

Measures to keep bad debt demons at bay

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A customer going bust before paying up is one of the painful realities of business – and one that Bruce Dodworth is still getting used to.

Last Friday, he received a letter explaining that one of his clients – a small design firm in Cambridge – had entered into a company voluntary arrangement. As a result, Bruce's public relations agency is going to have to kiss goodbye to payment for the work it did for the firm back in February.

"I feel pretty angry about the situation," Dodworth says – although he admits that he is also angry with himself for not chasing the debt.

But he is also lucky – in two respects. This is his first experience of bad debt in four years of trading, and the debt is only for a few hundred pounds. If it had been for thousands of pounds, his Lincolnshire business might be in trouble.

Plenty of other companies are now in that situation.

Stephen Law, president of R3, the insolvency practitioners' trade body, says he has just visited a company that is staring failure in the face because more than half its sales come from a single customer that has just entered administration.

"We are seeing a lot more of this," he says. "Last year, there was a lot of goodwill within the business community. But now that the recession is over, it has almost given businesses an excuse to push people to pay their bills on time."

According to the Bank of England, write-offs and other revaluations of loans by UK financial institutions reached £16.1bn in 2009, up from £9.3bn in 2008.

One option to avoid bad debt is to pre-empt the issue by refusing to take work from customers considered to be at risk.

John Kelly, of roof contracting business Weatherproofing Advisors, turned down an £800,000 contract with Vauxhall Motors last year after its parent, General Motors, made a Chapter 11 bankruptcy filing. Kelly was worried that it would not be able to pay.

Blantyne-based Weatherproofing, which prides itself on being considered a reputable operator in the building trade, also decided to pull out of any public finance initiative (PFI) work after seeing three competitors go out of business because of failed PFI deals.

This was not an easy decision at the time, as it led to a 33 per cent drop in Weatherproofing's annual revenues, to £12m.

"It was an absolute nightmare," Kelly recalls.

However, it gave the business a chance to reorganise the way it dealt with customers. One of the changes Kelly has made is to try to deal as much as possible with the end user directly, rather than acting as a subcontractor. This helped Weatherproofing's turnover recover last year to £14m, Kelly notes.

"What we are trying to do is build long-term relationships with clients," he says. "We want clients who have the money and who we can work with collaboratively."

Widget, a Stevenage-based distributor of consumer electronics products, is equally aware of the need for good credit control having seen a few of its customers go out of business in the past few years.

Consequently, the company has started insisting that some customers settle their bills by direct debit as a condition of extending credit.

“There is a certain amount of paperwork involved in administering direct debits, but it is not rocket science,” Mark Needham, Widget’s chairman, says. He notes that, in one case, a customer settled its account by direct debit days before collapsing into administration. “We would have lost that debt if we had been waiting for a cheque in the post,” he says.

Web marketing group iknow-uk managed to reduce its bad debts to just 1 per cent of sales last month – in spite of having more than 8,000 customers, from small holiday cottage owners to large travel brands, advertising on its 14 regional websites. These sites generate £15m worth of enquiries a year.

Managing director Marcus Simmons puts this achievement down to a “carrot and stick” approach to chasing payment.

“The key to managing bad debt is to make sure that we get paid as soon as possible after selling a listing on our websites by ensuring that we hit the ground running and give the customer a great experience from day one,” he says.

Making payment as easy as possible is key, Simmons believes. “At all times, we offer many ways to pay, including credit card, cheque, direct debit, bank transfer, agreed payment plan, even cash – although if we have a customer with a poor history of paying, we may make a note to accept debit or credit card payment only.”

The company’s basic terms are also short at 14 days – many companies offer 30 days as standard. This means that problems can be identified and dealt with very quickly, Simmons says.

About 40 per cent of iknow’s customers pay at the time of sale by card, and another 25 per cent pay monthly in 12 installments – so only about one-third of iknow’s customers are actually subject to the company’s credit terms.

Simmons also stresses the importance of repeat sales in keeping down bad debt: “Ninety per cent of our customers renew their listing each year so, by ensuring that our customers are completely satisfied, we are able to keep bad debt to the bare minimum,” he says.

For all the positive action, however, Simmons is clear that there comes a time when a business must be tough on its creditors.

“Once a payment has been outstanding for a further 14 days, we reserve the right to escalate action, including suspension of the listing and passing the customer to a specialist debt collection company,” he adds.

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