Debt Management

Are changes in the law on debt recovery needed and if so what should the changes be? Dinesh Weerakkody analyses the issue of Debt Management.

Most firms assign a high priority to credit control system, the purpose of such a system being to ensure that debtors pay up within a reasonable period Of time and to avoid very costly bad debts. On the other hand, banks who loan money unlike retail and manufacturing firms, having foreseen the possible impact on borrowers of a slow-growing economy, have adopted a cautious attitude only to assist genuine customers. Firms of all shapes and sizes do, in fact, spend a lot more time in shaping their credit policy. However, firms tend to neglect a creditor policy as trade creditors arise through the purchasing department. This places purchasing — and the operating cycle which follows the receipt of goods — in the forefront of cost control. It must be remembered that purchasing cuts across functional barriers and that its activities tend to reflect the increasingly competitive nature of a business. Creditors provide a vast amount of short-term finance. So, management should therefore devote more management time to devising a sound creditor's policy.

Creditor Policy

A company's creditor policy is shaped to a great extent by the structure of the industry. In certain eases a specific industry sets actual credit terms. Credit terms will be subject to the relative bargaining power of both the supplier and the buyer. In devising a policy on creditors the power relation- ships between buyer and seller should not be overlooked. For some firms this relationship alone may well be the factor which ultimately shapes their policy. Two other factors also play a role in determining a firm's policy on creditors and these will be identified

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briefly. For many firms, specially small firms, trade credit is a very useful and necessary form of short term finance.

According to research, trade credit can be as much as Of the shot-term liabilities for non-financial firms, because they may not qualify for finance from other sources. Through absolute necessity, they tend to rely heavily on trade credit.

One of the benefits of using trade credit as a source Of finance is that it is spontaneous and arising from ordinary business transactions and adjusts naturally to the level of business activity. The final factor to which the creditor policy must address itself is the settlement discounts, since it is important for a company to weigh the advantage of delayed payments to creditors against the benefits that accrue from prompt payment and the availability of settlement discounts. Quite apart from any financial gain or loss there is also the question of supplier goodwill to consider one's credit rating.

Delaying Payments

I guess most firms consider that it is a fair game to delay payment for goods for as long as possible, since some firms do not even charge interest for delayed payments, perhaps in some eases until the threat of legal action. In the business world, the practice of delaying debt settlement is as old as the hills, but it seems there has been a general awareness in recent

years that it is on the increase. What’s new is that the hitherto largely subterranean rumblings from those who suffer by the system have been vocalized as never before. Financial analysts point out that the pressure for action is now very much in evidence, with small business organizations calling for bills to be brought before parliament and the government being forced to take notice of the problem. Research suggests that the slowness of payments is wide- spread throughout all shapes and sues of commercial enterprises.

A leading businessman I spoke with even went to the extent of saying that ewe should see a change in legislation.’ The inherent injustice of the situation is that the creditor is deprived of his money, ‘indirectly he is financing the debtor.’ The law commission, in its 1978 report (UK) on interest says- we recommend that contract debts should carry a statutory right to interest unless otherwise In this context, are changes in

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the law on debt recovery needed, if so, What should be the change? The law prevailing on debt collection maybe unsatisfactory, But the best way to improve the situation would be to educate our business- men.

Finally, there seems to be no sensible alternative to a change in legislation to help small businesses, in particular in the short term. If this situation also assists in helping the businessmen focus their attention on the need for proper financial control, it will indeed be a bonus. Hence, the best strategy for debt management would be to identify trends as early as possible, as problems become very difficult and time consuming to correct later.

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