Giving credit where it's due

***Clive Pacey** argues that the role of the credit manager is one that should not be underestimated*

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A less-than-inspired financial director once introduced me to a fellow director with the words: "This is the debt collector who goes around with a baseball bat."

At the time, my role was managing the credit function of 40 businesses across nearly as many markets. I have to admit that it was an unflattering introduction but how can credit management be better explained? It is a role that is perhaps as readily underappreciated as it is undervalued.

Collections are key, of course. Managing risk is vital too. Although it is sometimes perceived as being on the fringes of finance, it is arguably right at the heart of almost any business. Naturally, it is the only finance function that is likely to interact with clients, which brings it closer to the sales function, to which it can attract surprising benefits.

However, that is another story. Primarily, every credit manager will have the objective of minimising debtor days but this must never be seen in isolation. Without looking at the wider picture, debtor days can be reduced both quickly and very effectively. Charge interest from the first day overdue… put the account on immediate stop…issue a statutory demand threatening winding-up proceedings. Your debtor days will drop like a stone and, believe me, I have encountered this advice frequently but, let's just say, it is not a recommended approach if you wish to maintain relationships.

There is an obverse side of the coin, in which collections are treated as if they are a distasteful function that will only upset the client. Ultimately, it is the bank that will be rather more upset than the client. The key to maximising results is to know your clients.

So, how do we get to know the debtor? Ask the account manager? It is not a bad start but, if he is inclined to tell you that they are "great for a round of golf", then it might not be the intelligence you are seeking. Put simply, you have to start with hard facts.

Eight out of 10 SMEs do not credit check their clients. This is an extraordinary statistic, courtesy of Barclays Bank, and excuses that I have heard range from "we've never had a bad debt" to "it won't make any difference". I have never been through a car windscreen but I still wear a safety belt.

Some scepticism revolves around the quality of credit reports and their integrity. Different agencies can give widely varying ratings and these will be based on the weighting they give to certain factors. Some cheaper reports do little more than take figures at face value, without any attempt to put the numbers into context. Yet, something is better than nothing.

The credit report has to be seen as the start of the analysis and it is essential to continue building the profile. Many factors may need to be brought into play and the final decision is not straightforward. It is almost as damaging to turn away a good client as it is to take on board a bad one, and a good credit manager will be attuned to this.

The objective is to find a mutual solution and the results of professional communications and negotiations can surprise. "Computer says no" is not really the best response to a marginal decision. On the other hand, becoming bogged down in justification can be a minefield. A balance should be sought.

However, is the initial credit assessment enough? Sorry, but no, it is not. During my time in the music industry, we extended considerable credit to an independent record label that specialised in compilations and with good reason. The company was phenomenally successful and the balance sheet was as strong as you would hope to see. Some 10 years later, when advising a media company, I encountered the very same debtor. That firm's management could not understand why credit insurance was unavailable, given that the debtor had "always been great".

Until that point, no-one had asked the obvious question. One look at the balance sheet, which was now a glorious sea of red, set alarm bells ringing. The exposure to my client was £2.5m. Within a fortnight, the debtor was in administration. Times change and, often, far more quickly than anticipated. It is an understandable error.

Any business can be blinded by the perceived value of a client, losing track of its actual worth subsequently. On the other hand, any outsider can advise extreme caution without having to understand the requirement to maintain sales and keep a workforce employed. Seasonality is another factor in credit decisions.

A good credit manager will get the balance right quietly. It is most certainly not a role to be underestimated.

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