Best Practices to Minimise Bad Debts

Bad debts arising from non-payment of invoices or credit accounts are a significant problem for many businesses. By implementing rigorous credit management policies and procedures, businesses can minimise the risks of bad debts and improve cash flow. This guide covers key strategies and best practices for reducing bad debts.

We are here to help you. Book your Free Consultation with our expert Debt Recovery and Insolvency Lawyers today.

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www.go-legal.co.uk 0207 459 4037 info@go-legal.co.uk

Get in touch with us for a Free Consultation

Go Legal is a leading City of London law firm dedicated to providing exceptional legal representation and strategic counsel to businesses and individuals. We specialise exclusively in commercial litigation and dispute resolution, and are the adviser of choice in England & Wales for many businesses.

We are dedicated to your debt recovery money claim and obtaining the payment you deserve. We have successfully been helping individuals and businesses that have suffered cash flow problems caused by unpaid and/or disputed bills. With our extensive experience, deep understanding of legal issues and our client's business needs, we strive to achieve successful outcomes for our clients.

We pride ourselves on our client-centric approach, tailoring our strategies and solutions to meet the unique commercial needs and goals of each client. We work closely with clients in many business sectors and provide your business with a range of debt recovery services:

- Debt recovery business health check
- Working with clients' credit control teams to reduce their average debtor days
- Effective pre-litigation processes to encourage early payment including letters of action
- Reviewing your business contracts, invoices and terms and conditions to avoid disputes and ensure prompt payment
- Asset/debtor trace reports (including searches at the HM Land Registry)
- Company due-diligence check reports (including searches at Companies House)
- Debt collection
- International debts
- Issuing legal proceedings
- Statutory demands and winding up petitions
- Representing clients at any hearings
- Obtaining and enforcing judgments
- Enforcement of debts, including charging orders, bankruptcy and winding-up procedures'
- Serving Court documents and demands for payment on the debtor
- Commercial rent arears
- Book debts and volume ledger instructions

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Our award winning-lawyers have regularly been asked to write authoritative publications for the Financial Times, Law Society and LexisNexis and have been quoted in the Law Society Gazette, The Student Lawyer, New Law Journal, Litigation Futures, and the Financial Times.

We work nationally across the UK – with an extensive UK and international client base. Our specialist litigation team is Partner-led with the aim of working for clients to provide clear guidance, strategy and advice on your matter at the very outset.

We also have a strong international legal network of over 200 solicitors, paralegals and barristers to call upon and advise you throughout your matter to ensure that you get the best team and result for your case.

Our solicitors and lawyers offer regulated, independent & confidential legal advice and are dedicated members of the London Solicitors' Litigation Association (LSLA), the Association of Cost Lawyers (ACL) and the Insolvency Lawyers' Association (ILA).

We regularly represent our clients at mediations often leading to early settlements. A number of our lawyers are also trained mediators and are also registered members of the Chartered Institute of Arbitrators (CIArb) and the International Mediation Institute (IMI).

Our award-winning specialist debt recovery team is committed to providing you with careful, straightforward, honest and strategic advice. We will determine the merits and prospects of your legal case and provide you with a clear strategy at the outset to obtain optimal outcome and at minimum cost.

Unlock the potential for success with our experienced debt recovery lawyers by your side. Whether you are an individual, a small business, or a multinational corporation, we are here to provide unwavering support and exceptional legal services to get you the compensation you deserve.

Implement Robust Credit Approval Procedures

The first step in avoiding bad debts is only extending credit or credit limits after proper credit approval checks on the customer. Key aspects of rigorous credit approval or due diligence processes include:

- **Verifying identity -** confirm the customer is who they claim to be by checking IDs and addresses. Fraudsters can be identified at this stage.
- **Assessing financials -** obtain and analyse accounts, bank statements, credit agency reports to assess financial strength and assets.
- **Investigating their reputation -** check references, complaints, online reviews to identify any negative indicators.
- **Reviewing trading history -** long-standing customers typically have lower risk than new accounts.
- **Understanding the business -** know who you are dealing with and the normal trading terms of the sector.
- **Credit application -** use a standardised application process requiring financial and other mandatory information.
- **Credit scoring -** apply a point rating or weighting system to support consistent credit decisions.
- **Approval authority -** apply tiered authority levels so higher risk applications are escalated to management.

Documenting proper due diligence checks on all new credit customers is vital.

Set Prudent Credit Limits

Once a customer is approved, appropriate credit limits must be established based on assessment of their size, profile, and risks. Key factors when setting credit limits include:

- **Financial capacity -** base the limit on ability to pay assessed from financial records.
- **Available security -** larger limits may be justified if adequate security is provided.
- **Payment history -** customers with good records warrant higher limits.
- **Credit references -** reports from trade creditors indicating prompt payment can support higher limits.
- **Business stability -** newly established customers should have lower limits.
- **Product risk -** limits may vary across your product range based on normal values and periods.
- **Industry standards -** align with normal B2B credit limits extended in that sector.

Conservative credit limits that can be increased gradually over time help manage exposure. Credit limits must be actively monitored and revised as circumstances change.

Obtain Guarantees and Security

For higher risk or higher value credit accounts, security should be obtained to mitigate the risks of non-payment. Options include:

- **Personal guarantees -** guarantors that will cover debts if the customer fails to pay. Require sufficient guarantor assets.
- **Director guarantees -** personal guarantees from directors of corporate customers.
- **Security over assets -** charges over property, motor vehicles or other assets to secure payment.
- **Lien over goods -** you retain ownership of goods until payment is made in full.
- **Credit insurance -** insurance that pays out if defined bad debts are incurred due to insolvency etc.
- **Standby letters of credit -** bank guarantees to cover payment on demand.

Security puts you in a stronger position to recover debts and gives customers added incentives to pay promptly.

Use Clear Payment Terms

The payment terms must be clear from the outset. Key elements to define in writing are:

- **Payment due date -** e.g. 30 days from invoice date
- **Acceptable payment methods -** e.g. bank transfer, cheque
- **Payment location -** where funds should be remitted
- Currency required
- Any early payment discounts
- Surcharges or interest for late payments
- Recovery actions for non-payment

This avoids misunderstandings. The terms can be reinforced with a pro forma invoice and in standard Terms & Conditions of business.

Follow Strict Credit Control Procedures

Consistent monitoring of account activity against limits is crucial through structured credit control processes. This requires:

- **Defined credit monitoring and review points -** e.g. weekly
- **Monitoring purchase patterns for anomalies -** this may indicate problems
- Flagging accounts approaching limits for review
- Automatic credit limit suspension for past due accounts
- **Formal periodic credit reviews -** e.g. annually
- Requesting updated financials from the customer where concerns arise
- Lowering credit limits at any signs of deterioration

Proactive account management identifies issues early when remedial action can be taken. Do not rely on customers to self-report problems.

Offer Early Payment Discounts

Providing discounts for early payment (e.g. 5% within 14 days) improves cash flow by incentivising quick payment. This prevents debts lingering and reduces administrative costs of pursuing late payers. Early settlement discounts will be attractive to reliable customers. The discounts can outweigh the costs of delayed payments.

Identify **Problems Early**

Carefully monitoring customer activity helps identify problems at the first sign of issues. Warning signs include:

- Breaching credit limits frequently
- Persistently paying late
- Making abnormal orders that are out of character
- Bouncing cheques or failed direct debits
- Downgrading payment methods e.g. from bank transfer to cheques
- Requests to renegotiate terms
- Difficulty obtaining updated financials from them
- News of financial problems at the customer

Once potential problems are flagged, you can undertake interventions like reducing limits, changing terms, securing guarantees, or preventing further credit. This protects your position.

Prompt Debt **Collection**

If debts do fall overdue, prompt credit control actions are required:

- **Phone/email promptly about the missed due date -** Most customers will pay once reminded.
- If promises are made to pay by a certain date, diarise and follow up immediately if broken.
- For larger debts, dispatch managers or directors to visit customers to investigate reasons and negotiate repayment.
- Charge late payment interest to incentivise payment.
- **Offer reasonable payment plans if customers are facing short-term challenges –** but secure these plans contractually.
- Threaten suspension of account which prevents further credit.

Swift but assertive credit control is key to contain debts before they escalate. Tailor the approach depending on factors like customer value, history, and problems experienced.

Use Legal Debt Recovery Procedures

If credit control efforts fail, legal procedures should commence:

- **Letter of demand -** a formal letter from your solicitors demanding payment and setting out consequences of continued non-payment.
- **Statutory demands -** a legal step preceding insolvency action which prompts many companies to pay.
- **County court action -** submit a claim through the courts to obtain a judgment and powers such as charging orders over assets.
- **Instructing bailiffs -** enforcement agents can seize goods to the value owed.
- **Winding up petitions -** petitions to liquidate companies to recover debts from assets.
- **Bankruptcy petitions -** in some cases personal bankruptcy action against debtors can lead to recovery.

Expert legal advice on recovery options, costs and timing should be obtained when pursuing debts. Litigation can prompt overdue payment.

Conclusion

Prevention is better than cure when it comes to bad debts. Following rigorous credit control and risk management procedures outlined in this guide from the customer acquisition stage will help protect businesses from the drain of bad debts on cash flow and resources.

Act quickly at the first signs of problems. Have clear debt recovery escalation procedures ready to enforce if needed. Managing credit professionally and promptly will assist companies in minimising the risks of bad debts and maintain healthier cash flows and client relationships

go legal

If you have a Debt Recovery or Insolvency dispute with a client, contractor, or supplier, please do not hesitate to call our expert lawyers. We will confidentially discuss whether you have a claim, the value of your claim and how best to proceed.

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