

# Guide to Good Credit Management

"A sale is not a sale until the money is in the bank."

For many a small business the excitement of getting the long awaited big order is the whole reason they are in business. However, whether your customer is a small business or a very large one, it's important to make sure they can pay you.

ASW Steel in South Wales was a massive business employing thousands of people and turning over hundreds of millions. They went bust and took a lot of small businesses with them. The aim of riskdisk.com is to provide you with a reliable, accurate and yet inexpensive source of information and enable you to assess the suitability of your customers and minimise the risk of bad debt.

You will also find useful advice and examples of sound business practice in this short but powerful document. Each section is designed to stimulate awareness of the benefits and pitfalls involved in granting credit facilities to a customer.

## Essential before Granting Credit

Many small companies may be dazzled by a large order from a huge multinational i.e. ASW. However, a competitive tender - producing a profit of a few pence per item could prove a real millstone, especially if your customer's payment terms mean that the overdraft / loan needed to service the order would not in fact be for 90 days but more likely for 180 days. Having geared up for production of the item, and perhaps now being dependent upon further orders, the small company could leave itself open to further enforced price cutting. Before you commit yourself to a credit transaction and permit your buyer to receive goods or services before payment, you must be completely certain that you have made a wise investment and that you are well placed to receive prompt and full payment for your product.

## Consider this...

You are approached in the street by an old and trusted friend who has had his wallet stolen. He needs £10 to get home.

You are approached by a down at heel but well spoken stranger, who informs you that he has had the misfortune to have been relieved of his wallet. He assures you that if you provide him with a loan of £10 together with your name and address, he will return the money at the earliest opportunity...

## To which would you extend credit?

Who in their right mind would hand over £10 to a total stranger? Yet unbelievable as it may seem, this is a situation which is encountered in the business world day after day, when supposedly astute businessmen cheerfully consign thousands of pounds worth of goods to clients about whom they know absolutely nothing or to whom they have applied the very flimsiest methods of assessment of credit worthiness.

## Indeed, the most curious criteria are often employed in assigning credit worthiness:

- They'll be O.K. After all, they are a limited company/PLC.
- We've heard they're doing really well.
- They're massive.
- They're a household name. (Use riskdisk.com to check some household names British Gas or Tarmac for example)
- They're part of a huge group.
- Just look at their prestige address - even the building is called after them.

## Hearsay and casual observation is not sufficient.

### What must be deduced for the purposes of credit assessment is:

1. Who/what are you dealing with?

2. Where are they located?
3. Do they have the money to pay?
4. Are they prepared to part with it promptly?

One of the most important aids in answering these questions is a good measure of self-confidence.

Consider the following assertions very carefully.

- A sale is not a sale until the money is in the bank. I shall ensure that it arrives there.
- In granting credit facilities to a client, I am making an investment in their business.
- It is my duty to safeguard that investment.
- I am quite within my rights in seeking answers to questions 1-4 .
- I am not doing anything subversive, underhand or devious in enquiring into my applicant's affairs and I shall display no reticence or shyness in so doing.

It is important to extend this self-confidence to recognising your own "business clout". You may be able to be selective in your choice of clients. If so, take full advantage.

## Make sure that your paper work really "works" for you

No matter how large or small your organisation, one of the most important aids in building an accurate profile on your prospective customer, is a well-designed credit account application form. This should be completed without exception, by all prospective customers.

We have drawn up a sample credit application form on Riskdisk; [print your own copy here](#)

### In drawing up your terms of trading, you must ensure that:

- They are presented in fluent, unambiguous English.
- They apply to all sales.
- They will supersede any terms imposed by the purchaser. This can be achieved by the inclusion of a clause, which emphasises that any variation to the terms, as defined, must be agreed in writing by both parties.
- They define the point at which ownership (and risk) passes from you to your purchaser.
- They include a Retention of Title clause.
- They stipulate when payment is due.
- They state any interest you wish to charge on overdue accounts.

### On receipt of the completed credit account application form, together with an official order, you must ensure that:

- Names/addresses/telephone numbers/registration/VAT numbers are identical on both documents. If there is any variation whatsoever, check it with your client and do not proceed until your query has been satisfactorily resolved.
  - The terms of purchase set by the client on his Official Order form do not include any penalty clauses which may be activated by late delivery etc. These may be overridden by your Order Acknowledgement (see below) but you must be sure to reject any clause, which is not therein protected and which is unacceptable.
  - An order acknowledgement containing your terms and conditions is sent, without exception, to every customer who places an order. As well as acknowledging safe receipt of the order and confirming its specifications, this form will by law, when sent to the customer, supersede their purchase order terms.
- Once your applicant has completed the Credit Application Form, you can put it to work for you. Close scrutiny of each section will yield a wealth of information about your prospective customer.

## Starting with the name...

Establishing the identity of one's prospective client is extremely important yet it often seems that the elation which follows on securing a sale, sweeps aside such mundane considerations as obtaining the correct name of the credit applicant. All too often, and too late, enquiries are only instituted when things start to go wrong. You must therefore make sure that you are in possession of the complete and correct name under which your applicant trades. Just by scrutinising the trading name alone, you should be building your own profile. However, it is early days yet and you must resist being dazzled by suggestions of grandeur. Judgement should be reserved until initial impressions are confirmed. Remember also that even very large prestigious, multinational companies can fail and the last decade has seen the demise of many companies across the globe.

### **A trading name can be employed by the following:**

- A sole proprietor
- A partnership
- A limited liability partnership (LLP)
- A private limited company (Ltd)
- A public limited company (PLC)

For example, a limited company by the name of "Tricktrack Ltd" could, if it wished, utilise its own limited style as a trading name, "Tricktrack Ltd" or it could elect to trade under a different name, such as "Shoes for Sport". In the latter instance, the trading name would be "Shoes for Sport" and the limited company style would be "Tricktrack Limited." To put this another way, the proprietor of the trading name "Shoes for Sport" would be the limited company, "Tricktrack Ltd". Any ledger card opened, would have to be made up as "Tricktrack Ltd" trading as "Shoes for Sport".

It is not unusual for a limited company to possess a trading style; in certain trades, it is common for a limited company to have several trading styles. Often in such cases, it is the trading name, rather than the limited company style, which is advertised in phone books and trade directories and it is the trading name, which is better known to the public. However, it is imperative that you, as a prospective trade creditor, should be fully aware of the correct limited company style as well as the trading name. Any litigation undertaken could fail unless the limited company style and trading name are quoted correctly. The same applies to all the above business types.

Note that no two live limited companies (either public or private) can share exactly the same limited style, although they could share the same trading name.

It is common for business entities to change their names or even "exchange" their names with another concern (the latter being quite usual in the case of limited companies). For this reason it is important to ensure that you are always up-to-date and have the "exact and "correct" style of the concern with which you are dealing. This is where a good monitoring system pays dividends. A limited company may change its name, but its registration number is permanent. The only real form of identification for a limited company is its registration number. It is therefore essential you have the limited company number and quote it on all documentation.

### **Points to consider:**

- If the details are taken over the phone, be sure to record the name absolutely exactly, up to and including any idiosyncrasy in spelling. Is it that famous petroleum company? No, it's actually 'Ezzo Ltd' Is it that huge chemicals group? No, it's actually 'Eye See Eye Ltd' It is vital that you obtain the correct name at the opening stage. This is extremely important and would certainly be of paramount importance in a court of law.
- Make sure that your applicant has inserted his "Trading Name" legibly. A businesslike approach is suggested, especially if the form is typed. Be sure now to match this professionalism by ensuring that when you transfer the name to your ledger, you do so exactly, up to and including any idiosyncrasy in spelling or punctuation. This is extremely important and would certainly be of paramount importance in a court of law.
- If the trading name contains initials, you must, no matter how laborious it might

seem, ensure that the initials are used at all times, i.e.: "E.K.J.R. Smith Ltd" must always be referred to as just that, never as "Smith Ltd"

- If the trading name is a long one, never be tempted to shorten it, i.e.: "Take Your Money And Leg It Ltd." must always be referred to as just that, never as "T.Y.M.A.L.I. Ltd".
- If the name suggests grandeur, reserve judgement until such suggestions are confirmed by your subject's financial status. "Intercontinental Imports" could be a name employed by a large and well established international conglomerate, or by a young man with no experience, who has just set up in business with a desk and a phone.

Every limited company is required by law to mention its name in legible characters on all business letters, orders for money or goods and, as a result of recent legislation, also on their web site and emails. You are quite within your rights to request clarification if such information is absent. If your client trades under a name which is different to its limited style, you must be sure that you possess its correct limited style up to and including any small idiosyncrasy in spelling. If you have any queries relating to the trading name, make sure that they are resolved before proceeding further.

### Now take a long, hard look at the address...

When considering where your subject is located, first ask yourself (and think very carefully about this) where you would expect them to be located?

Take for instance a manufacturing company, would you expect to find it at:

Unit 18, Aerodrome Trading Estate? or at:

12, Rosewood Gardens?

The answer of course is at the first address, since 12, Rosewood Gardens is suggestive of residential property.

The 1990's saw the beginnings of a hugely popular trend for working from home and it is entirely reasonable to find private individuals conducting professional, consultancy and many other types of enterprise from private houses. However, these will mostly be business people whose credit needs are not great. So if it transpires, upon enquiry, that the address quoted is indeed residential, an alarm bell might ring if the credit sought were sizeable. Has your subject sought approval from the local authority to carry on a business of any size from a residential property?

In considering the name of the company, we caution against suggestions of grandeur. This is equally applicable to the address itself. Just as "Intercontinental Imports" could apply to a prestigious multinational organisation, or a "tin pot firm", so too could "Intercontinental House" comprise a large luxurious freehold office block, or one room in a suite of serviced offices. There are several well known service companies in the London area alone, that offer a desk and a phone on an hourly basis. Ideal for the international businessman perhaps, but think of the shadier purposes to which such a facility could be put. Never mind "here today and gone tomorrow", more a case of "here this morning and gone this afternoon". A seemingly "prestige" address can often be deceptive and an office located in one of the top class streets in London's West End, could in fact turn out to be a small top floor room (no lift) with a desk, chair, telephone and filing cabinet.

Impressiveness can also be the stock in trade of confidence tricksters. A respected accountant, giving a lecture to businessmen, told the audience that the signs of a failing business were often those that might give the opposite impression: the Rolls Royce with the personalised number plates; the elegant foyer or reception area; the move to larger or more impressive premises and, all too often, a one man style of management.

In the case of a concern which bears the same name as the property (or road) in which it is located, do not automatically assume that it was the business that came first. Whilst many prestigious concerns have lent their names to properties, streets etc., so too have many businesses, in the initial stages of their life, taken their name from the premises, street or even general neighbourhood in which they are located.

If your applicant apparently possesses only one address, it is important to check it carefully and to satisfy yourself that it is entirely appropriate, since it is to this address that your goods are to be consigned and from which payment is to be made.

If your applicant possesses more than one address, this would seem to suggest a concern of some size. Once again, it is important not to be taken in by suggestions of grandeur or size, until these are confirmed. Time should be allocated to scrutinising each of the addresses, so that there remains no doubt whatsoever that they are entirely appropriate to an apparently sizeable business. It could of course transpire that your client has a vast number of branches, but the particular branches that will be of interest to you are a) the head office b) the place to which your goods are to be consigned and c) the place from which payment is to be made.

### Points to consider:

- Make sure that all addresses completed on your application form are legible.
- If the address(es) suggest grandeur, reserve judgement until such suggestions are confirmed by your subject's financial status.
- Look for obvious clues as to whether it is a residential address.
- If the address consists solely of a P.O. Box number and town, we would advise that you employ extreme caution. Whilst we have no reasons to doubt the status of any legal entity operating from a post office box number, we would emphasise that considerable complications could arise should credit be sought from such an address and non payment subsequently ensue. You must now take steps to ensure that you obtain from your client the full trading address here before granting credit.
- If you are in any doubt as to the suitability of the premises when comparing them to your client's stated line of trade, or size of credit requested, do not hesitate to make a polite but firm enquiry of your applicant.
- Don't forget the humble postcode, it is an important mark of identification. Make sure you have it - in full.
- Beware of any company that has an ex-directory listing. Ask yourself (and if necessary your client) why they are not seeking to promote their business by making the telephone number available to the public.

At some stage, you will probably have occasion to ring your applicant. Take careful note of how the phone is answered. It is important that you should feel completely satisfied that the telephone is answered in a professional manner which clearly confirms the identity of the subscriber. The following could pose problems to those seeking payment of money, if they are given as the sole point of contact:

- Telephones which are permanently serviced by answering machines.
- Telephones which are never answered.
- Telephones which are permanently engaged.
- Telephones which are answered merely with a number.
- Telephones which are answered with a "yes" or "hello".
- Telephones which are answered with a different name altogether.

Remember that in advancing money to your applicant, you have, as it were, made an investment in his business and therefore have an interest in its advancement. Put yourself for a moment, in the place of a client (rather than a creditor). Would you buy from this concern, or would you be put off by their lack of professionalism?

### VAT registration...

Value Added Tax (VAT) is a tax, which is levied on most business transactions within the United

Kingdom and The Isle Of Man. Since 19 March 1991, VAT registration has been compulsory for any "body" (proprietorship, partnership, limited company) whose taxable turnover within the past 12 months has exceeded a certain amount - currently £65k However, it should be noted that it is still possible for a "body" to be registered for VAT, even if the taxable turnover is below the quoted limit.

### What are you dealing with?

Not only is it important, but it is your right by law to establish the legal status of the concern

with which you are to deal. Your credit application form should enable you to discover the correct legal status of your applicant and determine whether you can obtain financial information upon the organisation from public record.

### **Private limited company (Ltd)**

A private limited company is a legal entity in its own right - a body corporate which has been funded by those to whom shares in the company are allocated. The personal liability of the shareholders and directors is normally limited to the amount represented by the nominal value of their issued shares.

For a company, the equivalent of bankruptcy is insolvency and whilst a director is obliged to liquidate an insolvent company, he or she will face no personal loss or stigma, apart from any contribution to the share capital, should the company fail. A limited company, like a person, can be sued in the civil courts but any financial penalty imposed will normally be paid from the company's funds and not from the directors' /shareholders' pockets.

Unlike a person, a limited company can never die; it can only terminate when it is wound up. If one of the directors or shareholders were to die, the company would continue, with new directors and shareholders.

The main advantage of operating a limited company is that of the limitation of the liability enjoyed by its shareholders with regard to the company's debts.

The original idea behind the first Joint Stock Companies Act of 1844 was to enable business promoters to set up limited companies more conveniently. Prior to that date, it had been necessary to obtain an Act of Parliament to do so.

Nowadays, the small private limited company is a vehicle, which enables a businessman to set up with little or no risk to himself and thus encourages enterprise. He is protected from the company's creditors by way of the limited status (unless of course he has provided personal guarantees) and is afforded more manoeuvrability.

He knows that if all else fails, his personal property will be protected from seizure.

By its proliferation however, the limited company has lost its former unassailable status of respectability and the words "limited company" do not necessarily indicate stability or financial wellbeing.

### **Public limited company (PLC)**

The public limited company is one whose shares may be purchased by the public and traded freely on the open market.

It must be emphasised that, despite the elevated status often accorded to a limited company merely because it is prefixed by the word public, it is only the very largest of these entities which are actually quoted on the Stock Exchange. Confirmation of their number can be obtained by reference to the financial pages of a daily newspaper.

There is however a growing number of insignificant PLCs, whose public share dealing status is reserved more for a matter of convenience than actuality. The words "public limited company" do not necessarily indicate respectability or financial well-being.

### **Filing of documents for private and public limited companies**

Annual documents must be filed with the Companies' Registry, revealing the financial state of the company as well as the names and addresses of those engaged in its management and involved in its ownership. An example of these documents can be viewed with the aid of Riskdisk.com.

### **How easy is it nowadays to form a private or public limited company?**

With respect to company formation, one can arrange for a limited company to be set up from scratch and indeed, it is possible to wade through the formalities oneself by obtaining the necessary forms relating to the memorandum of association and the articles, from companies house. However, for the sake of a hundred £ or so, the task can be undertaken by an accountant or solicitor.

Another method of forming a limited company, public or private, is simply to walk into a shop and buy one, much as one would purchase an "off the peg" suit. This can be done through any company formation agent and the process is instantaneous. Companies purchased in this manner are referred to as "shelf" or "ready made" companies. The articles of which are fairly all-embracing and hold, as it were, something for everyone.

In theory, it is possible to purchase a "shelf" company on Monday and to trade with it on Tuesday and whilst this is not necessarily true in practice, it does mean that one does not have to wait up to say six weeks or so in order to obtain Registry approval and formal registration.

### **Drawbacks to "shelf" companies...**

The name can be an odd sounding one, often produced by a computer program, or clearly revealing the company's ready-made origins, with names such as: "Shelf Company 191 Ltd" or "Ready Made Company 191 Ltd" (indicating that they are the one hundred and ninety first company in that particular series to have been registered !). Obviously, there is no reason whatsoever why the above named limited companies should not be proprietors of a trading style "Shelf Company 191 Ltd" trading as "Smarts Caterers".

### **Sole proprietorship**

A sole proprietor or sole trader is a single individual, who trades on their own account, either in their own name or under a trading style. Whilst the sole proprietor can trade in his own name without too much difficulty, some care has to be taken in the selection of a trading name, firstly by insuring that one is not treading on any local toes in selecting too similar a style to one already in existence and secondly by insuring compliance with the laws of the land, which prohibit the use of such words as "Royal" and "English" in a trading style - a complete list of prohibited names is available upon request from Companies House. Perhaps it should also be stressed that one cannot use the word limited as the last word in a trading style unless the business is incorporated and duly registered as such. Prior to the 1981 Companies Act, which abolished the Business Names Registry, it was necessary for a sole proprietor to register his trading style if he carried out the business under any name other than his own. Now however, the name of the business does not have to be registered with any body or authority and it is merely necessary, if trading is carried out other than in ones own name, for the name of the proprietor to be shown on all business stationery and in notice form on the business premises - this notice should also include an address at which documents can be served. Furthermore, although annual accounts do have to be prepared and submitted to HM Inspector of Taxes, they do not have to be presented to Companies House or made accessible to the general public. It is a relatively simple procedure to set up in business as a sole proprietor, the major disadvantage however, being that one is personally liable for any debts incurred during the course of business. When a sole proprietor dies, his firm dies with him. As for the possible advantages to a supplier in dealing with a sole proprietor, well, providing that one is certain about the individual's identity and whereabouts and furthermore that one is confident regarding his/her financial status, the risks should be fairly minimal. Again, the emphasis is upon "knowing who you're dealing with" and where (should things go wrong) to seek them out. An insight into the proprietor's payments can be gained by using Riskdisk.com to carry out a county court judgements check against the place of his residence and his place of business.

### **Partnership**

Like a sole proprietorship, a partnership does not require any special formalities in order to commence business. It is an association between two or more persons carrying on a joint business venture with a view to making a profit. As with a proprietorship, care must be taken in selecting a trading name. Annual accounts do not have to be presented to Companies House or made accessible to the general public. Like the sole proprietor, the partners risk bankruptcy if the business fails. Whilst different partnership agreements vary in relation to the apportioning of profits and the definition of the separate professional roles, it can be assumed that the partners share equally in their responsibility in discharging a debt, since all partners are jointly and severally responsible. In the last resort therefore, any one person within a partnership can be liable to pay its business debts.

### **Limited Liability Partnerships (LLP)**

A Limited Liability Partnership (LLP) shares many of the features of a normal partnership - but it also offers reduced personal responsibility for business debts. Unlike members of ordinary partnerships, the LLP itself is responsible for any debts that it runs up, not the individual partners. The liability of the partnership is as a general rule limited to the partner's investment and assets in the partnership.

## Franchises

The idea behind a "franchise" operation, is that a "good idea" or "good name" is sold complete with backup. A franchise may be operated as a limited company (private or public), a proprietorship or a partnership. A number of well-known concerns, including The Body Shop, MacDonald's, several dairies etc., all franchise their operations. They provide to the franchiser:

- A supply of merchandise / raw materials.
- Consultancy concerning promotion of product.
- Advice on premises, refurbishment of same (using a universal scheme and colours).
- Back-up advertising.
- Various other back-up services.

The business which takes on a franchise may have nothing to lose (apart from its money) but the franchiser, whilst unlikely to lose money directly, does stand to lose goodwill and/or the value of his name or goods. It is therefore common practice for the franchisee to investigate closely the business acumen and financial stability of his franchiser before letting him loose upon the business. It is normal practice for the franchiser to prohibit their name being incorporated into a limited company style by those actually trading. Bearing the above in mind, do not be misled by what is apparently a "big name." If you are in any way confused, make a polite but firm approach and ask. Remember, it is your money, your goods and in your interest to determine ownership and responsibility.

## Registration numbers

Every limited company is required by law, to quote its registration number in legible characters on all business letters, order forms, emails and any web sites it operates. With respect to the allocation of registration numbers to limited companies in England and Wales, the first company to be registered held the registration number 1, the second 2 and so on. At the present date, we are half way through the four million series, with hundreds of new companies being registered daily. It should be noted that Scotland has its own registration system and numbers usually preceded by the letters SC. It is important to remember that whilst a company may change its name, it can never change its registration number. If you are dealing with a limited company, you must be sure that you are in possession of the company's registration number. You can easily check the number matches the name with Riskdisk.com.

## Registered office

Every limited company must have a registered office to which all communication and notices may be addressed. The address of the registered office must be listed on all business, order forms, emails and web sites. Whilst the registered office can be situated at the company's trading address, it is very often located at an accountant's or solicitor's office, or sometimes at the home address of one of the directors. Limited companies can and do (for a variety of reasons) change their registered office. Notice of any change in the situation of a registered office must be given within 14 days to the Registrar of Companies. For purposes of litigation, it is imperative that one possesses the correct address of the current registered office.

## Point to consider

- If you are dealing with a limited company, you must be sure that you are in possession of the company's registered office address. This can be easily checked on Riskdisk.com.
- 40% of all business's go down in the first two years.
- Every organisation starting out in business will require time to become established, so be sure to allow some leeway.
- Whilst it can logically be assumed that most concerns will have obtained sufficient funding to ensure their continuance for at least the first three months, it should also be remembered that bills are not necessarily due/paid within that initial "honeymoon" period.

A notorious danger zone often occurs from the 5th month onwards; during which time a business may struggle to establish a pattern in meeting its commitments. Also relevant, is the fact that small concerns are often tempted to take on something bigger than their capacity, using slow payments to their suppliers as a means of providing them with working finance.

Obviously, the older the business, the better would seem the indications for its continued survival and success. However, do remember that danger zones are present in the life of every organisation, no matter how old established or prestigious. In the case of limited companies of recent formation, a potential creditor could possibly be deprived of the opportunity of viewing their accounts (using Riskdisk.com) for up to 22 months (not including any delays, which might occur at the Registry) after the company's formation. Naturally, the older the business, the greater amount of information will be available for its assessment. Resist the temptation however, to dismiss a company out of hand merely because of its extreme youth, since the latter can often bring with it, a fresh approach to old problems and all the enthusiasm connected with a youthful enterprise.

**If you are dealing with a limited company, be sure that the time stated to have been in business tallies with that on Riskdisk.com.**

### **What if there is no financial information available on a limited company?**

If you were hoping to obtain financial information upon a fairly new company but it transpired that none was available on Riskdisk.com one way to proceed would be to ask for a copy of their management accounts. If no such copy exists, you should certainly seek some form of security for your dealings. This could take the form of:

- A guarantee from one or more of the directors.
- A guarantee from the parent company (if there is one)
- A guarantee from the ultimate holding company (if there is one)

### **Accounts interpretation guide**

Many people are bewildered by what they consider to be the "mystique" attached to financial statements. All too often, the protest is heard: "But I can't possibly interpret company accounts - I'm not an accountant". You don't need to be. With Riskdisk.com all the hard work is done for you. However, if you do want to get inside the numbers, it's not that difficult. Here are a few tips....

Firstly, in order to dispel some of the mystery, let us consider the necessity for financial statements. Accounts are drawn up for the express purpose of outlining the success (or otherwise) of a business in achieving its basic aim, which is "to make a profit". If any money is left after payment of all the business running costs and tax (yes, the chancellor always wants his bit) this is a "profit". If, on the other hand, the company spends more on its costs than it has actually generated by the sale of its finished product, this is a "loss". The purpose of a "profit and loss account" is to lay out the exact expenditure on the above, deduct it from the income and explain it in detail, by means of notes.

**For more information about our Business services or to become a Riskdisk.com customer, call us today on 0844 871 1868 or email [info@riskdisk.com](mailto:info@riskdisk.com)**