	1.2	Research methology	2
		1.2.1 Development of the questionnaire	
		1.2.2 Definition and nature of the population sampled	
		1.2.3 Previous work	
	1.3	Survey of the literature on credit control	3
	1.4	The survey questionnaire	5
	1.5	Analysis of survey answers	6
CHAPTER 2			
2.	Research findings		
	2.1	Why companies grant credit	8
	2.2	Analysis of responses received from companies surveyed	9
CHAPTER 3			
3.	Credit administration		
	3.1	Responsibility for establishing overall credit policy	13
	3.2	Prerequisites for successful credit management	14
	3.3	Number of credit managers employed	15
	3.4	Additional duties performed by credit managers	16
CHAPTER 4			
4.	The credit decision		
	4.1	Companies credit and collection policies and procedures. - Written versus Verbal	18
	4.2	The determination of credit terms	18
	4.3	The basis of evaluating and establishing a customer's credit facility	19
	4.4	Factors considered important when considering the granting of credit	22

CONTENTS (continued)

		Page
CHAPTER 5		
5.	Sources for obtaining information when investigating creditworthiness	
5.1	The rating of information obtained from the various sources	26
CHAPTER 6		
6.	Limiting the risk factor	
6.1.	Methods of limiting the risk factor	
6.1.1	Credit limits	30
6.1.2	Payment guarantees	31
6.1.3	Credit insurance	34
CHAPTER 7		
7.	Collection policies and procedures	
7.1	Cash discounts	36
7.2	Days taken to collect outstanding debtors	37
7.3	Percentage of debtors overdue	37
7.4	Percentage of sales over the past year that resulted in bad debts	38
7.5	Cause of bad debts	38
7.6	Collection tools used to collect outstanding debts	39
CHAPTER 8		
8.	Evaluation of the credit control function	
8.1	Methods of measuring the effectiveness of the credit and collection function	42
8.2	Computerisation of debtors	43
CHAPTER 9		
9.	Top management awareness of the investment in debtors	46

CONTENTS (continued)

	Page
CHAPTER 10	
10. Training programmes	
10.1 The importance attached to training programmes for credit personnel	47
10.2 Reasons for insolvency	49
CHAPTER 11	
11. Summary and conclusions	50
CHAPTER 12	
12. Principles to ensure the success of credit policies	55
LIST OF REFERENCES	56
APPENDICES	
A - THE SURVEY QUESTIONNAIRE	57
B - ANALYSIS OF SURVEY RESULTS	63
C - ANALYSIS OF ANSWERS PROVIDED	
C.1 Factors considered when granting credit	67
C.2 The rating of sources of information obtained when investigating creditworthiness	68
C.3 Cause of bad debts	69

CHAPTER 1

1. INTRODUCTION

Debtors normally represent a significant portion of a company's assets and as such their effective control is an extremely important component of sound financial management.

The credit policy of a company can have a significant influence on its sales. A relaxation of the credit policy normally brings with it an increase in sales, and therefore an increase in debtors. Experience indicates that high interest rates and the current economic climate in South Africa are forcing many companies to re-examine their credit policy. Bad debts and the cost of financing these debtors are taking their toll on companies, forcing many companies into liquidation.

1.1 PURPOSE OF REPORT

The purpose of this report is to examine the credit procedures adopted by successful companies and to determine whether any trends exist for successful credit management.

The report examines:

1. The reasons why companies grant credit.
2. Requirements for successful credit management.
3. The manner in which the credit decision is made and the factors considered when making that decision.
4. Collection of the debt.
5. Evaluation of the credit department.
6. Training programmes for credit management.

1.2 RESEARCH METHODOLOGY : Design of the survey

1.2.1 DEVELOPMENT OF THE QUESTIONNAIRE

Method of data collection

The initial decision made was that data was to be collected via a questionnaire. Erdos [1] states that mail questionnaires afford the researcher little control in securing a response from the intended respondent. No incentive for answering the questionnaire could be offered other than the possibility of obtaining a better understanding of both the credit control function and how this is related to the company's overall financial position.

Nonetheless, in view of the geographical location of many of the companies and the extent of detail required, a mail questionnaire was felt to be the only alternative. The mail questionnaire afforded respondents the opportunity to be more frank on certain sensitive issues as anonymity was promised.

The letter to the participants gave the writer's telephone number to enable participants to contact the writer to discuss any of the issued raised in the questionnaire. Many participants did in fact telephone and gave valuable insight into the reasoning behind certain of their answers.

1.2.2 DEFINITION AND NATURE OF THE POPULATION SAMPLED

The population

For the purposes of this study the population was defined as the top 100 companies as determined by Financial Mail (1984). These companies are all quoted on the Johannesburg Stock Exchange. Many of the companies surveyed were, however, investment holding companies, with little or no trade debtors. Where this was the case, questionnaires were sent to their largest trading subsidiary or subsidiaries.

1.2.3 *PREVIOUS WORK*

A pilot survey on "Methods of Assessing Creditworthiness" [4] was undertaken in December 1984 as an exploratory study for this research. The objectives of that study were :

- to determine why companies give credit
- to determine the methods used by companies to assess the creditworthiness of their customers when they applied for credit initially
- to assess these methods against specified criteria.

The research techniques employed to achieve those objectives were ;

- a "questionnaire" survey covering 16 Witwatersrand-based companies
- a literature survey on methods of assessing creditworthiness.

This survey provided an indication of results to be expected from the present survey.

1.3 SURVEY OF THE LITERATURE ON CREDIT CONTROL

From the literature survey it appears that much has been written on the subject of credit control and how a credit operation should be organised and controlled, and on the apparent inadequacy of an effective credit attitude on the part of many senior company executives. However, very little literature of significance could be found on the way South African companies actually organise and control their credit operation.

The Department of Statistics keeps certain information and statistics on companies going into liquidation. Certain credit management organisations publish in the daily press interpretations of these statistics. These statistics present a gloomy picture and show that tight credit control with emphasis on cash flow is essential if business expect to be around at the beginning of 1986, when an upswing in the economy is expected [14].

A number of overseas surveys have been carried out regarding credit management practices. Results from two of these surveyed are compared to the results of the survey in this study. These surveys are :

1. Kirkman P.R.A. Modern Credit Management, Great Britain George Allen & Unwin, 1977 ("UK SURVEY")
   UK Credit Management practices were surveyed. A book on the study of the management of trade credit under inflationary conditions was produced.

   A detailed questionnaire was sent to most of the companies included in the Times 1 000 list of leading UK companies.

2. Benz G.V. International Trade Credit Management Great Britain Gower Press 1975. ("WORLD SURVEY")
   The effective credit practices of 22 countries were surveyed. 429 questionnaires were sent to companies in 22 countries. These countries included the United States, Great Britain and South Africa.

   90 companies completed the U.K. survey and 149 companies completed the world survey.

   The objective of both the above surveys was to produce a theoretical and practical framework to be used by companies when establishing or reviewing their credit operations.

1.4 THE SURVEY QUESTIONNAIRE ('S.A. SURVEY')

The questionnaire contained 31 questions on credit management and related operations. (Appendix A).

Questions 1 - 6 obtained general information regarding the following:

1. Classification of company
2. Total sales
3. Percentage of turnover represented by credit sales
4. Total trade debtors
5. The size of trade debtors in relation to the assets of the company
6. Number of active customers.

Questions 7 - 11 obtained information as to the credit administration of the company. These questions established:

7. Responsibility for establishing overall credit policy
8. The most important prerequisite for successful credit management
9. The manner in which the credit policies were recorded
10. The number of credit managers employed
11. Other duties performed by the credit manager

Questions 12 - 21 covered the credit decision of the company and factors considered when granting credit. These questions established:

12. Credit terms
13. Payment guarantees
14. The reliability of information obtained from banks, competitors, customers, information agencies and salesmen.
15. Whether a standard credit evaluation form was used.
16. The basis on which a customer's credit facility was evaluated and established.
17. Factors considered when granting credit
18. Percentage of customers with credit limits
19. The risk of the company debtors
20. Whether credit insurance was used
21. Whether cash discounts were granted

Questions 22 - 25 considered the overall performance of the debtors department.

22. Days sales outstanding
23. % of debtors overdue
24. % of bad debts to sales
25. Cause of bad debts

Question 26 considered the various collection tools used to collect outstanding debts.

Questions 27 - 30 considered general management issues.

27. How the credit and collection function was measured
28. Whether debtors were computerised
29. Reports generated
30. Top management's involvement in the debtors department.

Question 31 covered the importance attached to training programmes for credit personnel.

In analysing the answers to these questions it was found that certain questions were more appropriate under other headings and therefore answers to these questions were included in other sections.

1.5 ANALYSIS OF SURVEY ANSWERS

Each question in the questionnaire had a number of alternatives:

1. Where the respondents were limited to answering only one of the stated alternatives, the number of respondents answering each alternative was translated into a percentage, being the ratio of the number of respondents answering that alternative over the total of respondents answering that particular question.

2. Where the respondents answered more than one alternative, the alternatives were ranked from 1 upwards, with 1 being the most popular alternative answered, and so on.

3. Certain of the questions required the participants to rank the alternatives on a scale of 0 to 10, 10 being a very positive response with 0 being a very negative response.

Where this was required, these rankings were 'narrowed' into 5 alternatives. Answers were 'narrowed' as follows:

RANKING OF ALTERNATIVES	NARROWED TO	WEIGHTED AS FOLLOWS
0,1,2	1	1
3,4	2	2
5,6	3	3
7,8	4	4
9,10	5	5

Here 1 represents a very negative response and 5 a very positive response. These responses were then aggregated as follows:

For each alternative, the number of responses falling into a specific range was multiplied by the relevant weighting. This gave a score for each alternative, and the alternatives were then ranked as in 2 above.

Comparison of this ("S.A.") to U.K. Survey and World Survey

Where possible the results obtained from this survey were compared to the U.K. and World Surveys.

Certain questions in the U.K. and World Surveys were adapted for South African conditions and thus it was not possible to compare these results to the U.K. and World Surveys.

CHAPTER 2

2. RESEARCH FINDINGS

INTRODUCTION

2.1 WHY COMPANIES GRANT CREDIT

Companies grant credit in order to sell to customers who have not the immediate facilities to pay cash for the merchandise offered, but who, at some time, either in the immediate or distant future, or over a period of time, are going to be able to settle the account. [2]

Selling on credit also provides a convenience to the customer in that he can purchase goods when the need arises, but only has to pay for the goods at a later more convenient date.

Selling on credit has the following significant advantages.

(i) Increase in turnover

The facility of credit brings within the business sphere of operations a completely new range of customers.

(ii) Increase in size

With an increase in turnover, businesses grow in size. Such an increase in size should lead to an increase in productivity and thus the business is able to provide the customer with a better and wider variety of merchandise and services.

(iii) Increase in buying power

By increasing turnover, the buying power of the business is automatically increased, and such increase in buying power can lead to bulk buying discounts and other more favourable terms. These benefits can either be retained by the business or passed on to its customers.[?]

Today there is an increasing acceptance of the use of credit.

2.2 ANALYSIS OF THE RESPONSES RECEIVED FROM COMPANIES SURVEYED
(Appendix B)

Questionnaires were sent to the top 100 companies in South Africa as determined by Financial Mail (1984). Where these companies responded indicating that they were holding companies with little or no trade debtors, questionnaires were then sent to their largest trading subsidiary or subsidiaries.

Questionnaires originally sent	100
Answers received from investment holding companies with little or no trade debtors	6
	94
Questionnaires sent to subsidiaries	14
	108

38 responses were received. These responses covered a broad spectrum of companies. In order to indicate the respective sizes of the companies surveyed, the turnover figures have been provided for each industry classification.

(% = percentage of respondents falling into the respective categories).

('No. of companies' represent responses received from S.A. Survey).

CLASSIFICATION	NO. OF COMPANIES	%	TURNOVER (R million)			
			0 - 10	11 - 50	51 - 100	>100
Wholesale	6	15	1	2	1	2
Financial	4	10		1	1	2
Motor	3	8				3
Construction	2	5				2
Manufacturing	9	24	2	3		4
Hotels	1	3				1
Fuel	2	5			1	1
Pharmaceutical	2	5	1		1	
Engineering	5	13			1	4
Packaging	1	3		1		
Shipping	1	3	1			
Fishing	1	3			1	
Furniture	1	3				1
	38	100	5	7	6	20

Questions 2-6 *in the questionnaire* requested survey participants to provide the following information:

Total sales

Sales R million	%
0 - 10	13
11 - 50	18
51 - 100	16
>100	53

Percentage of Turnover represented by credit sales

%	%
0 - 30	3
30 - 60	3
61 - 90	8
90	86

The above two tables indicate the turnover of the respondent companies and the percentage of that turnover represented by credit sales. 86% of the companies surveyed sold more than 90% of their products/services on credit.

Total trade debtors

Trade debtors R million	%
0 - 10	29
11 - 50	47
51 - 100	11
>100	13

Relative size of the "trade debtors" asset

Size	%
The biggest asset	24
The biggest current asset	42
The second biggest current asset	34
A small asset	

The value of total trade debtors and the relative size of this asset indicates the functional importance of trade debtors to the respondent companies.

Number of active customers

Number of active customers	%
0 - 500	37
501 - 1 000	11
1 001 - 2 500	13
>2 500	39

The number of active customers indicates the importance of the credit-granting and credit-controlling functions.

The above information was requested:

(i) In order to gain a perspective into the size of the companies surveyed.

(ii) To determine whether answers obtained were linked to the size of the companies surveyed.

No correlation could be found between the size of the companies surveyed and any of the other survey answers. This indicates that the credit control decision and the credit function are not dependent on the size of the company.

CHAPTER 3

3. CREDIT ADMINISTRATION

For most companies, debtors are an extremely important investment. Indeed none of the companies surveyed indicated that their trade debtors represented a small asset. 13% of the companies surveyed actually had trade debtors in excess of R100 000 000.

One hears daily about tragic company failures caused by bad debt losses. Cash management is an important part of financial management and thus the administration and collection of the company's debtors plays a vital role in the survival of the company. It was therefore deemed appropriate to determine the levels of seniority of persons responsible for the credit function.

3.1 RESPONSIBILITY FOR ESTABLISHING OVERALL CREDIT POLICY

PERSON RESPONSIBLE	S.A. %	U.K. %
The managing director	42	30
A company director	42	39
The credit manager	11	11
Other	5	20

This decision is mainly made at director level in both South African and U.K. companies, which indicates that both local and U.K. companies recognise the importance of the company's credit policy. Other bodies responsible for establishing credit policy include marketing committees (2) and a management committee (1).1.

1. (Numbers in brackets represent number of responses received).

3.2 REQUIREMENTS FOR CREDIT MANAGEMENT

According to Benz (1975) in addition to expertness in all the technical phases of credit, dynamic credit management requires the ability to :

(i) Analyse, plan and develop objectives, policies and programmes.

(ii) Build an organisation.

(iii) Delegate responsibility and maintain accountability for results.

(iv) Review standards and practices, and effect remedial action wherever and whenever required.

(v) Inspire confidence, motivate teamwork and maintain growth. [3]

The views of the respondents were sought as to the most important prerequisites for credit management.

3.2.1 Prerequisites for successful credit management

PREREQUISITE	S.A. *	U.K. *
Knowledgeable, creative and innovative credit executives	1	1
Top management support	2	2
Competent credit management by competitors	4	3
Other	3	4

* = Ranking

Knowledgeable, creative and innovative credit executives

An individual in every organisation has the ultimate responsibility for granting and controlling credit. High interest rates and tight money market conditions have enforced a need for companies to employ credit executives who are resourceful and alert so as to expedite collections, eliminate delay, and ensure that the company's average collection period is a reasonable length of time. More than 50% of the S.A. survey (U.K. 72%) felt that this was the most important prerequisite for successful credit management.

Top management support

Although most respondents indicated that top management support is not as important as knowledgeable, creative and innovative credit executives, optimum support by top management is nonetheless a most important prerequisite for successful credit management. Top management support does not only have to be active, but can be passive in that important decisions are left to credit managers and provided they perform their duties effectively, management does not have to interfere. Competent credit managers can function effectively knowing they have full support of top management.

Top management is, however, still responsible for basic policy outline, defining the authority, relationship and decision power of the credit department, and the giving of recognition and credit for the department's achievements [3]

Competent credit management by competitors

Many companies try to match their competitors. This includes credit practices [8]. Concessions granted by a competitor may have to be copied in order to retain existing business. This invariably leads to a breakdown in the firm's credit standards. Fortunately this was not considered an important prerequisite for successful credit management in both the S.A. Survey and the World Survey.

Other prerequisites

Competent staff (2)
Hard work (1)

3.3 NUMBER OF CREDIT MANAGERS EMPLOYED

The answers to this question varied from 1 to 20. As no correlation could be found to answers to this question, and the size of the companies surveyed, the managing director of a prominent firm of credit management consultant was telephoned to try and establish the reasons for the disparity of the answers. Three types of credit managers were identified.

(i) Credit manager at executive level

This credit manager is *responsible for making decisions* and, as such, has a fair understanding of the credit control procedures and how such procedures are related to the company's overall financial position.

(ii) The day-to-day credit manager administrator

This person makes no decisions but merely manages the day-to-day affairs of the credit department.

(iii) The clerk 'credit m ger'

This person does little more than reconcile accounts and request outstanding payments.

Thus the companies surveyed could have interpreted this question in any one of the three ways above. It was therefore not possible to draw a correlation between the number of 'credit managers' employed and any of the other answers provided by the respondents.

3.4 ADDITIONAL DUTIES PERFORMED BY THE CREDIT MANAGERS OR PERSONS WITH THE DUTY OF CREDIT MANAGER IN ADDITION TO THEIR OTHER DUTIES

DUTIES	S.A. %
Finance	47
Marketing	8
Purchasing	3
Other	8
None	34

The credit department is generally part of the accounting function (47% above). This has traditionally been the most popular location for the credit department, especially in the smaller business organisation where it may not be possible to justify a senior credit appointment [8]. The receipt of funds from credit sales is also an important part of the cash flow management of the organisation and many accountants are reluctant to give up complete control over those receipts.

If it is considered that the smaller business organisation is an organisation with sales below R51 million, 67% of such companies have the credit department as part of, or falling under the responsibility of the accounting department.

CHAPTER 4

4. THE CREDIT DECISION

The Survey attempted to identify how the credit decision is made in South Africa. In this regard the following questions were asked.

4.1 Are company credit and collection policies and procedures:

COMPANY'S CREDIT AND COLLECTION POLICIES	S.A. %	U.K. %	WLD %
Written	34	33	35
Verbal	5	9	6
A combination of written and verbal	61	58	58
Non-existent			1

A credit policy is the basis upon which plans are formulated and decisions taken in line with the goals set by management. A written policy is obviously the most preferable; nevertheless, many organisations do not take the time to document their policies, or, if their policies are documented, they are not always up to date. Only 34% of the S.A. Survey and 33% and 35% of the U.K. and World Surveys respectively had a written credit policy. However, 61% of the S.A. Survey, and 58% of the U.K. and World Surveys did have a combination of written and verbal credit policies and procedures. Written policies promote delegation of authority, management by exception, consistency, continuity, planning, teamwork, understanding, training and good human relations.[8]

4.2 Are credit terms determined by:

	S.A. *
Competitors terms	3
Product availability	4
The credit standing of the buyer	1
The company's financial position	5
The company's marketing and pricing policy	2
Other	4

* = Ranking

Responses revealnd that credit terms are primarily determined by the credit standing of the buyer and the company's marketing and pricing policy.

Other factors determining credit terms are current trade practices, the current demand situation and negotiation. If there is a low level of demand, credit terms granted tend to be more generous.

4.3 On what basis do you evaluate and establish a customer credit facility?

	S.A. *	WLD *	
Character, capacity of customer	3	3	5 "C's"
Liquidity, activity, profitability, potential	1	2	LAPP
Past experience, with a general impression about the customer	2	1	
Other	4	4	

* = Ranking

(i) Character, capacity of customer

Weston and Brigham [5] propose five "C's" that are considered relevant in the evaluation of credit risk and which should consequently be examined when evaluating creditworthiness (and the establishment of a customer credit facility).

CHARACTER - This attempts to measure the probability that a customer will try to pay, as opposed to the other four "C's" which measure his ability to pay.

CAPACITY - Involves a judgement decision on the basis of past experience or business potential on the customer's ability to pay.

CAPITAL - An objective measure of the general financial position of the customer's business by way of ratio analysis or some other means.

Responses revealed that credit terms are primarily determined by the credit standing of the buyer and the company's marketing and pricing policy.

Other factors determining credit terms are current trade practices, the current demand situation and negotiation. If there is a low level of demand, credit terms granted tend to be more generous.

4.3 On what basis do you evaluate and establish a customer credit facility?

	S.A. *	WLD *	
Character, capacity of customer	3	3	5 "C's"
Liquidity, activity, profitability, potential	1	2	LAPP
Past experience, with a general impression about the customer	2	1	
Other	4	4	

* = Ranking

(i) Character, capacity of customer

Weston and Brigham [5] propose five "C's" that are considered relevant in the evaluation of credit risk and which should consequently be examined when evaluating creditworthiness (and the establishment of a customer credit facility).

CHARACTER - This attempts to measure the probability that a customer will try to pay, as opposed to the other four "C's" which measure his ability to pay.

CAPACITY - Involves a judgement decision on the basis of past experience or business potential on the customer's ability to pay.

CAPITAL - An objective measure of the general financial position of the customer's business by way of ratio analysis or some other means.

COLLATERAL - Constitutes any security or pledge of assets the customer can provide to secure the credit.

CONDITIONS - Refers to external economic factors in the customer's business environment that will affect his ability to pay.

Both the S.A. and World Surveys ranked the 5 "C's" third when evaluating and establishing a customer credit facility.

(ii) Liquidity, activity, profitability, potential

This was the most popular basis for evaluating and establishing a customer credit facility. This basis entails the following:

LIQUIDITY - Cash is more important than profit. What are the: current assets compared to current liabilities; current assets less inventories compared to current liabilities; and debts compared to owner's equity?

ACTIVITY - More sales require more funds through either debt or equity financing. What are the: sales compared to the total assets; cost of goods sold compared to the average inventory; (i.e. the inventory turnover) and the number of days' sales and days' purchases outstanding?

PROFITABILITY - Shareholders' prime interest is profit and the maximisation of their equity. What are the: gross and net profit compared to sales; profitability in relation to the investments; and effective use of assets and equity?

POTENTIAL - The potential of a company lies in the future. Examine: the management ability; human resources; the product mix; the facilities; the financial resources; the market penetration; the contracts and relationships.

This analysis, therefore, is based on financial as well as non-financial factors; an evaluation of the balance sheet and income statement versus an evaluation of the future development and growth possibilities of the company.

(iii) Past experience with a general impression about the customer

The World Survey ranks this basis number 1 while the S.A. Survey ranks this number 2. Past experience implies that a dishonest buyer will be prevented from obtaining a credit facility. Credit managers can with a little effort find out what 'others' have to say about the customer and any bad reputation will soon emerge.

4.4 FACTORS CONSIDERED IMPORTANT WHEN CONSIDERING THE GRANTING OF CREDIT (Appendix C.1)

FACTORS CONSIDERED WHEN GRANTING CREDIT	S.A.* SURVEY	USA [6]
Financial statement ratios	6	1
Agency costing/reports	13	2
Bank reports	1	3
Trade references	7	4
Paying experience	1	5
Personal visit - major accounts	3	6
Customer requirements	14	7
Salesman's opinion	17	8
Major supplier	11	9
Profitability of products	16	10
Competitive conditions	12	11
Degree of need for the customer's business	15	12
Customer's reputation	4	13
Character of management	5	14
Years in business	7	15
Growth potential of customers	10	16
Seasonal factors	18	18
Area and industry economic conditions	7	19

'USA' represents the priority sequence mentioned by credit managers in a United States Survey by Eckstrom [6].

In the S.A. Survey participants ranked on a scale of 0 to 10 the factors they considered relevant when granting credit.

* = Ranking

The S.A. Survey revealed the following:

(i) Paying experience

The participants consider paying experience to be one of the most important factors when granting credit.

Paying experience for new customers can be determined from information provided by information agencies such as Dun and Bradstreet, or trade references.

Many business organisations insist that all prospective credit customers should fill in a credit application form, which generally asks for 2 trade references.

Among the questions asked of the references are maximum credit allowed and normal speed of payment. These questions give an indication of paying experience.

For existing customers paying experience is easily determinable. Companies are able to establish the paying history of each customer at the end of each month and can therefore re-evaluate their policy of granting credit to a particular customer.

(ii) Bank reports

Bank reports are also one of the most important factors considered when granting credit. However the S.A. Survey did not rate the information obtained from this source as high as information obtained from customers or information agencies. (See chapter 5).

(iii) Personal visit

The next most important factor considered is information obtained from a personal visit by sales or credit personnel. The information obtained as a result of personal visits includes:

° Size and status of the organisation
° Length of time in business
° Conditions of premises and equipment
° Type of business
° Size of stocks
° Competitive situation

This information can be of great assistance when considering the granting of credit.

(iv) Customer's reputation

This speaks for itself. Customers with bad reputations are not likely to change and therefore should not be granted credit. A good reputation can assist the credit decision.

(v) Character of management

This goes hand in hand with the customer's reputation.

SUMMARY

In contrast to the S.A. Survey, the USA Survey found financial statement ratios, agency costings, bank reports, trade references and paying experience the most important factors (in that order). The S.A. Survey and the USA Survey had only bank reports and paying experience in common in determining factors considered important when granting of credit.

The least important factors were seasonal factors, salesman's opinion, profitability of products, and degree of need for the customers business. The low rating of the salesman's opinion is a surprising factor. Perhaps companies feel that their salesmen are more interested in making a sale than in whether the customer is actually creditworthy and able to pay for that sale.

Both Surveys felt seasonal factors to be the least important factor considered when assessing the granting of credit.

The above items include both financial and non-financial factors.

Paying experience, bank reports, personal visits, customer reputation and *character of management* were considered by the S.A. Survey to be the most important factors in the credit control decision. The last 3 factors above *depend on good judgement*.

CHAPTER 5

5. SOURCES FOR OBTAINING INFORMATION WHEN INVESTIGATING CREDIT WORTHINESS

In the United States, almost unlimited sources of credit information are normally available. Over a period of many years these sources have steadily expanded on the basis of a relationship of mutual confidance and respect among credit managers themselves, and among customers and credit managers. In Europe the quantity, quality, extent and sources of credit information are of a far lower standard than in the United States. [3]

5.1 The Surveys tested perceptions as to the quality of information provided by the following sources.

SOURCES	RANKING		
	SA	UK	WLD
Banks	3	4	1
Customers	2	2	4
Competitors	5	5	5
Information agencies	1	1	2
Salesmen	4	3	3

The S.A. Survey indicated that most companies relied upon credit references obtained from information agencies, customers and banks. The U.K. Survey found information agencies to be the most reliable, while the World Survey considered information obtained from the banks to be the most reliable.

(i) Banks

[3] In the United States, banks, on request, normally provide a detailed report on the customer, indicating the customer's average bank balance expressed as a medium five figure balance or high six figure balance, as well as the following:

Customer's credit line
Type of loan
Manner in which repayments are handled
Company history
Antecedent information
Conduct of business, etc.

In contrast to this, South African banks normally only give the following information to their own clients: They reply to a question as to whether a customer is good for a certain amount of credit as follows:

A = Undoubted for enquiry
B = Good for amount quoted
C = Good for amount quoted (if strictly in way of business)
D = Fair trade risk
E = Figure to high
F = Financial position unknown
G = Paper occassionally dishonoured
H = Frequently dishonoured

Occassionally, if requested, the bank may give additional limited information on the history of the customer. Bank references, although usually reliable, can be misleading, as many firms who behave badly towards creditors behave impeccably towards their bank managers.

The S.A. Survey rates the information obtained from banks only the third most reliable source. In an interview with a manager of a bank, the manager stated that majority of references given are 'good for amount quoted' (if strictly in way of business). This is very limited information and does not give a company any real indication of the customer's financial position.

(ii) Customers

Obviously the best source of credit information is (or should be) the customer himself. Customers, if they have nothing to hide, are only too pleased to talk about themselves if given the chance. The S.A. Survey and the U.K. Survey found the customer to be the second best source of information. The World Survey did not find the customer to be a particularly good source of information.

References given by the customers themselves are often misleading as customers would never supply the name of a reference with whom they have had a bad account.

(iii) Competitors

An uncommon source of credit information is competitors or other suppliers. Nevertheless, other suppliers probably know the customer and may be willing to supply the information needed. The exchange of credit information may prove fruitful and help keep potential losses to a minimum.

(iv) Information agencies

Information agencies are professional organisations providing credit information on prospective customers.

Information agencies were rated highly in all the surveys. The U.K. and S.A. Survey rated information agencies number one while the World Survey rated information agencies second.

The most well known of the information agencies is Dun and Bradstreet. They provide the following information about prospective customers.

- Names and functions of directors, owners or partners
- Holding and associate companies
- Financial status, where available
- Line of business
- Operations and history
- Court record
- Payment habits
- Credit ruling
- Bankers and branch.

The information is usually available within a week of the request, and enables a company to assess the creditworthiness of a prospective customer.

(v) Salesmen

Salesmen should be used more often to obtain credit information about prospective customers. The salesman often has direct contact with the customer, as he normally visits the customer's premises and is therefore able to observe the manner in which the customer conducts his business.

Summary

In an interview with a bank manager, it was found that although the banks normally had access to client's financial statements, cash flows, etc. they did not want to give this information to the public for fear of breaching the confidential relationship between them and their clients and thus harming their reputation.

Information agencies are reliable sources for obtaining credit information as shown above. The demand for services provided by information agencies is likely to increase as these agencies (unlike the banks) are willing and becoming increasingly more able to provide information required by companies.

CHAPTER 6

6. LIMITING THE RISK FACTOR

'No one's credit is as good as his money is' [15].

In any credit business there are different grades of risk. The risk catergory that customers *fall into should* be derived from the credit evaluation of the customer. The participants were asked to grade their customers into the following risk categories:

Risk categories	S.A. %
Very high risk	2,5
High risk	7,5
Medium risk	40
Low risk	50

Most participants considered their customers to be MEDIUM to LOW risk. The participants who graded their customers high and very high *felt that this was mainly* due to the type of industry their customer operated in.

6.1 METHODS OF LIMITING THE RISK FACTOR

6.1.1 CREDIT LIMITS

A credit *limit is the maximum* amount that a seller is prepared to invest in a buyer by way of trade credit.

Percentage of debtors with credit limits?

% OF DEBTORS WITH CREDIT LIMITS	S.A. %	U.K. %
0 - 20	25	54
21 - 50	19	16
51 - 75	11	5
76 - 100	45	26

Credit limits limit the amount of risk the seller is willing to allow a buyer to present.

The U.K. Survey presented a sharp contrast to the S.A. Survey. It is not sure why the U.K. companies did not give most of their customers credit limits as no reason was given in the U.K. Survey. In S.A. most companies give most of their customers credit limits. There is also a considerable degree of flexibility in the credit limit depending upon the manner in which the customer conducts his account.

Credit limits, if operated efficiently, should speed up decision-making and reduce or contain the bad debt loss to the amount of the limit.

6.1.2 PAYMENT GUARANTEES

Other methods of limiting the company's exposure to bad debts are payment guarantees.

Payment guarantees requested	S.A. %
Yes	51
No	49

TYPES OF GUARANTEES	S.A. *
Letter of credit	5
Bill, promissory note	8
Bank guarantees	2
Post dated cheques	3
Prepayments	10
Personal guarantee of owners	1
Personal property of owners	3
Cession of accounts receivable	6
Retention of ownership	6
Other	8

* = Ranking

(i) Personal guarantees

The most popular form of payment guarantee was usually personal guarantee of the owners. Thus, if the customer is unable to pay its debts, the directors will then become personally liable.

In a survey conducted by Brett [4] none of the companies surveyed attempted to establish the personal worth of the sureties. They (the companies) felt that the main benefit of having a director sign surety was a deterring one as they presumed that any person who had signed surety would ensure that all debts personally guaranteed were settled prior to the company being liquidated.

(ii) Letters of credit

Letters of credit are usually only used in international trade.

(iii) Bills, promissory notes, post dated cheques

Post-dated cheques and bills and promissory notes do not normally guarantee payment as these may be dishonoured when presented for payment. The only reason for obtaining these is that the collection process is made easier as, in the event of court action, the cheque or promissory note is adequate proof of the debt.

(iv) Retention of ownership

In the survey conducted by Brett [4] 6 out of 10 companies surveyed had a standard clause on their credit application form stating:

"Notwithstanding that all risks in and to all goods sold by the seller to the customer shall pass on delivery as herein dealt with, ownership in all goods sold and delivered shall remain vested in the seller until the full purchase consideration in respect thereof shall have been paid."

In a U.K. case Aluminium Industie Vaassen BV and Romalpa Aluminium Limited (Court of Appeal, January 1976) it was decided that a seller of goods may validly reserve his title to the goods, to other goods produced from them, and even to the proceeds from resale of those goods, until they have been paid for by the immediate buyer.[10]

The question of 'retention of ownership' has also come before the South African courts. In Oakland Nominees Limited v Geiria Mining and Investment Company Limited 1976(1)S.A. 452(A) the South African law of estoppel in regard to ownership was discussed. In this case it was stated that the owner will be prevented from reclaiming his goods if the following requirements are satisfied:

(a) There must be a representation by the owner, by conduct or otherwise, that the person who disposed of his property was the owner of it or was entitled to dispose of it.

(b) The representation must have been made negligently in the circumstances.

(c) The representation must have been relied upon by the person who acquired the goods.

(d) The person who acquired the goods would not have done so were it not for that representation.

Thus, if a company 'sells' goods to a 'customer' who it knows is buying those goods for resale, the company will be prevented from claiming its goods from a third party who subsequently buys those goods on the grounds that by allowing the 'customer' to display its goods, it knowingly misled the third party into believing that the 'customer' was the owner of the goods.

Many companies insert this term retaining ownership on their application form so that, if a customer goes into liquidation, they are able to retrieve any unsold stock. The Romalpa case above would support this position.

The registration and obtaining of guarantees is a delicate aspect of credit management. However, certain companies attempted to get as many guarantees as possible. Where the company had very few competitors in its products, guarantees were easier to obtain than where the products were freely available.

49% of the companies granted credit on the basis of mutual trust and requested no payment guarantees. Many of the companies who requested payment guarantees also indicated that guarantees were only requested in specific instances.

6.1.3 CREDIT INSURANCE

Credit insurance policies protect a supplier against default by trade customers.

Percentage of customers covered by credit insurance

%	S.A. %
0	73
1	3
2	3
5	6
10	3
60	3
100	9

The cost of insuring outstanding debtors is on average 0,28% per month of the outstanding book debts at the end of each month. The insurance company requires a credit application form for each customer of the insured, with the amount of cover requested. If the customer is approved, the company is insured against any default in payment by that customer. Most of the companies surveyed did not insure any of their trade debtors. Bad debts and the cost of insuring outstanding debtors should be regularly compared. Where the bad debts exceed the cost of insurance, companies should take the necessary steps to insure their debtors and thus limit their losses to the cost of the insurance.

CHAPTER 7

7. COLLECTION POLICIES AND PROCEDURES

Inadequate collection procedures often result in considerable delays in payment by debtors. Companies offer cash discounts as an incentive to customers to pay more quickly than would otherwise be the case. Personal experience has shown that if businesses offer cash discounts for prompt settlement or 30 days net, most customers either pay within the period required for obtaining the discount offered, or pay at the last possible moment thereby stretching the terms to 60, 90 days or more. The early receipt of the cash thus helps a business reduce its financing cost. The settlement discount is thus:

(a) an incentive for the customer to pay within a stipulated period;

(b) a method of reducing bad debts, as honest customers are normally able to pay for goods soon after delivery. Circumstances may however change making them unable to pay for the goods at a much later date.

7.1 Cash discounts

7.1.1 Are cash discounts offered?

	S.A. %	U.K. %
Yes	64	40
No	36	60

7.1.2 What discount is offered?

DISCOUNT %	S.A. %
1	13
2	9
2½	65
4	4
5	9

7.2 DAYS TAKEN TO COLLECT OUTSTANDING DEBTORS

DAYS	S.A. %	WLO %	U.K. %
30	12	11	12
60	63	42	50
90	11	31	36
120	6	9	2
150	3	6	
over 150		1	

Although each company surveyed provided the actual number of days debtors are outstanding, these responses were classified as above into 30, 60, 90, 120 and 150 days. Where the number of days exceeded say 30 days but was less than 60 days this was categorised as a 60 day debt.

From the above most companies took an average of between 30 and 60 days to collect outstanding debts. [S.A. Survey 63%. World Survey 42%. U.K. Survey 50%]. South African companies appear to collect their debtors more rapidly than companies in the World or U.K. Surveys.

7.3 PERCENTAGE OF DEBTORS OVERDUE

%	S.A. %
1 - 20	75
21 - 40	14
41 - 60	11
over 60	-

In 75% of the companies surveyed, less than 20% of their debtors were overdue.

7.4 PERCENTAGE OF SALES OVER THE PAST YEAR THAT RESULTED IN BAD DEBTS

%	S.A. %	U.K. %
0, - 0,1	55	79
0,2 - 0,5	19	17
0,6 - 1,0	14	3
1,1 - 2,5	6	1
over 2,5	6	0

55% of this Survey and 79% of the U.K. Survey had bad debts of less than 0,1% of sales. Thus, most of the S.A. and U.K. companies surveyed are able to limit their bad debts to satisfactory levels.

7.5 CAUSE OF BAD DEBTS
(Appendix C.3)

CAUSE	RANKING	
	S.A.	WORLD
Dishonesty	8	6
Inadequate equity	2	3
Inadequate working capital	1	2
Lack of experience	7	1
Competition	5	7
Insolvent trade debtors	4	4
High overheads	6	8
Unexpected misfortunes	3	5

Both S.A. and World Surveys considered inadequate working capital and inadequate equity to be major causes of bad debts.

Equity is permanent funds put in the business by its owners. These funds can be used for any purpose such as the acquisition of fixed assets or to finance working capital. Working capital is used to fund the day to day operations of a company.

Unexpected misfortunes and insolvent trade debtors are also high on the list of reasons for bad debts. Companies do not expect large customers to go insolvent. It has been recently reported in the press that many large companies have experienced large losses. As a result these companies have been unable to pay their debts. This can cause a ripple effect, in that if a company's debtors go insolvent, this can lead to the company's own failure.

The World Survey considered lack of experience to be the major reason for bad debts. Entrepreneurs with little experience begin businesses they are not qualified to run, and soon learn the error of their ways. Unfortunately, other companies suffer as a result of their inexperience. The S.A. Survey considered this the most minor cause of bad debts. The reason for this is possibly the buoyant economic conditions that have prevailed during the last few years. Unfortunately, the economic conditions have changed and lack of experience may soon be a major reason for insolvencies.

Surprisingly, both surveys did not consider dishonesty and high overheads to be major causes of bad debts. Perhaps most companies feel that people are inherently honest, or that most companies make genuine attempts to settle debts before the business goes insolvent.

7.6 COLLECTION TOOLS USED TO COLLECT OUTSTANDING DEBTS

COLLECTION TOOLS	S.A. *
Further statements	5
Reminder letters	2
Telephone calls	1
Visits by sales representatives	4
Visits by credit personnel	3
Debt collection agency	6
Court action	4

* = Ranking

(i) Further state

Further s[illegible] t considered by many companies to be a collection [illegible]ompanies automatically sent out further statements until whe[illegible] was paid or written off.

(ii) Reminder letters

Most business organisations send out reminder letters when the account is overdue. Reminder letters are most effective when a debt has just become overdue. However it is unlikely that there would be a satisfactory response if a debt is many months overdue as 'many months overdue' indicate a greater problem such as inability or unwillingness to pay the debt rather than forgetfulness on the part of the customer.

(iii) Telephone calls

Credit managers make extensive use of the telephone system when debts are overdue. An experienced credit manager is likely to have a contact person such as the purchasing officer or a senior member of the accounting department to whom contact can be made when there are problems with the account. Telephone calls provide a sense of urgency, and it can also produce previously unknown information e.g. non-arrival of goods. It may also produce a frankness regarding cash resources that would never be possible in written communication.

(iv) Visits by sales representatives

In many instances sales representatives receive commission. This commission may be reduced by any bad debts, or only paid on receipt of payment from the customer. In such instances the sales staff may be keener to ensure that payment is actually received.

(v) Visits by credit personnel

Credit personnel usually visit large debtors to arrange quicker payment of outstanding amounts. The visit may also provide a better picture of the premises, equipment and background of the customer.

(vi) Debt collection agency

Very few of the companies surveyed use debt collection agencies as a collection tool. Many companies prefer using the services of lawyers to collect outstanding debts. The lawyer is able to resort to litigation if the debtor does not pay.

(vii) Court action

If all the above debt collection procedures do not produce the desired results, court action becomes the only alternative. If the size of the debt is sufficient, most companies surveyed would resort to the courts to collect long outstanding debts.

Summary

In order to reduce bad debts companes can resort to many collection tools. The most popular of these are telephone calls, reminder letters and visits by credit personnel. These are cheaper and more pleasant methods of collecting outstanding debts than resorting to debt collection agencies or court action.

CHAPTER 8

8. EVALUATION OF THE CREDIT CONTROL FUNCTION

8.1 METHODS OF MEASURING THE EFFECTIVENESS OF THE CREDIT AND COLLECTION FUNCTION

MEASUREMENT	S.A. %	WLO %
Aged analysis of accounts receivable	59	46
Average collection period	35	36
Movement of debtors versus sales	6	12
Percentage of bad debt losses to total sales	-	6

From personal experience it is found that most companies would like to be able to assess the efficiency of the credit control department. A measurement of the department's efficiency would be valuable to both executives and credit managers. Certain reports, such as the reports named above, can be valuable aids in measuring the credit and collection function.

(1) Aged analyses of accounts receivable

Today almost all computerised debtors systems produce an aged analysis of accounts receivable. This report usually provides a detailed monthly breakdown of individual debtor accounts and the total amount outstanding from debtors. The outstanding debtors balance is usually broken down into current, 30, 60, 90 and 120 days and over. Companies usually examine all debts over 30 days to determine the reasons for the outstanding debt. The type of action taken to collect the debt will normally depend on the period for which the debt has been outstanding.

(ii) Average collection period

The average collection period is normally defined as

$$\frac{\text{Average debtors}}{\text{Average daily credit sales}} \times 365$$

The result of this calculation can be compared with agreed credit terms. Management are then able to determine the efficiency of their credit department. It is noted that averages should be calculated by category of product or customer where trade terms differ.

(iii) Movement of debtors versus sales

Only 2 companies surveyed actually used this as a means of measuring the credit and collection function.

(iv) Percentage of bad debt losses to total sales

The S.A. Survey did not use this ratio. No reasons were given. Bad debts normally take place months after the actual sale took place and timing differences can distort the results obtained.

8.2 COMPUTERISATION OF DEBTORS

All the companies surveyed had their debtors computerised. In the world survey only 50% of companies surveyed had their debtors computerised. It must however be remembered that the World Survey was in 1975, which was 10 years ago. The advent of micro-computers has made computerisation cost-effective. If the same World Survey is carried out today, it is probable that the number of companies having their debtors computerised would be higher than the 50% obtained above.

Without computerisation credit managers and top management would only be able to receive basic reports. Computerisation has enabled management to obtain sophisticated reports, thus enabling them to analyse their debtors and to take prompt and corrective action against delinquent debtors.

8.2.1 Reports received

REPORTS RECEIVED	RANKING	
	BY YOURSELF*	TOP MANAGEMENT*
Customers statements	3	6
Collection reminders	6	5
Overdue account report	2	1
Aged debtor analysis	1	1
Credit limit review report	4	3
Discrepancy reports	5	4
Customer history reports	7	4

* = Ranking

The aged debtors analysis was received by the credit manager and top management in most of the companies surveyed.

CHAPTER 9

9. TOP MANAGEMENT'S AWARENESS OF THE INVESTMENT IN DEBTORS

Do top management:	YES/NO	S.A. %	WLD %
Agree that neither a higher price nor additional sales are needed to compensate for longer payment terms	Yes	63	20
	No	27	80
Know the approximate cost of the company's investment in debtors	Yes	100	91
	No		9
Have a good idea about the financial standing of the top 50 customers	Yes	97	75
	No	3	25

Compensation for longer payment terms

Longer payment terms represent a larger investment in debtors and therefore the additional cost of carrying these debtors. This cost is either interest on loans used to finance these debtors or, where the company has sufficient cash resources, opportunity cost of interest lost.

27% of companies surveyed as compared to 80% of the world survey felt that a higher price or additional sales were necessary to compensate for longer payment terms. It could not be established why there were such big discrepancies in the Surveys. Possible explanation for the low score by S.A. companies could be:

(i) A lack of awareness of the real cost of debtors (despite responses to the contrary in the following question).

(ii) High levels of competitiveness in South Africa which prevent price or sales increases.

It is not believed that the South African economy is more competitive than the economies of the countries in the World Survey. Therefore, the lack of awareness of the real cost of debtors could be a cause for concern. Future research could usefully address this issue.

Cost of company's investment in debtors and financial standing of top 50 customers

Top management should have a knowledge about the cost of the company's *investment in debtors and the financial standing of its top 50 customers.* The top management of all (but one) of the S.A. Survey knew this information, as did most of the management of the companies in the World Survey. Top management would thus appear to be aware of the important contribution debtors make to the overall financial position of the company. However the validity of responses to this type of question may be suspect in that respondents may be unwilling to reveal their ignorance.

CHAPTER 10

TRAINING PROGRAMMES

10.1 THE IMPORTANCE ATTACHED TO TRAINING PROGRAMMES FOR CREDIT PERSONNEL

IMPORTANCE	S.A. %
Very important	23
Important	29
Average	32
Not considered	16

52% of the companies surveyed felt that training programmes for credit personnel were either important or very important, however as far as is known there are no university or technicon courses on credit management.

South Africa has 2 professional associations for credit managers. These are 'The United Association of Credit Management', and 'The Institute of Credit Management'. The associations have less than 1 000 members, but they offer various courses such as a national certificate course in credit administration and a national diploma in credit management. These courses are offered both by the associations and by certain educational colleges.

The national certificate course in credit administration contains the following courses:

Theory and practice of credit terms
Commercial credit bureaux
Credit insurance
Organisational structure of credit and collection departments
Credit sales policy
Credit department's operational manual
Establishing new accounts
Risk assessment and credit approval
Analysis of financial statements
Credit limits
Negotiable instruments
Insolvency and credit management
Securing accounts receivable
Collection principles and procedures
Mathematics of credit management
Management reporting
Measuring credit department's effectiveness.

The course is designed to turn a credit manager into a professional manager and the course lasts approximately 4 months.

The national diploma in credit management teaches:

Credit management
Financial accounting
General principles of law
Economics
Commercial law
Management.

This diploma is the highest 'credit' qualification that can be obtained, and enables successful candidates become associate members of both professional associations.

Various other organisations also offer one or two day seminars on credit management.

In view of the complexity of successful credit management, it is therefore felt that training is an indispensable requirement for obtaining professional credit managers who are able to manage debtors successfully as without training credit managers can never be fully effective, no matter how strongly motivated they are.

10.2 REASONS FOR INSOLVENCY

In an article by Mills [13] 'The easy path to the graveyard' ten reasons related to untrained credit managers are given for insolvency.

1. Unqualified staff making investments in trade debtors which the company cannot afford.
2. Expanding sales to financially weak customers, thereby creating serious cash flow problems.
3. Mismanagement of debtors.
4. Granting credit to customers without knowing if the customers are able to service their increased purchases.
5. Increased sales to existing customers. This may indicate that the salesmen are super-salesmen or other suppliers have stopped supplying.
6. Not collecting payments from debtors fast enough.
7. Not reconciling debtors regularly and the late identification of outstanding and overdue invoices.
8. Not recognising the risk category of each debtor.
9. Having credit department jobs for people and not people for credit department jobs.
10. Credit staff not being thoroughly trained in their jobs.

Any of the above reasons can cause a serious cash flow crisis, and the insolvency of the company. Successful credit training and therefore successful credit management can therefore eliminate many of the causes of company insolvencies.

CHAPTER 11

SUMMARY AND CONCLUSIONS

1. Companies grant credit to grow in size and thereby to increase profits.

2. CREDIT ADMINISTRATION

2.1 The person responsible for establishing the overall credit policy is normally the managing director or company director. This indicates the relative importance placed on this decision.

2.2 The most important prerequisite for successful credit management is knowledgeable, creative and innovative credit executives. Successful credit managers should be sensitive to the psychology of the consumer, have a keen understanding of sound credit fundamentals, and be informed on effective collection techniques. Above all, they must be flexible and able to adjust their actions and maintain control of individual situations.

2.3 47% of the credit managers surveyed have finance duties in addition to credit duties. The accountant or the financial director is usually the person responsible for credit management and control.

3. THE CREDIT DECISION

3.1 Company's credit and collection policies are normally a combination of written and verbal policy statements. The verbal part of the policy can create problems, and lead to frustration and misunderstandings. Verbal policies may not result in flexibility, but can result in confusion.

3.2 Credit terms are determined primarily by the credit standing of the buyer and the company's marketing and pricing policy. Credit terms are normally the length of time that a customer may take to settle his account. In certain instances, the credit standing of the buyer e.g. large chain store might enable him to gain more favourable terms than other customers.

3.3 The most popular basis for evaluating and establishing a customer's credit facility is on the customer's liquidity, activity, profitability and potential i.e. an evaluation of the customer's ability to pay and of non-financial information such as management ability, human resources, contracts and relationships.

3.4 Factors considered important when formulating policies on the granting of credit are, in order of importance:

Bank reports
Paying experience
Personal visits
Customer's reputation
Character of management.

4. SOURCES FOR OBTAINING INFORMATION WHEN INVESTIGATING CREDITWORTHINESS

4.1 The S.A. Survey rated the value of information obtained from the following sources in the following order:

Information agencies
Customers
Banks
Salesmen
Competitors.

Although bank reports were one of the most important factors considered when granting credit, the information contained in these reports was not sufficient. Information agencies and customers provided more valuable information.

5. LIMITING THE RISK FACTOR

5.1 Most customers of the companies surveyed fell into the medium risk category.

5.2 Methods of limiting the risk factor include:

Credit limits
Payment guarantees
Credit insurance.

Most companies surveyed limited the amount of credit available to each company by assigning the customer with credit limits which should not be exceeded.

Where possible, the companies tried to obtain payment guarantees, usually in the form of personal guarantees, owners, bank guarantees, or personal property of owners.

In contrast to the above, most companies did not avail themselves of credit insurance, even though the cost of the premium may have proved to be cheaper than the loss from the bad debt.

6. COLLECTION POLICIES AND PROCEDURES

6.1 In order to collect debts more quickly, cash discounts were offered as an incentive to pay on due date. Most companies did not take advantage of cash discounts offered as they paid after the time allowed for the discount to be granted.

6.2 The average time taken to collect outstanding debtors in the S.A., World and U.K. Surveys is 60 days. 63%, 42% and 50% of the S.A., World and U.K. Surveys respectively fell within the 31 to 60 day category.

6.3 Very few of the companies' debtors were overdue with their payments and the companies surveyed had a very low percentage of bad debts in relation to sales.

6.4 The most frequent cause of bad debts are considered to be inadequate working capital, inadequate equity and unexpected misfortunes.

6.5 The telephone is regarded as the most popular collection tool. This entails a person phoning all overdue debtors, to ascertain why the payment is late or when the cheque can be expected. Other popular collection tools are reminder letters and visits by credit personnel.

7. EVALUATION OF THE CREDIT CONTROL FUNCTION

7.1 The most important measurement of the credit and collection function is the aged analysis of accounts receivable. The printout is reviewed both by credit managers and top management and appropriate action is taken against outstanding debtors.

8. TOP MANANGEMENT

8.1 Almost all the top management apparently know the approximate value of the company's investment in trade debtors and have a good idea about the financial standing of its top 50 customers. This indicates they are thus involved in the management of the business and are informed about the debtors of the company.

9. TRAINING PROGRAMMES

Virtually half of the companies surveyed felt that training programmes for credit personnel were important, while half felt they were not that important. This may correspond to the fact that many of the credit managers had a knowledge of finance and probably felt that their knowledge was sufficient for successful credit management.

10. CONCLUSION

Credit policy involves a trade-off between the profits on sales that bring in debtors, and the cost of carrying these debtors plus any bad debt losses. The credit policy becomes a failure when the profit from each additional sale is exceeded by the cost of carrying that debt or the bad debt loss that results because of the relaxed credit standards.

The ratio of bad debts to sales may be misleading, as a company with very low bad debts might have restrictive credit policies that prevent it from obtaining sales that may not prove to have a unacceptable risk. The S.A. Survey indicated that the companies surveyed had few bad debts and overdue accounts. However the average number of days outstanding is in line with international norms so that it would appear that credit policies are not unduly restrictive. It would therefore appear that the credit policies of South African companies may be taken as acceptable.

CHAPTER 12

PRINCIPLES TO ENSURE THE SUCCESS OF CREDIT POLICIES

1. Leave the responsibility for establishing overall credit policy to a senior executive preferably a director.

2. Ensure credit managers are knowledgeable, creative and innovative.

3. Request as many customers as possible to provide personal guarantees for their debts.

4. Where possible, offer cash discounts for prompt payment.

5. Where a customer does not pay within a stipulated period, contact the customer by telephone to ascertain reason for non-payment, ask when payment will be made and, if possible, arrange for collection of the cheque.

6. Use aged analysis of accounts receivable to analyze the debts and obtain information of all debts that are overdue.

7. Keep top management informed of the company's investment in trade debtors and the financial standing of its top customers.

8. Where credit managers are not financial executives, ensure that they are adequately trained to fulfil their duties responsibly and competently.

REFERENCES

[1] Erdos, P.E. Professional Mail Surveys New York, McGraw Hill, 1970. P59

[2] Mayo, O.G. Consumer Credit Control Gower Press, 1971. P2,3

[3] Benz G.V. International Trade Credit Management Great Britian, Gower Press, 1975

[4] Brett J.K. Methods of Assessing Credit Worthiness M. Com Dissertation University of the Witwatersrand, Johannesburg, 1984

[5] Weston and Brigham. Managerial Finance Holt, 1979. P183

[6] Whiteside C.D. E.D.P. Systems for Credit Management Wiley, New York, 1971 pp 39-48 Survey by Eckstrom C.

[7] Adams, R. Practical Credit Control Accountants Publishing Company Limited, Australia, 1968

[8] Kirkman, P.R.A. Modern Credit Management, Great Britian, George Allene Unwin, 1977

[9] Fetyko, D.F. and Patterson, M. How an Oil Company Analyses Credit Management Accounting August, 1983

[10] Howe, J.T. Managing Accounts Receivable Effectively Management Accounting August, 1983. P38

[11] Van Horne, J.C. Financial Management and Policy, London, Prentice-Hall International, 1980

[12] Financial Staff, South Africans are a Nation of Slow Payers The Star 9 October 1984

[13] Mills K. Why companies Go Bust Credit Alert July 1985. P14

[14] Dun E. Bradstreet Draft Press Release June 4, 1985

[15] Quotation by E.W. Howe [3]. P63

[16] Woolf E.H. Auditing today London, Prentice-Hall International 1979. P475

APPENDIX A

UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

DEPARTMENT OF ACCOUNTING

RESEARCH QUESTIONNAIRE

PLEASE ANSWER THE QUESTIONS BELOW BY CIRCLING THE APPROPRIATE ANSWER/S (E.G. A) OR BY SPECIFYING ANSWERS IN THE SPACE PROVIDED.

1. WHAT CLASSIFICATION MOST CLOSELY DESCRIBES YOUR COMPANIES ACTIVITIES, E.G. Food, Tobacco, Furniture.

   _____

2. TOTAL SALES AMOUNT TO?
   R'Million

   A) 0 - 10
   B) 11 - 50
   C) 51 - 100
   D) over 100

3. WHAT PERCENTAGE OF THE TURNOVER IS REPRESENTED BY CREDIT SALES?

   A) 0 - 30
   B) 31 - 60
   C) 61 - 90
   D) over 90

4. TRADE DEBTORS AMOUNT TO?
   R'Million

   A) 0 - 10
   B) 11 - 50
   C) 51 - 100
   D) over 100

5. TRADE DEBTORS REPRESENT?

   A) the biggest asset
   B) the biggest current asset
   C) the second biggest current asset
   D) a small asset

6. HOW MANY ACTIVE CUSTOMERS DO YOU HAVE?

   A) 0 - 500
   B) 501 - 1000
   C) 1001 - 2500
   D) over 2500

7. WHO IS RESPONSIBLE FOR ESTABLISHING OVERALL CREDIT POLICY?

   A) The managing director
   B) A company director
   C) The credit manager
   D) Other - please specify _____

8. WHAT IN YOUR OPINION IN THE MOST IMPORTANT PREREQUISITE FOR SUCCESSFUL CREDIT MANAGEMENT?

   A) knowledgeable, creative and innovative credit executives
   B) top management support
   C) competent credit management by competitors
   D) other - please indicate

   .....

   .....

9. ARE COMPANY CREDIT AND COLLECTION POLICIES AND PROCEDURES

   A) written
   B) verbal
   C) a combination of written and verbal
   D) non-existent

10. HOW MANY CREDIT MANAGERS ARE EMPLOYED BY YOUR COMPANY?

    _____

11. WHAT OTHER DUTIES DO YOU HAVE IN ADDITION TO CREDIT MANAGER?

    A) finance
    B) sales
    C) marketing
    D) production
    E) purchasing
    F) other .....

12. ARE CREDIT TERMS DETERMINED BY :

    A) competitors' terms
    B) product availability (i.e. buyers' or sellers' market)
    C) the credit standing of the buyer
    D) the company's financial condition
    E) the company's marketing and pricing policy
    F) other .....

13. ARE CUSTOMERS REQUESTED TO PROVIDE PAYMENT GUARANTEES? [YES] [NO]

    IF YES IS THIS GUARANTEE:

    A) letter of credit
    B) bill/promissary note
    C) bank guarantee
    D) post dated cheques
    E) prepayments
    F) personal guarantee of owners
    G) personal property of owners
    H) cession of accounts receivable
    I) retention of ownership of goods
    J) other .....

14. HOW DO YOU RATE THE INFORMATION OBTAINED FROM THESE SOURCES?

0 = No value
10 = Outstanding
(Below 5 indicates unsatisfactory)

Banks
0 1 2 3 4 5 6 7 8 9 10

Customers
0 1 2 3 4 5 6 7 8 9 10

Competitors
0 1 2 3 4 5 6 7 8 9 10

Information agencies
0 1 2 3 4 5 6 7 8 9 10

Salesmen
0 1 2 3 4 5 6 7 8 9 10

15. DO YOU HAVE A STANDARD *CREDIT EVALUATION FORM*? [YES] [NO]
IF YES, PLEASE ATTACH A COPY

16. ON WHAT BASIS DO YOU EVALUATE AND ESTABLISH A CUSTOMER CREDIT FACILITY?

A) character, capacity of customer
B) liquidity, activity, profitability, potential
C) past experience with a general impression about the customer
D) other/please specify .....

17. *WHEN CONSIDERING* THE GRANTING OF CREDIT, WHICH FACTORS DO YOU CONSIDER IMPORTANT. RANK ON A SCALE OF 0 TO 10.
0 = NOT IMPORTANT AT ALL
10 = EXTREMELY IMPORTANT

	RANKING
A) financial statements ratios	
B) agency castings/reports	
C) bank report	
D) trade references	
E) paying experience	
F) personal visits - major accounts	
G) customer requirements	
H) salesman's opinion	
I) major supplier	
J) profitability of products	
K) competitive conditions	
L) degree of need for the customer's business	
M) customer's reputation	
N) character of management	
O) years in business	
P) growth potential of customer	
Q) seasonal factors	
R) area and industry economic conditions	

18. WHAT % OF YOUR DEBTORS HAVE CREDIT LIMITS?

A) 0 - 20
B) 21 - 50
C) 51 - 75
D) 76 - 100

19. DO YOU CONSIDER THE MAJORITY OF YOUR CUSTOMERS

A) very high risk
B) high risk
C) medium risk
D) low risk

20. WHAT % OF YOUR CUSTOMERS DO YOU COVER BY CREDIT INSURANCE? [ ]

21. DO YOU OFFER CASH DISCOUNTS? [YES] [NO]

WHAT %? _____

22. HOW MANY DAYS ON AVERAGE DOES YOUR COMPANY TAKE TO COLLECT OUTSTANDING DEBTORS?
i.e. WHAT ARE YOUR DAYS' SALES OUTSTANDING?

_____

23. WHAT % OF DEBTORS ARE ON AVERAGE OVERDUE?

A) 1 - 20
B) 21 - 40
C) 41 - 60
D) over 60

24. WHAT % OF YOUR SALES OVER THE PAST YEAR WERE BAD DEBTS?

A) 0 - 0,1
B) 0,2 - 0,5
C) 0,6 - 1,0
D) 1,1 - 2,5
E) over 2,5

25. WHAT WAS THE CAUSE OF THE BAD DEBTS?
RANK ON SCALE FROM 0 - 10

0 = NEVER OCCURED
10 = MANY CUSTOMERS

	RANKING
A) dishonesty	
B) inadequate equity	
C) inadequate working capital	
D) lack of experience	
E) competition	
F) insolvent trade debtors	
G) high overheads	
H) unexpected misfortunes	

26. WHICH COLLECTION TOOLS ARE USED BY YOUR COMPANY?
MARK MORE THAN ONE IF APPLICABLE.

A) Further statements
B) Reminder letters
C) Telephone calls
D) Visits by sales representatives
E) Visits by credit personnel
F) Debt collection agency
G) Court action

27. WHAT IN YOUR OPINION IS THE MOST IMPORTANT MEASUREMENT OF THE CREDIT AND COLLECTION FUNCTION?

A) aged analysis of accounts receivable
B) average collection period
C) movement of debtors versus sales
D) percent of bad debt losses to total credit sales

28. ARE YOUR DEBTORS COMPUTERISED? YES NO

29. WHAT REPORTS ARE RECEIVED?

	BY YOURSELF	TOP MANAGEMENT
A) customers statements		
B) collection reminders		
C) overdue account report		
D) aged debtors analysis		
E) credit limit review report		
F) discrepancy report:		
G) customer history reports		

30. DO TOP MANAGEMENT :

A) agree that neither a higher price nor additional sales are needed to compensate for longer payment terms YES NO

B) know the approximate cost of your company's investment in debtors YES NO

C) have a good idea about the financial standing of your top 50 customers YES NO

31. WHAT IMPORTANCE DOES YOUR COMPANY ATTACH TO TRAINING PROGRAMMES FOR CREDIT PERSONNEL?

A) very important
B) important
C) average
D) not considered

ANY OTHER COMMENTS

_____

_____

_____

_____

_____

NAME: _____

POSITION IN COMPANY: _____

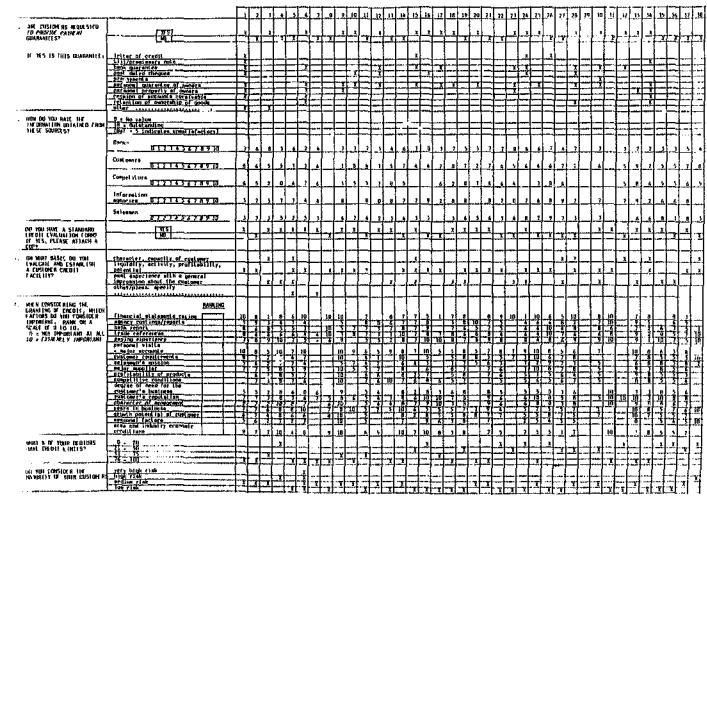
DATE: _____

...versity of the Witwatersrand, Johannesburg

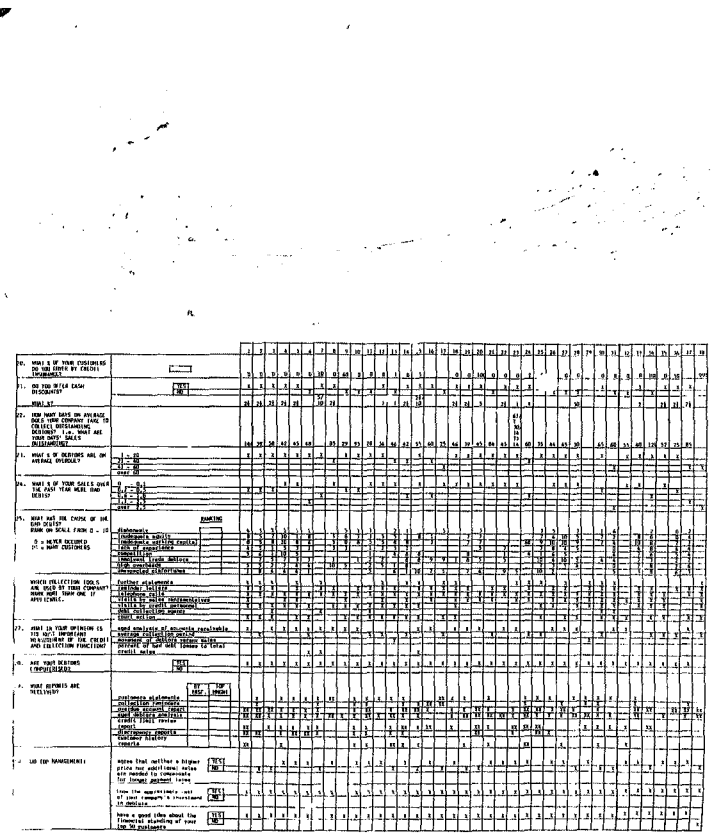
DEPARTMENT OF ACCOUNTING

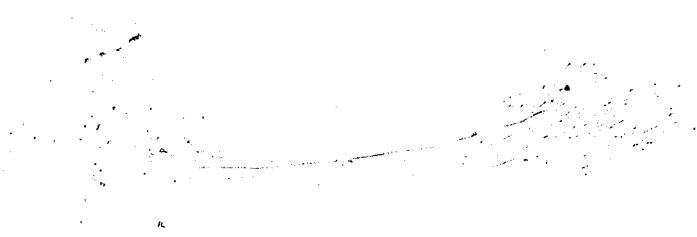
RESEARCH QUESTIONNAIRE

| | | |



- 89 -





		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38
31. HOW IMPORTANCE DOES YOUR COMPANY ATTACH TO TRAINING PROGRAMS FOR CIVIL PERSONNEL?	very important		X														X																					
	important	X		X		X	X	X			X		X			X			X			X				X						X			X		X		X
	average				X				X	X		X		X	X			X		X	X		X	X	X		X	X	X	X	X		X	X		X		
	not considered																																						
ANY OTHER COMMENTS																																							

APPENDIX C.1

When considering the granting of credit which factors do you consider important?

FACTORS CONSIDERED WHEN GRANTING OF CREDIT	*****	****	***	**	*	SCORE	S.A. SURVEY	USA [6]
Weighting	5	4	3	2	1			
Financial statement ratios	9	13	4	1	9	120	6	1
Agency costing/reports	3	11	8	5	9	102	13	2
Bank reports	3	12	10	7	4	137	1	3
Trade references	4	12	10	7	3	115	7	4
Paying experience	12	14	6	1	4	137	1	5
Personal visit - major accounts	11			1	3	134	3	6
Customer requirements	4			3	12	99	14	7
Salesman's opinion	2			9	10	90	17	8
Major supplier	4	12	9	1	10	107	11	9
Profitability of products	2	7	13	1	13	92	16	10
Competitive conditions	2	11	13	1	9	104	12	11
Degree of need for the customer's business	2	8	11	5	10	95	15	12
Customer's reputation	8	13	10	3	2	130	4	13
Character of management	8	13	6	4	5	123	5	14
Years in business	5	12	10	3	6	115	7	15
Growth potential of customers	3	13	11	2	8	112	10	16
Seasonal factors	3	5	9	4	15	85	18	18
Area and industry economic conditions	7	12	6	3	8	115	7	19

***** EXTREMELY IMPORTANT

**** IMPORTANT

*** AVERAGE

** CONSIDERED IN PASSING

* NOT CONSIDERED



How do you rate the information obtained from these sources?

	OUTSTANDING			VERY GOOD			GOOD			SATISFACTORY			UNSATISFACTORY			SCORE			RANKING		
WEIGHTING	5			4			3			2			1								
SURVEY SOURCE	SA	UK	WLD	SA	UK	WLD	SA	UK	WLD	SA	UK	WLD	SA	UK	WLD	SA	UK	WLD	SA	UK	WLD
Banks	-	5	8	15	17	20	9	38	40	8	18	46	3	12	23	106	265	355	3	4	1
Customers	1	14	1	12	21	8	12	22	43	9	12	40	1	21	45	108	265	291	2	2	4
Competitors	-	9	3	6	22	14	15	22	29	5	7	32	9	-	59	88	241	281	5	5	5
Information agencies	3	10	3	19	33	17	4	32	51	3	7	44	6	-	22	115	300	346	1	1	2
Salesmen	1	6	2	7	13	12	8	48	35	13	10	43	6	-	45	89	259	294	4	3	3

What was the cause of bad debts?

CAUSE	NUMBER OF COMPANIES								
	WORLD	VERY FRE-QUENTLY	FRE-QUENTLY	AVERAGE	LESS THAN AVERAGE	SELDOM	SCORE	RANKING	
								S.A.	WORLD
WEIGHTING		5	4	3	2	1			
Dishonesty	6	-	-	4	5	28	50	8	6
Inadequate equity	18	2	12	6	1	16	94	2	3
Inadequate working capital	23	6	13	6	2	10	114	1	2
Lack of experience	32	-	4	4	9	20	66	7	1
Competition	4	1	4	8	3	21	72	5	7
Insolvent trade debtors	15	4	8	3	5	17	88	4	4
High overheads	0	1	5	5	4	22	70	6	8
Unexpected misfortunes	9	4	7	4	9	13	91	3	5

Author Brett Jonathan K
Name of thesis The Credit Control Decision. 1985

PUBLISHER:
University of the Witwatersrand, Johannesburg
©2013

LEGAL NOTICES:

Copyright Notice: All materials on the University of the Witwatersrand, Johannesburg Library website are protected by South African copyright law and may not be distributed, transmitted, displayed, or otherwise published in any format, without the prior written permission of the copyright owner.

Disclaimer and Terms of Use: Provided that you maintain all copyright and other notices contained therein, you may download material (one machine readable copy and one print copy per page) for your personal and/or educational non-commercial use only.

The University of the Witwatersrand, Johannesburg, is not responsible for any errors or omissions and excludes any and all liability for any errors in or omissions from the information on the Library website.