Guide from
Raymond Benn & Co. Limited

Tel: 01892 545021/549754
Fax: 01892 548956
Email: brian@raymondbenn.co.uk
Website: www.raymondbenn.co.uk

Managing your creditors

You rely on good relations with creditors for the smooth operation of your business. Suppliers (trade creditors), the bank, and statutory bodies such as HM Revenue & Customs (HMRC) all affect the cashflow of most businesses.

When your cashflow is tight, you may not be able to pay your bills on time. If you manage the situation well, your creditors will have more trust and confidence in you than before. But managed badly, the situation can develop into a crisis.

This briefing covers:

- **Deciding your objectives for each creditor.**
- **Identifying your key creditors.**
- **Handling your bank and the taxman.**
- **Dealing with creditors if you are in financial difficulties.**

1. Your payment policy

A well thought-out payment policy is a vital part of building a strong and trusting relationship with your suppliers and other creditors.

1.1 For every supplier, work out what your purchasing objectives are.

- The priority is usually reliability, followed by quality, price and then credit terms.
- Shop around. If you have a choice of good suppliers for a particular product, your supplier may be prepared to extend the credit period to keep your business.
- Agree these objectives with your accounts department, and train them in how to treat your creditors.

1.2 Set out a general policy on payment and make sure your suppliers understand your payment terms. For example, you might pay within 30 days of receipt of invoice.

- If you generate cash, like most retailers tend to, you can afford to pay quickly in return for price or settlement discounts.
- Write down your terms of trade and ask any new supplier to agree them by signing and returning them. If the supplier's terms of trade conflict with yours, come to a (written) agreement before you order.

If you manage your cashflow well, you should be able to pay your suppliers on time

1.3 Allow for some flexibility.

- Be prepared to trade off credit in return for other concessions (or vice versa) from your suppliers.
- Some suppliers operate on a cash-up-front basis, or require a deposit.

1.4 Communicate the benefits to your suppliers, so they support you in the future.

- If you pay promptly, your suppliers should expect to do you a favour in return when you need one.
- If you negotiate extra credit, show the suppliers what they get in return.

1.5 Review your terms regularly.

- Check whether other suppliers would offer better terms. If they would, ask your existing suppliers to improve theirs.

Make sure that your financial controller is following the policy. There is a tendency to delay payments to creditors even when it is not necessary to do so. (See box).

2. Key creditors

Identify which creditors are vital to the survival and growth of your business. Then work out tactics to win the support of each one.

2.1 Your financial backers are usually top of the list.

- Treat your bank as an investor, by providing regular management accounts in a format which the bank has agreed is useful.
- Make sure you are aware of what would happen if you were unable to make a payment on time. For example, at what point would your hire purchase company repossess the equipment?

2.2 Decide which suppliers are mission critical, on the basis that there is no alternative supplier immediately available.

- IT suppliers (who regularly maintain your IT system) are often high up the list, as trying out a new supplier can be a risk in itself.
- Your landlord may have the right to evict you (for non-payment) at short notice. But your landlord would have the right to seize goods within your premises, without going to court.
- Suppliers of commodity items, which you can buy elsewhere, are bottom of the list.

2.3 Identify which creditors are likely to be inflexible, and could seriously damage your business as a result. (See box, page 3).

- Statutory bodies such as HMRC can automatically surcharge you for late payment. (See 5 and 6). Your local authority can sue you for non-payment of business rates.
- Utilities suppliers can cut off your telephones, electricity, water or gas.

One problem is that these organisations are large and impersonal, so it is hard to build a supplier relationship (see 3). If you hold back payment because of a dispute, you may be penalised immediately. You may have to pay up first and argue your case afterwards.

Many businesses have found that they are affected by late or missing payments from key creditors during the current economic downturn. For these businesses HMRC have launched a dedicated Business Payment Support Service (Tel 0845 302 1435, Mon–Fri 8am to 8pm, Sat and Sun 8am–4pm).

If you’re worried about being able to make payments to HMRC such as tax, National Insurance or VAT payments, staff can review your circumstances and discuss temporary measures such as arranging for payments to be made over a longer period.

3. Building a relationship

Will the supplier go the extra mile for you when you need a rush delivery, or extended credit?

3.1 Negotiate clear, written agreements at the outset. Then stick to them.

- Be aware of your supplier's right to interest on late payments.

3.2 Involve your suppliers in your business, so that they understand your needs.

- Suppliers are often good at coming up with ideas for how to improve your product or your whole business, as they supply other companies like your own.

3.3 Keep them informed, to build up their trust in you. Otherwise small problems can escalate into large ones.

- A common example is the situation where you withhold payment because you received damaged goods. It is not enough to telephone the operational manager at the supplier, to explain the situation.

You should also confirm it in writing and copy the letter to the managing director or finance director there — otherwise when they review the aged debtors list, they may assume that you are simply refusing or are unable to pay on time.

Also keep informed about developments at your suppliers. For example, a change of ownership can mean a drastic reduction in the credit a supplier extends to you.

3.4 Ask for benefits in return for giving suppliers what they want.

- For example, you might negotiate to receive an enhanced service in return for committing to place regular orders or pay on shorter terms.

4. Your bank

If you are going through a cashflow crisis, you need your bank more than ever. But if your bank is financially exposed, this is the exact time when the bank is most likely to reduce its financial support for you.

4.1 Identify who the real decision-maker is at the bank.

- More and more lending decisions are made on the basis of computer-generated risk profiles. This leaves local bank managers with less decision-making power.
- You need a champion in the bank who knows your business and who will be listened to when decisions are made.

4.2 Build up a track record, so the bank trusts you and the information that you provide.

- Supply the bank with regular management accounts, including cashflow forecasts and a brief commentary explaining variances. Be proactive, rather than waiting to be asked for the information.

4.3 Give advanced warning to the bank of any cash shortages. The earlier your warning, the more support you may receive in return.

- Provide evidence to show that the cash shortage is only temporary. Third party evidence, such as a confirmed order, can be particularly effective.

4.4 Shop around, so you have options ready when you need them.

- Even if you expect to remain a loyal customer, find out what is on offer from other banks and alternative sources of finance. This will enable you to negotiate better terms, and you can win the bank's respect in the process.
- In principle, the bank can demand repayment of an overdraft at any time. Consider the benefits of alternatives such as bank loans, leasing, hire purchase and factoring. In smaller businesses, personal finance is increasingly a major source of funding as well.

Banks have been known to reduce a borrowing facility as a direct result of the business (in financial difficulties) asking for it to be extended. Providing the right information in the first place is the best way of ensuring that this doesn't happen.

5. VAT

HMRC has a reputation for rarely tolerating unnecessary delays in the payments due to it. Paying VAT late, or making any mistakes in your VAT return, can be costly.

5.1 If you need time to pay, approach the VAT office with a clear payment plan.

- Unless you have clear evidence that the plan is reasonable and viable, it is unlikely to be accepted.
- The first answer you receive is almost invariably 'no'. But continued, reasoned correspondence may lead to a solution.
- You are far more likely to be granted a temporary 'arrangement to pay', such as paying off the debt monthly over three months, than a longer term arrangement.
- If you fail to stick to the agreement you can be surcharged, and are less likely to be granted other arrangements thereafter.

5.2 If you repeatedly fail to pay VAT on time the penalties escalate rapidly.

- Once you have been warned, the next step is a fixed surcharge of 2 per cent of the tax outstanding for that period. This increases to 5 per cent, 10 per cent, and 15 per cent for each subsequent default.
- Once a surcharge liability has been incurred, you need to pay your VAT on time for a full year to come out of the surcharge system (and revert to a pre-warning status).

6. Employer's PAYE and NI

HMRC and the Contributions Office are similar in their approach.

If you are late in paying tax or National Insurance, there may be less onerous penalties.

6.1 Individual Collectors of Taxes (or tax inspectors) have the authority to agree an arrangement to pay with you.

- Adopt the same approach as for HMRC.

6.2 Interest is payable on any late payments, currently at a rate of 7.5 per cent per annum.

7. Financial difficulties

7.1 If you are in financial difficulties, or expect to be, get professional advice quickly.

- Consult a reputable firm of insolvency practitioners. Contact the Association of Business Recovery Professionals (020 7566 4200) or the Insolvency Practitioners Association (020 7623 5108).
- Directors who allow their limited company to continue trading with no reasonable prospect of avoiding insolvent liquidation may be personally liable for 'wrongful trading'.

They also run the risk of 'creating preferences'. For example, if you paid back a director's loan in preference to paying a trade creditor this would probably be a preference — in which case the money would have to be repaid.

Assuming that you are not advised to cease trading, take steps to improve your cashflow (see 7.2 and 7.3).

7.2 Agree extended credit with your suppliers.

- The further ahead you can plan this, the better. Reassure your suppliers that the problem is only temporary.

For example, you might explain that you are taking on a large order which will cause a hole in your cashflow in four months' time. Or you might be recruiting and training a new salesman, which will reduce sales in the short-term but will boost sales thereafter.

- Agree a plan, then stick to it. Don't be too optimistic.

- You will probably be advised to part-pay several creditors, rather than paying one and ignoring the rest. Aim to achieve some visible progress in the eyes of all the creditors. This will help buy you time to trade your way out of the difficulty.

7.3 Keep your bankers informed, to avoid any panic at their end.

- If you have not done so already, investigate the scope for extending your borrowings. (See 4.4.)

7.4 If you receive any writs, immediately ask your solicitor or accountant how to proceed.

Free — with a sting attached

Many businesses help themselves to credit from their suppliers, far in excess of the terms that were agreed. Because trade credit is usually interest-free (see 3.1), there is a temptation to abuse it.

Asking for extra credit from a supplier is fine, and most suppliers will support you. But helping yourself to extra credit shows that you are untrustworthy, that you disregard the supplier's own cashflow needs, and perhaps that your business is in financial difficulties.

Creditor rankings

In the case of insolvency, creditors are paid off in the order below.

A. Secured creditors with a fixed charge on assets such as property and machinery.

Most bank finance is secured with a fixed charge and/or a floating charge (see C).

If you fail to make payments on time, the creditor has the right to have the asset sold to cover all or part of the debt.

B. Preferential creditors, whose categories have been reduced. Employees are now the main preferential creditors for holiday pay, up to four months' wage arrears (subject to a set maximum) and contributions to occupational pension schemes.

C. Secured creditors with a floating charge on assets such as stock and work in progress.

D. Unsecured creditors, including most trade creditors.

Unsecured creditors may be entitled to part of what would previously have gone to HMRC, where there is a floating charge — but only where it has been created on or after 15 September 2003.

Experts' quotes

"It is vital that all of your suppliers value your business. Of course, the best way of keeping them loyal is to pay them on time. When your own circumstances do not allow this, you need to communicate with them early and regularly."
Philip King,
Institute of Credit Management

"Don't give your customers an increased credit limit without checking their existing payment terms are up to date."
Brian Hayden,
Hayden Associates

"To maintain good relationships with suppliers, it's vital to ensure payments are made promptly. If there are going to be any delays due to cashflow difficulties, going to suppliers upfront and explaining the situation will ensure there is no misunderstanding."
Neil Munrow,
Equifax

Expert contributors

Thanks to Brian Hayden (Hayden Associates, 07785 532266); Philip King (Institute of Credit Management, 01780 722912); Neil Munroe (Equifax, 0207 298 3000).

Further Help

ACCA's advisory website is dedicated to meeting the needs of ACCA members in practice. www.accaglobal.com/advisory contains a wide range of information prepared by qualified accountants and is updated by ACCA's Technical Advisory team.

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