Cash, Profits & Credit Management: Bringing Finance & Sales Together

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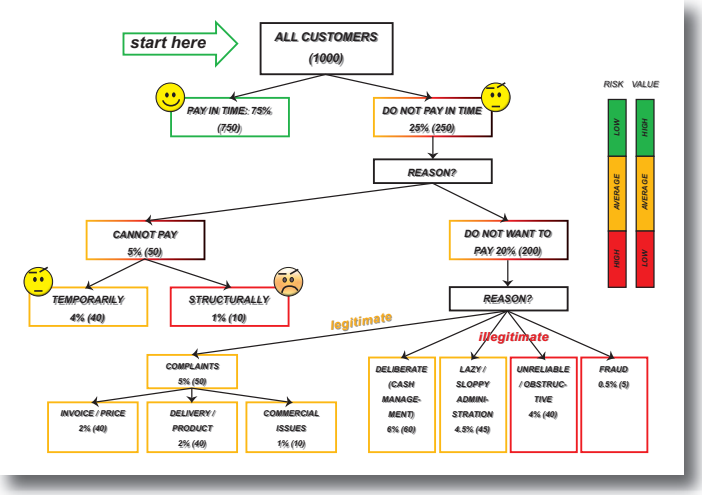
Most people have actually no idea what you are talking about when you mention the word *credit management*. In my opinion, there are two main reasons why credit management is so often so poorly understood: 1) credit management is inconsistently or incorrectly explained and 2) interesting stories and case studies are mostly distributed via specialized media only. Credit people talk to other credit people, wondering why the outside world does not understand the importance of their work. '*Preken voor eigen parochie*' and '*onbekend maakt onbemind*' typically applies to credit management. As a new overseas member of the Dutch Chamber of Commerce in Hong Kong and as an introduction, I feel honored to write this article about my profession, B2B credit management. I hope this article will give you a better idea what credit management is about and how it can help organizations to optimize cash flow, operational performance and results.

Introduction

When B2B companies do business, they often do so on an open account – invoice – basis. This basically means that we lend money to our customers and trust that our customers will pay us for the goods or services we have delivered or will deliver. However, with doing business on open account we run two mayor risks that may affect our future performance and results:

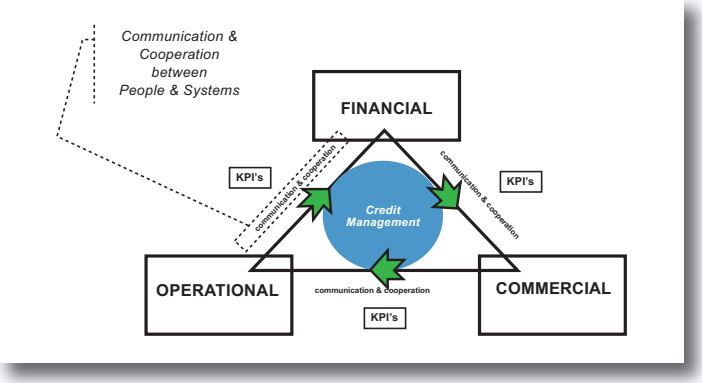
1. the risk of not getting paid, because the customer has no money (for us) - and
2. the risk of not getting paid in time, because the customer does not want to pay us (for legitimate and illegitimate reasons).

Credit management tries to deal with these problems by managing and optimizing what we call 'the order to cash cycle'. Not getting paid or late payments, no matter what the reason is, has a negative impact on your cash (in)flow, your ability to pay others, your need to finance working capital, your costs and ultimately your bottom line. Furthermore, late payments often have a negative impact on our relationship with the customer (two ways!), which, on its own may have a



CUSTOMER	ABLE TO PAY	NOT ABLE TO PAY
WANTS TO PAY	Hopefully the majority of your customers. The basis for developing profitable customer relationships	Structural (long term) or incidental (short term). Know your customers and the reason why they cannot pay you.
DOES NOT WANT TO PAY	Legitimate (complaints, disputes) or illegitimate (payment behavior). Apply automated structured complaint management and 'raise' your customers.	Fraud, lack of money , avoid those 'customers'. Apply sound credit checks for both new and existing customers.

Ideally we like to do business with customers who can and will pay us on a timely basis. The reality is that some customers pay us late for legitimate (complaints, disputes) or illegitimate (payment behavior, lack of money) reasons. As such, the tasks of credit management can be divided into 3 main areas.



negative impact on sales. Improving payment behavior or preventing your customers from paying late is therefore important and starts by analyzing how your customers actually pay you.

Measuring, monitoring, analyzing and improving payment behavior of our customers is one of the main tasks of credit management. However, being able to pay and wanting to pay are two totally different aspects of the business cycle as this overview shows.

Financial

The financial aspects of credit management focus on the following areas:

a. **Managing and improving of operational cash in flow.** Simply put: we can optimize cash (in) flow by making sure that our customers are able and willing to pay us in a timely manner. The first can be ensured by regularly checking the creditworthiness of your new and existing customers. The latter boils down to making sure that customers have no valid reasons to pay us late and the application of customer oriented (differentiated) dunning strategies (based on financial risk and payment behavior).

b. **Reducing the need to finance working capital.** By improving cash flow and minimizing bad debt, we can reduce the need to finance working capital or simply put, reduce amounts unnecessarily 'stuck' in outstanding invoices. As long as our customers do not pay us, we obviously cannot use that money for other - more productive - purposes.

c. **Typical accounts receivable related activities** such as assessment of credit lines, financial analysis of your customers, payment arrangements, sending reminders, calling overdue customers, contacts with collection agencies, etc. etc.

Operational

Due to the relationship between complaints and invoices, (automated) complaint management is an integral part of credit management. Wrong invoices, wrong deliveries, wrong products, commercial disputes mostly lead to blocked (= unpaid) invoices, unhappy customers and of course dissatisfaction on your side. Complaints or disputes take time, resources, people, and negatively affect cash flow which all costs money. Obviously complaints or disputes need to be solved, so we should better do that in an efficient (simple, easy) and effective (fast results) manner to minimize the impact on the customer relationship or your own performance. By registering and monitoring complaints, credit management can analyze the root causes. Based on their findings, credit management can give suggestions on how to improve business processes and procedures, which ultimately has a positive impact on cash flow, performance and results.

Commercial

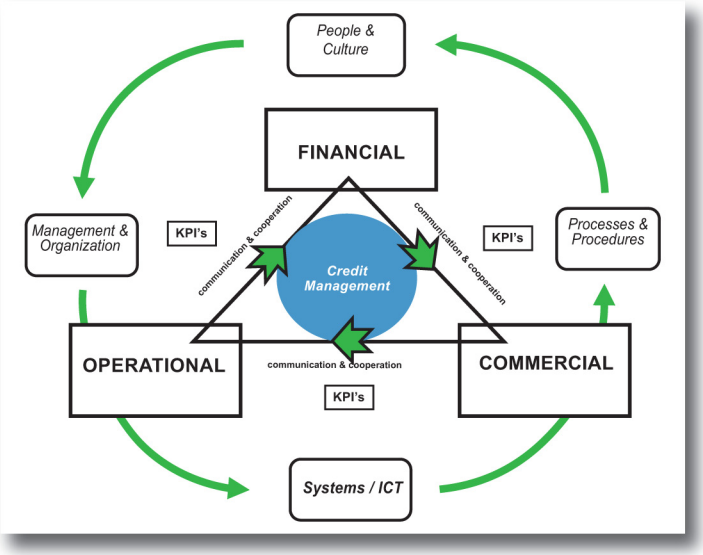
When we talk about sales and customer relations, we often do not think about finance or credit management. But actually we should. Take new customer acquisition for instance. Especially in B2B, this is often a time consuming and costly process. Once sales has finally managed to close the deal with the new customer, nothing is more frustrating than finding out that we cannot ship the (first) order due to a poor financial status of the customer. As such, one of the objectives of credit management is to establish a pro-active working relationship with sales in order to avoid these problems as early as possible. In the end, the purpose of a company is to create value and build profitable customer relationships and we do not do that by doing business with customers who (structurally) cannot or do not want to pay us. Furthermore, it s important that both credit management and sales have a more or less consistent and transparent vision on how to deal with customer relations, so we can avoid situations in which sales is building a relationship with customer X, while credit management is breaking the relationship down due to for instance poor payment behavior.

The Integrated approach

Since financial, operational and commercial activities of any business are fully intertwined, credit management has the best return on investment when it is applied in an integrated way. Integrated means that credit management, finance, sales/marketing and service (pro-) actively need to work together and share relevant information in order to optimize the business process in sustainable and profitable way. Though this approach obviously may take time to implement, more and more case studies indicate that this way of applying credit management clearly pays off.

Though credit management may be applied differently for different kinds of organizations, there is no exception to the rule that customers, cash

flow and profitability are vital to every business and inextricably linked to each other. Lack of either customers, cash flow or profits will inevitably sooner or later result in business failure. By understanding with whom we do business, building strong relationships with (potentially) profitable customers, focusing on the operational efficiency of our business processes / procedures, analyzing payment behavior and understanding that all these aspects are related to each other, we can create a structured and customer oriented framework for sustainable growth and profitable business. As such credit management can add significant value to any organization. ◎



If you like to know more about credit management or related software solutions, please feel free to drop me an email.