Managing bad debt
What is the definition of a bad debt?

Bad debt is debt that is not collectable and therefore worthless to the creditor. Bad debt is usually a product of the debtor going into bankruptcy but may also occur when the creditors cost of pursuing the debt collection activities is more than the amount of the debt.
How to minimize risk and exposure to bad debt

1. Tightening your T&Cs with the appropriate indemnity clauses

2. Personal/Director guarantees to protect yourself

3. Be proactive in accounts receivable

4. Know when to refer the debt to a collections agency
1. Tightening your T&Cs with the appropriate indemnity clauses.
Definition; An indemnity clause is a contractual transfer of risk between two contractual parties generally to prevent loss or compensate for a loss which may occur as a result of a specified event.

The type of indemnity clause that is imperative from an accounts receivable perspective is a clause that talks about who is liable for collection costs.

This allows a mercantile agent to add the costs of collection and litigation to the amount owing. In do so, appointing a professional third party to recover the money should essentially cost you absolutely nothing, and your bottom line is always protected.
An example:

The customer accepts liability for any legal or other expenses incurred by us in our attempt to obtain payment of any overdue amount.
2. Personal guarantees to protect yourself if your debtor becomes insolvent
If a individual becomes insolvent and is forced into bankruptcy or is deceased, you can pursue guarantors for payment as they are personally liable.

Most banks will not lend money to a person without some form of security or guarantee, why should you.

If the residential agreement has more than one guarantor, each person can be held liable for the total amount of debt and will be pursued jointly and severally.
3. Be proactive in accounts receivable
1. Communicate with your customer before a payment is due

A good way to stay on top of your customers mind is to continue to support them after you’ve made the sale. Genuinely reach out with the purpose of connecting and adding value. Take the opportunity to check their satisfaction with your services, and if they need anything further from you. Your sales team is a great resource at this point in the collections journey.
2. Accept credit card payments

Paying by credit card is a common consumer behavior — MYOB research showed that 64 percent of Australians prefer to pay by card and 5.1 million Australians walk away from a sale if they can’t pay by card—so businesses should also meet this expectation. Accepting online credit card payments makes it easy for customers to pay you: customers can pay 24/7 and they don’t need to rely on having cash in their bank account to pay you.
3. Add a PAY NOW button to your emails and invoices

A simple ‘Pay Now’ button on emails and/or invoices, leading to your online payment gateway, means your customer is one click away from paying your invoice quickly and securely. They no longer need to spend time searching for a cheque book, envelope and stamp!

Slater Byrne Recoveries is developing an automated collections app called “SBR collect” where users will have access to a free debt collection letter and will easily be able to manage their debts from the portal. This app will be available towards the end of March.
5. Map and track your accounts receivables

Your business should be able to pinpoint priority problem areas quickly so you can assess the impact of overdue debt on your cash flow.
If your accounts receivables are being managed efficiently, these are the sort of questions your business should be able to answer easily:

1. What is the total amount owing to my business?
2. What is the total overdue amount owing to my business?
3. How many accounts are 30 days, 60 days, 100 days etc. overdue?
4. Which customers owe me over $10,000, $50,000, $250,000 etc.?
5. Which of my customers are in the 2nd follow-up, 4th follow-up, legal demand stage?
6. Which customers do our management team need to be alerted about (for example, your management might always want to know about customers who are in your ‘red zone’ i.e. are over 60 days overdue)
7. What is my largest overdue account worth?
8. Which is my oldest overdue account?
6. Enact a multi modal communications plan

Your business should have a pre-planned, escalating communication strategy ready to activate as soon as an invoice is overdue. Use a variety of channels to reach your customers: email, post, SMS, phone. You can do this manually, or automation software can track invoices for you, so that as soon as an invoice becomes overdue your customer starts receiving polite system-generated reminders. When your customer responds, listen and respond with empathy; this can go a long way to understanding your customer’s payment difficulty, coming up with a payment plan, and saving your relationship. Record your collections activities and conversations in one place so you have a complete history at your fingertips.
7. Thank your customer for payment

Your simple thank you is positive reinforcement that you are monitoring your accounts and that you appreciate their business. A ‘thank you’ email can be generated from your accounting software (if it has that functionality) or manually. Whichever method you use, never underestimate the power of a timely ‘thank you’
8. Undertake credit monitoring

Monitoring your customers’ credit activities means you can put safeguards in place before your business is adversely affected by events like a customer declaring bankruptcy. Some credit reporting bureaus offer credit monitoring services to alert companies of changes that may affect their customer’s credit status. Receive email alerts about activities that could be detrimental to your business:

- Court judgements
- Payment defaults
- Insolvency notices
- Mercantile enquiries
Summary

Best practice collections are:

**Proactive:** Have a pre-determined system in place that includes risk management strategies, consequences for late payment, and prompts you to stay ahead of credit control.

**Consistent:** Teach your debtors that every late payment will always be followed up promptly and accurately. Set the standard for how you want your invoices to be treated.

**Persistent:** Don’t stop communicating with your customer (even if they have stopped communicating with you). Anticipate the road blocks by sending your reminders using multiple modes. Honestly and openly advise your customers on the next course of action if payment is not completed.

**Polite:** Manners never go out of style. Even if you automate communications, look for software that has a deep respect for the customer relationship and allows you to customize communications so they always look and sound like they come from you.

PREVENTION IS EASIER THAN COLLECTION
4. Know when to refer the debt to a collections agency
You didn’t go into business to start legal action with your customers, but remember, you didn’t go into business be a substitute bank to them, either! Starting debt collection or legal action is often the point at which businesses stall in the debt recovery process. Don’t panic—referring your customer to a debt collection or legal agency doesn’t mean your payment problem will escalate into a court case. Even a simple demand letter from a third party can be enough to prompt an outstanding payment. The staff at SBR are all very professional and often debtors we are chasing, actually engage us after the collection is done to assist them to recover their own debts as well. Debt collection isn’t something you should be afraid of commencing.