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Are Unreliable Customers Throwing Your Business Into Financial Ruin?

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Abstract

With the economy in shambles, both large and small companies are under tremendous pressure to generate revenue. If large, well-known customers are struggling and preparing to file for bankruptcy, imagine how small businesses may fare. Learn about steps you can take to better manage your customers and help protect your business from the effects of a recession by taking an analytical approach.

Introduction

Just when businesses thought things might be getting back to normal post-pandemic, the economy has taken a turn for the worse with record-high inflation rates, skyrocketing energy costs, increased materials costs, supply chain disruptions and labor shortages. It's like playing a game of Jenga and seeing how much more you can pile onto the top before it all comes crashing down.

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July Dates To Remember:

July 4th: Independence Day

With the economy in shambles right now, businesses (big and small) are under enormous pressure to close sales deals and generate revenue. Not to be dramatic, but it could mean the difference between surviving the impending recession or going out of business. If big companies like Bed Bath & Beyond, VICE Media and Party City are struggling and preparing to file for bankruptcy, just imagine how much worse it will be for small businesses.

Recession fears have companies panicking about missed customer payments

Many companies have already been struggling with late customer payments, mounting debt and negative cash flow. As our 'Feeling the Recession Pinch' study reveals, 85% of North American businesses are paid late by their customers – with 42% of those businesses owed money from 11-30% of their customers and nearly one in 10 businesses waiting for payments from over 30% of their customers.

Just think about that for a minute. Let's say a large company has 100,000 customers and 30% of them don't pay their invoices on time. That means 30,000 customers owe that company money. If even 10% of those are high contract values, that could equate to a big chunk of monthly recurring revenue that isn't deposited into the company's accounts. All the while, the company still needs to pay for operational expenses, infrastructure costs, inventory, materials, employee wages and suppliers.

As if that wasn't bad enough, our study also found that 28% of North American businesses expect to rack up between $500,000 and $3 million in debt over the next 6 to 12 months. Is it any wonder that nearly two-thirds (64%) of business leaders believe the recession will have a moderate to severe impact on their business?

Don't assume big, well-known brands will be reliable payers

You're probably wondering – 'How did we get in this position in the first place?' It usually starts with the sales process.

Consider this scenario. Your sales team is inches away from closing a monumental deal with a large, well-known brand. The deal has the potential to bring in $3 million in revenue over the next three years. Everyone's ecstatic – your sales team is celebrating and high fiving each other. What could go wrong? A lot. I repeat, a lot.

I don't care how big and well-known a brand is, they aren't immune to financial issues. Don't just assume a big company will be a reliable payer because of their size or how reputable you think they are. So, if your finance team didn't review the business credit report of the potential customer before signing a contract, there's a considerable chance the 'big deal' everyone was so excited about could end up being a habitual late payer (or not pay at all) and push your cash flow into the red. Not good, not good at all.

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The sad fact is that many large companies deliberately choose to pay suppliers late for various reasons. For one, they may want to earn extra interest on their accounts (that have large sums of money in them). It's also possible that businesses in certain industries – like agriculture, manufacturing, mining and construction – are purposely holding back some cash in their accounts to pay for anticipated machinery/equipment repairs and replacements. In these industries, machinery and equipment are often large in size, complex to use and expensive to buy (and replace parts or the entire thing).

No business can afford to be so lax with credit risk management. It takes minutes to run a credit check. So, there's no plausible excuse or reason not to do it. It's irresponsible. If your customers fail to pay your business on time (or stop paying completely), just imagine the domino effect that has on your cash flow, debt burden and financial responsibilities to your employees and suppliers. Plus, it will impact your creditworthiness and decrease your chances of being approved for a business loan or financing.

Hard data should always rule over customer 'friendships'

Given how turbulent the economy is right now and how common late payments are, you'd think companies would be extra cautious about who they work with and do everything possible to make sure they get paid. But our study found this to be far from the case, with 36% of businesses admitting they sign contracts with new customers without running a credit check. What's even worse is that 26% of businesses admitted they either rarely or never run credit checks on their existing customers.

I can't tell you how many times I've heard a business leader say, 'We don't run credit checks on our customers because they're our friends and we trust them.' I'm sorry but that's just not an acceptable response from anyone in finance. You can't let customer 'friendships' cloud your judgment and stop you from running credit checks on them.

No customer's financial health will stay the same for the entire period they do business with your company. Their customer demand may drop in certain seasons, their revenue could decline, their days sales outstanding (DSO) could increase – all while their expenses may have increased. All this will affect their cash flow and will be easy to spot from certain data points in their business credit report.

As a leader, your company's financial health should always come first. If you're not doing your financial due diligence because you're scared of ruffling feathers or losing their business, that's not a good enough reason. And if your so-called 'friends' (customers) are repeatedly paying their invoices late and leaving you in the lurch, why would you continue to be lenient with them? Hard data and fiscal responsibility should be your guideposts, not trying to be buddy-buddy with customers.

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Embed tech and automation into your Accounts Receivable and Accounts Payable processes

Over the last few years, many companies have been increasing their investment in digital transformation. It's a good thing. Digital technologies and automating processes offer so many benefits, including increased productivity and cost savings. And it's usually the CTO, CDO, CIO and/or CISO who lead the digital transformation charge. These are all roles where technology and automation are critical and embedded into every process from the start.

But the finance profession has historically been slow and hesitant to adopt technology into their roles and processes. This is a profession that, in many cases, still uses Excel sheets to maintain its ledgers and manage its cash flow and debt collection.

The good news is that many finance teams today are starting to realize they can't keep dismissing technology. To that end, 37% of the business leaders we surveyed admitted that their biggest cash flow management mistakes are caused by tech and automation lags – with manual, outdated processes and tools (21%) cited as their top mistake, followed by failing to automate their accounts payable and accounts receivable processes (16%). Technology can and should be a finance team's ally. It's about making sure you have the right tools that provide the right data so you can make the most informed business decisions.

For instance, a lot of businesses use ERP (enterprise resource planning) software to manage day-to-day financial activities within accounting, procurement, project management, risk management, compliance and supply chain management. The software is meant to help companies plan, budget, forecast and report on financial performance.

But there are several challenges with ERP software. In many instances, ERP software isn't correctly implemented across all functions, which leads to internal errors and failures. Another problem is that businesses can't always properly integrate their ERP software across their entire technology stack. This happens because legacy systems are so outdated that they can't communicate and integrate properly with ERP software – and that leaves companies stuck with data quality problems that often lead to misinformed decisions, which inevitably expose their business to financial and legal risks.

Let's also not forget that ERP software doesn't always have important metrics you need to manage your cash flow, such as accounts receivable (AR) metrics. Without these metrics, companies are left with a huge blind spot that could put them at risk of increasing their DSO (days sales outstanding) and reducing their cash flow significantly.

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No company will be immune to the effects of a recession

It’s impossible not to expect businesses to be negatively affected by the current financial climate. Whether this could drive business credit scores down has to do with a combination of factors – how businesses manage their cash flow, how they vet potential customers for credit risk and the debt collection strategies they put in place. Due to the current economic climate, it’s likely that many businesses, especially smaller ones, may see their customers clamping down on their budgets, which could lead to less revenue for their business. This could certainly put a strain on cash flow and lead to late payments from customers.

A big part of this financial strain can be managed and reduced if companies take an analytical approach to managing their risk – by reviewing their own business credit reports regularly to see if there are any derogatory marks, legal judgments or other risks that could bring their business credit score down and cost the business in the long run. At the same time, they should also be more strategic with their debt collection strategy. I’d suggest looking at the trade payment data for all their customers to see who pays regularly and who has a track record of paying late repeatedly.

In some cases, businesses may need to ask for payment in advance (or shorten the payment terms) until customers make on-time payments on a regular basis. In other cases, businesses may need to make the tough decision to terminate the relationship because late payments are pushing their business to the edge of failure or bankruptcy.

About the author:

Matthew Debbage is the CEO of the Americas and Asia for Creditsafe. As a longtime veteran of Creditsafe, he has held various leadership roles including COO of Creditsafe Group and CEO of the Americas and Asia since 2012. Over the last 10 years, he led the expansion of the business in the United States, where he has built a high-performing team, driven impressive revenue growth and worked with thousands of American businesses across various industries.

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JULY WEBINARS

Credit Professionals Alliance has been working hard to provide our clients with the most up-to-date webinars concerning today's challenges in the credit field. Watch your email for upcoming registration information on all of the following webinars.

July 19th: **A Customer Service Adventure—It's Everyone's Business**

July 19th: **Deductions Management?**

July 25th: **Fundamentals of International Credit Assessment**

Be sure to check out our website www.nacskc.com/education.html for additional educational opportunities as these are constantly being updated.

Are you looking for Certification and Certificate opportunities? Credit Professionals Alliance can lead you in the right direction, contact Rhonda Ross for additional information at rross@nacskc.com or (913) 383-9300.

Educational Update:
Credit Research Foundation Webinars

July 2023

CRF offers a variety of educational programs: Proctored Courses, On-Demand Courses as well as webinars.

August 7-9, 2023	August Forum & Expo—Kansas City, MO
November 6-8, 2023	November Forum—Mission Hills, CA

It is very simple to participate: Go to http://www.crfonline.org and click on the Education.

Now offering a Certificate Program!

For additional information go to http://www.crfonline.org/events/current.asp

The following webinars are being offered by NCS Credit
to register for these go to: www.ncscredit.com/education-center/webinars

July 11, 2023
Webinar: Building Payment Security with Preliminary Notices

July 25, 2023
Webinar: Equipment UCC Filings

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