

**CREDIT CONTROL STRATEGIES IN THE CLOTHING INDUSTRY.**

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## SYNOPSIS

Many organisations that go out of business often mention cash flow as an explanation for the organisation's failure. These organisations usually generate an acceptable level of turnover, their pricing structures are accurate and costs under control, but they are owed too much money which is not collected on time.

Debtors form a major part of a organisation's working capital and even if the total outstanding debt is collected eventually, it tends to erode organisation profits if it is not collected as per agreed upon terms. Organisations should therefore formulate policies that would improve cash flow, encourage prompt collection of debt and reduce costs of collecting such debt.

There are two types of strategies that retailers operating within the South African clothing industry can choose from, namely, in-house credit control and factoring. The main purpose of this paper is to explore these strategies in detail and weigh their benefits and limitations as applicable to organisations that operate within the clothing sector of the economy.

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## CHAPTER 1

### SCOPE AND OBJECTIVES OF THE STUDY

#### 1.1 INTRODUCTION

Knight, a managing director of Commercial Information Agency (CIA) wrote in "Confidence" March/April 2001 an official magazine of the South African chamber movement, that about a third of organisations liquidated in South Africa go out of business while still showing a profit. The problem he claims is that they simply run out of cash. He maintains that these organisations lose sight of the fact that debtors is probably their largest asset within the organisation and these organisation's way of managing this large asset is often reduced to simply employing someone to phone for the money. These sentiments are echoed by Dixie (1997:6) who claims that United Kingdom (UK) organisation graveyards are filled with organisations which were owed too much money and failed to collect it on time even though they were not insolvent.

Selling on credit increases an organisation's turnover and gives such organisations a competitive edge in the market, but if the organisation has not put in place proper debtor administration systems it might not be able to collect the money on time or never at all. Organisations that sell on credit make a provision for bad debts and if the bad debts written off do not exceed the provision made they believe that they have achieved their objective when in fact that money could have been saved if proper credit control systems were in place. This however does not mean that allowances for credit losses should not be made, Knight (2001) claims that even the most sophisticated credit control departments in South Africa incur credit losses but he says that they do so by design. He goes further to say organisations that do not wish to



incur credit losses should simply not sell on credit. He maintains that what credit managers should aim for is a balance between credit sales and losses and set a provision as a percentage of credit sales that does not exceed about two percent. A credit manager for one of the organisations operating in the South African clothing industry quoted an industry norm of about six percent which is very high.

These problems are not only confined to consumer credit where the amounts owed by individual clients are small, but are also inherent in corporate credit where moneys owed are very significant and cannot be easily written off as bad debt without eroding the organisation profits.

According to Kritzinger (1997:9) credit can be divided into two categories, corporate or trade credit and retail or consumer credit. Corporate credit is granted to the manufacturers of goods, service suppliers and the resellers like wholesalers and retailers. This credit is granted, for example, when a manufacturer buys raw materials on credit or when a retailer buys on credit from a wholesaler. Consumer credit on the other hand is granted by enterprises selling goods and services to the final consumer for personal consumption not for resale.

Consumer credit is a credit sale between a retailer and the final consumer. The retail industry according to Cole & Mishler (1995:68) is very wide, it includes all those enterprises that supply the final consumer with goods such as motor vehicles, major appliances, hardware, furniture, clothing, groceries etc. Retailing includes all the activities in selling goods and services to final consumers for personal consumption. Any organisation that does this type of selling whether a manufacturer, wholesaler or

retailer is doing retailing. For example, wholesalers like Makro sell to both retailers and final consumers. Any organisation therefore that sells to the final consumer on credit is involved in retail or consumer credit.

The retail industry is very diverse, with diverse goods and services offered under different credit terms and different credit regulations. The motor industry for example, is regulated differently from the clothing industry. According to the Credit Agreements Act (75 of 1980), ten percent deposit is payable when a car finance agreement is entered into and the credit terms are a maximum of fifty four months for an instalment sale and sixty months for a lease agreement. In the clothing industry on the other hand according to the Credit Agreements Act, there is no deposit requirement and the credit terms range from six to twelve months. The motor vehicle serves as collateral for the duration of the credit contract, while the clothing retailers may not have that advantage. The credit control strategies in the retail industry therefore may differ depending on the nature of the products offered and legal regulations regarding credit terms.

In the clothing industry retailers can choose between an in-house credit control strategy and outsourcing the entire credit control function. An in-house strategy is where the organisation establishes its own credit department, finances its debtor's ledger from its own working capital and collects its own debt. Outsourcing the credit function entails a variety of strategies including factoring which is referred to by financial institutions like Standard factors and Nedbank as invoice discounting. Most financial management textbooks define factoring of debtors as purely a source of financing the credit sales ledger, however this function has evolved into a more

comprehensive service. In this strategy an organisation can establish its own credit department and collect its own debt but only discount its invoices with a financial institution. The financial institution will remain directly involved in monitoring the movement of those invoices through the organisation's age analysis. Smaller and medium size organisations can sell on credit and seek a financial institution that will administer its entire credit control function.

Almost all the clothing retailers offer credit programmes save for those that have managed to differentiate their products and serve niche markets, for example boutiques. Those that sell on credit offer instalment credit terms that range from six months to twelve months. Instalment credit has been a profitable and effective tool for retailers who wish to increase their sales. It has also created satisfaction for their customers because of the lack of disposable income. The real danger in instalment credit is not in its use but in its abuse (Cole et al., 1995:44). Consumers can easily overextend themselves with this type of credit and most of them will have instalment debts that are out of proportion to their ability to pay. Retailers must therefore accept credit wisely. By adhering to sound principles of credit management and choosing effective credit control strategies that would suite their needs, organisations can do much to avoid individuals who do not have the ability to pay, whose accounts would have to be written off as bad debts and erode organisation profits.

It is commonly known that in the past large items only, like motor vehicle, furniture, major appliances etc, were generally offered on credit, but today items like clothing and even perishable goods such as groceries can be purchased on credit. Consumers are not usually motivated to pay their accounts after they cease to gain any economic

value from what they bought. Many pick out the purchase first and decide later how to pay for it. As a result of these problems, it was a natural development for retailers to become involved in the creation of a signed instalment contract. Retailers do the necessary credit checking and decide whether a credit agreement should be entered into. If the contract is entered into and the retailers do not wish to carry the contract themselves, they will seek a financial institution to purchase it (Cole et al., 1995:66).

Retailers who carry their own instalment contracts need working capital to finance their credit sales and they need even more capital if they wish to increase sales volume by offering instalment credit services. Those who want a faster turnover of their own capital and desire to shift much of the credit risk burden may outsource this function to a financial institution that specialises in this practice. Today retailers carry only a small portion of the debt they are influential in creating and commercial banks hold most of the instalment paper, for example, Queen's Park and Bally Spitz are few of those organisations that participate in this practice. Their debtor's books are managed by Standard Bank card division and First National Bank respectively. This practice is common among small businesses who wish to increase their sales volume but do not have financial resources to finance their debtors book or lack financial expertise necessary in debtor administration.

According to Cole et al. (1995:68) all experienced instalment credit department managers in commercial banks know that the risks involved in indirect finance, the practice where a financial institution finances an organisation's credit sales ledger are substantially greater than they are in a direct instalment credit. It is referred to as indirect finance because the bank does not lend money to the retailer's customers

directly, but the contract entered into is between the debtor and the retailer. Retailers who wish to sell their debtor's book must be carefully policed in indirect financing, and often, the bank does not know as much as it would like to about prospective borrowers. Yet, indirect business can produce a high volume fairly quickly. As a result, indirect business offers the bank an opportunity to generate substantial loan volume with little effort.

Banks need to formulate a policy on factoring and in doing so, the credit department first considers the quality of the retailer's sales ledger. In most cases the retailer's ledger is only as good as the organisation's financial position. As a result, the retailer's moral and financial qualifications are extremely important and must be reviewed carefully. Most banks spend considerable time reviewing the retailer's track record, including details about their financial and business history.

A variety of financing plans are offered by financial institutions, for example, full factoring with recourse or non-recourse, bulk factoring or invoice discounting. Those retailers selected depend on the competitive conditions prevailing and on the bank's credit policy. Some commercial banks offer the retailers a choice of several plans, others make only one program available and handle all invoices purchased under that plan.

## **1.2 PROBLEM STATEMENT**

One of the most important reasons for a high failure rate among small and medium size organisations is their inability to implement good credit management policies. Financial management is taught in almost all the tertiary institutions in this country

and yet many organisations still experience problems in formulating sound financial management policies. If financial management is taught in tertiary institutions and yet organisations still experience these problems one could perhaps ask the following questions;

- (i) Is it because credit managers do not have knowledge of financial management in general and working capital management expertise in particular?
- (ii) Is it because they do not have sufficient working capital management expertise in particular debtors?
- (iii) Is it because they do not understand cash flow effects experienced by fast growing organisations?
- (iv) If information on financial management is readily available, could it be that there are no clear guidelines to assist organisations that wish to enter consumer credit on whether they should manage credit internally or outsource the function?

### **1.3. OBJECTIVES OF THE RESEARCH**

#### **1.3.1. Main research objective**

The main objective of this paper is not to rewrite the topic in financial management textbooks but to formulate practical guidelines with regards to the management of the debtors function.

#### **1.3.2 Specific research objectives**

The specific objectives for this paper can be summarised as follows;

- To explore in-house credit programmes and factoring programmes in detail and weigh their benefits and limitations as applicable to organisations that operate within the clothing sector of the economy.
- To establish what current debtor management strategies are available for organisations operating in the South African clothing industry.
- To provide broad and general guidelines that will assist organisations in choosing a suitable credit control strategy.

#### **1.4 METHOD OF STUDY**

The methodology adopted in this research paper was a combination of literature review and limited primary research.

**Literature** - literature available on credit control strategies was reviewed. The different types of credit control strategies were explored and compared in terms of their effectiveness in debt collection and in terms of costs associated with each.

**Limited research** – was conducted from a number of organisations operating in the clothing sector to determine which strategy is more cost effective in managing the credit control function. These organisations were divided into two categories, those that manage and finance their own credit and those that outsource this function.

In this regard in-depth interviews were conducted regarding the main themes of credit management in the clothing industry. Three credit managers from eight organisations that operate in the clothing industry were interviewed. One of these managers is a group credit director in-charge of a group of six clothing retail stores. Each store has a distinctive brand name. This is a big organisation with 700 branches countrywide and

an annual turnover of about R6,8billion. The credit control function in this group is centralised. This organisation implements both in-house and factoring credit control strategies.

The other two credit managers are in-charge of the credit control function for medium size organisations. One store has 19 branches and the other 39 branches with an annual turnover of R80million and R300million respectively. The credit control function in both organisations is centralised and they both outsource their credit control function.

In-depth interviews were also conducted with three credit managers from three different commercial banks. These credit managers are in-charge of the factoring divisions in their organisations. Due to the confidential nature of the information and for strategic reasons the names of these organisations will not be mentioned, but only referred to as organisation A, B and C and commercial bank X, Y and Z.

## **1.5 DIVISION OF THE STUDY**

**Chapter 2** - provides an in-depth literature study of credit control strategies. When an organisation sells on credit it needs capital to finance debtors which might lead to cash flow problems if this function is not managed properly. This chapter therefore, looked at the importance of cash flow on the trading activities of an organisation, the effects of poor credit control and an in-depth study of different credit control strategies, for example, in-house and factoring strategies of managing credit.



**Chapter 3** – provided an in-depth study of the different credit control strategies in the clothing sector in South Africa. In-depth interviews were conducted with few role players in the industry, for example, those that outsource this function to a financial institution, those that manage this function internally and those that manage the credit control function internally but discount their invoices only. Of those that participate in factoring, this paper determined the type of factoring service used. An organisation can choose between full service factoring with recourse or non-recourse, bulk factoring or invoice discounting.

**Chapter 4** – dealt with the challenges of choosing a strategy that will increase sales and cash flow, reduce costs, improve profitability and the image of an organisation. The challenge here is to choose a strategy that will help organisations balance their image, profitability and growth potential because factoring is still viewed negatively by many. This chapter also provided guidelines on how to select a strategy that will enable smaller organisations to offer credit and gain a competitive edge in the market while overcoming the problems stated earlier.

**Chapter 5** – presents recommendations and conclusions that can be drawn from the preceding chapters.

## **CHAPTER 2**

### **CREDIT CONTROL STRATEGIES**

#### **2.1 INTRODUCTION**

The purpose of this chapter is to explore and compare different credit control strategies and their impact on an organisation's cash flow. People often hear the words "cash flow problems" used as an explanation for an organisation's failure. The problem could be that the organisation lacks working capital expertise, for example, it has invested too much money on stock or extended too much credit and its credit control function is not effective.

An organisation can have an acceptable level of turnover and might even be solvent, that is its assets exceed its liabilities, but if it is owed too much money that is not collected on time it can be liquidated. It can be liquidated because it will not be able to meet its interest obligations and its running expenses in general, for example, wages and salaries, electricity, water etc. Liquidity is not the only problem organisations that sell on credit experience, other problems are those associated with borrowing in the short-term, while the other is the opportunity cost. If the organisation, for example, was able to collect the debt within the agreed upon terms, it would be able to invest the excess cash and earn interest or avoid interest charges associated with short-term borrowing. Interest charges on overdraft and other forms of short-term borrowing tend to erode organisation profits.

The primary function of a credit department is to ensure that all moneys due on credit are paid within the agreed upon terms. Too often organisations spend too much time and money chasing late payments and enforcing collection procedures. Even the

assistance from legislators that allows organisations a statutory right to levy interest on overdue accounts does very little to alleviate the problem of late payment and bad debts that have to be written off (Dixie, 1997:147).

Businesses must also be careful when using and extending credit. If too many customers use credit to purchase goods and services, and do not pay as agreed, many rands of profit will be required to make up for the loss. One of the most important reasons for a high failure rate among small and medium size businesses is the inability to implement good credit management policies. Businesses must exercise extreme care in making sure that only qualified customers are given the opportunity to use credit. Effective collection departments must be organised to bring about positive cash flow credit operations. Also, the costs of extending and collecting credit must be controlled to make sure that profits are not eroded (Cole et al., 1995:13). Manufacturers, distributors and retailers have found that sales will generally increase if they offer credit programmes. Also, if their competitors offer credit, businesses may not be able to escape offering credit options and will have to match the competition. For example, Woolworths could not escape offering credit because its competitors were selling on credit and the fact that customers would generally prefer to buy from those sources that offer an alternative to cash purchases. If the organisation decides to offer credit perhaps the most important decision would be to determine whether to develop an in-house credit programme or use an outside provider of credit purchase options, for example, factoring.

This chapter will first look at the importance of cash flow on the organisation's trading activities and its profitability and the effects of poor credit control. But the main

purpose is to explore in-house credit programmes and factoring programmes in detail and to weigh their benefits and limitations as applicable to organisations that operate within the clothing sector of the economy.

## **2.2 IMPORTANCE OF CASH FLOW ON THE ORGANISATION'S TRADING ACTIVITIES**

It is important to first look at why an effective credit control function is necessary to create cash flow, the importance of cash flow and the devastating effect that failing to control it can have on an organisation's trading profit. People often say "but he always pays his account eventually, what does it matter if it is not today" (Dixie, 1997:142).

The problem is that the organisation needs cash to survive. If it does not collect the money owed to it, it will need to raise money through short-term borrowing, for example, arrange an overdraft with the bank to pay its bills. If the debtors do not pay their accounts over an extended period, the bank may extend the overdraft period up to a point where it might feel that its money is at risk. The bank might increase their overdraft charges to reflect this level of risk. Beyond this stage a bank might not extend the period, but call in the loan, forcing the organisation into bankruptcy. The debtors may have every intention of paying their accounts, but if there are delays the organisation may become insolvent. This is one of the reasons why an effective credit control function is important.

Some organisations could have the financial resources to be able to trade without relying on short-term borrowing, even though they may be taking longer to collect their debts. Although they may not be experiencing any cash flow problems, they will not be maximising their profit levels either and as a result their growth potential will

suffer. The capital used to finance debtors could have been invested in more profitable projects.

Kirkland (1998:30) is of the opinion that growth of any business is to a great extent dictated by the level of cash available to it. The cash available to an organisation will depend on the length of its cash cycle. The cash cycle is defined by Ross et al. (1996:478) as the time between cash disbursement and cash collection. The cash cycle is determined by the organisation's operating cycle which is the time period between the acquisition of inventory and the collection of cash from receivables. The operating cycle starts with the acquisition of inventory and the time it takes to convert it into cash. The longer the inventory cycle the longer the cash cycle. When stock has been sold on credit, the collection cycle will also determine the organisation's cash cycle. To increase cash flow the challenge is to strike a balance in working capital management by asking the following three simple question;

- What is a reasonable level of cash to keep (in a bank) to pay accounts?
- How much should the firm borrow short-term?
- How much credit should be extended to customers?

The organisation should not invest too much capital on inventory or improve its credit control systems. If, due to an ineffective credit control function, organisations are forced to use overdraft or loan capital to finance their sales ledger, they will find it more difficult to achieve an acceptable level of growth. This inability to generate long-term cash flow usually affects small businesses, especially during a recession.

On average in the United Kingdom (UK), it takes a business 78 days to collect payment for the credit it extends to consumers. This level of days sales outstanding

(DSO) allows a business to turn over its cash owed by debtors only 4.68 times in the course of a year, for example,  $365/78 = 4,68$  times. If an organisation managed to collect all its debts in 30 days however, it could increase this figure to 12,17 cash turns per annum (Dixie,1997:147). In South Africa initially, it took clothing retailers 180 days to collect credit extended. This allowed them to turn credit into cash ( $365/180=2,03$ ) times per annum. According to a credit manager of six large clothing chain stores, the majority of clothing account holders in this country are in the low income earning group. This forced the industry to increase the collection period even further to 12 months or 365 days.

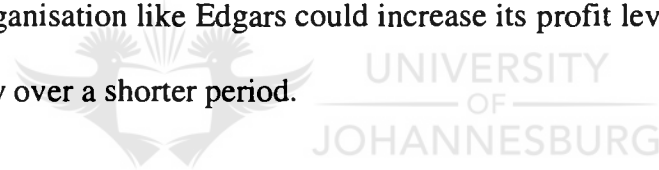
The higher the number of cash turns an organisation can generate in the course of a year, the lower its DSO level becomes, and the greater the increase in the organisation's cash flow. This increased cash flow can be used to meet the organisation's cash requirements, and as a result loan capital or retained profit could be used to finance the organisation's expansion needs instead of trading activities. The following table shows the relationship between an organisation's DSO and its cash flow, and also how its cash flow can be increased through better control of its debtors.

**Table 2.1 The relationship between a organisation's DSO and its cash flow.**

<b>DSO</b>	<b>Cash turns</b>	<b>Increase in cash flow</b>
78	4.68	UK average
65	5.6	20.1%
50	7.30	56.0%
35	10.43	122.9%
30	12.17	160.0%

Source: Adapted from Dixie, 1997 p143.

Increasing the number of cash turns generated in the course of a year will help to increase an organisation's profit level. If one takes an example of an organisation with a credit sales figure of R20 000 000 which is financed through an overdraft facility at an interest rate of 15% per annum, the increased profit level will reduce its DSO without increasing its sales figure. Edgars for example, operates a 180 DSO credit facility among other credit programmes. To finance its credit sales of R20 000 000 at 180 days level, the cost will be R1 479 452 ( $20\,000\,000 \times 15\% / 365 \times 180$ ). However, if Edgars, for example, does not implement a tough credit control policy and allow its debtors to pay over an extended period of 270 days, its costs will increase to R2 219 178 ( $20\,000\,000 \times 15\% \times 270 / 365$ ). This results in an increased finance charge and reduced profit levels of  $2\,219\,178 - 1\,479\,452 = R739\,726$ . Without increasing its level of sales an organisation like Edgars could increase its profit level by encouraging its customers to pay over a shorter period.



### **2.3 THE EFFECTS OF POOR CREDIT CONTROL**

According to Dixie (1997:144) the way organisations carry out their credit control function has a wider impact than they may at first imagine. He gives an example of small businesses that, during recession accepted long delays in account payments as a way of maintaining demand for their goods. As the economy entered a new period of growth, these businesses struggled to convince their customers to revert back to their normal 30-day credit terms. This lack of proper credit control practice is causing a delay in the recovery of the retail industry, which is essential for the UK economy. In South African organisations like financial institutions encouraged their clients in 1997 to 1998 when the prime lending rate escalated to 25% to pay what they could afford over and above their regular instalment. The clothing sector delayed tough collection

actions like suspension of credit to those customers whose accounts were overdue in order to maintain some level of demand.

Dixie further contends that as the UK becomes tied ever closer to Europe, their organisations will find they have to compete for orders with their European neighbours. If they are to compete successfully, they will need to match European DSO levels. At the present time German organisations collect their debts on average 30 days quicker than UK organisations. As a result they only have to factor 48 days credit into the prices they charge for their goods whereas their UK counterparts factor 78 days credit. This will result in German goods being marketed at a lower cost than their UK equivalents, and will make their goods more appealing to cash sensitive customers. If UK organisations wish to remain competitive with their European neighbours, they need to absorb the additional finance costs associated with higher debtor DSO. At present the only way they can achieve that is by reducing their profit levels even though this would have serious effects on their growth potential and that of the UK economy as a whole. With the advent of technology organisations that factor longer DSOs will be affected because their prices would be much higher than those that factor shorter DSOs. As more and more people become exposed to shopping on-line, local clothing retailers would be forced to compete globally. The South African retailers for example factor 180 and 365 days into the prices they charge. Even though they do not compete with their Europeans counterparts, the principle is still valid.

If the organisation that operates an in-house credit control strategy realises that it cannot afford to implement tougher credit control measures without losing customers, may be it might consider outsourcing its credit control function. There are



benefits and limitations in both strategies which organisations selling on credit should explore in order to make informed choices.

## **2.4 IN-HOUSE CREDIT CONTROL STRATEGY**

### **2.4.1 Introduction**

The business decision to offer credit programmes actually involves two basic questions. The first question is, should I offer a credit purchase option or require cash sales only? The second is, assuming a credit option is desired, should I operate my own credit programme or use an outside provider of credit management services (Cole et al.1995:18). If the answer to the second question is, operate your own credit programme, the organisation should look at its financial position to determine whether it would afford to finance its own credit. Usually big organisations manage their own credit because they have the financial resources necessary to do so. According to Kritzinger (1997:19-20) there are many costs associated with managing your own credit, for example;

- The cost of credit investigation and assessment of the buyer's creditworthiness.
- The cost of financing debtors.
- The cost of administering debtors.
- The cost of collecting debt.
- The cost of bad debts that have to be written off.

This section will look at the following topics in detail;

- The factors that influence the decision to develop an internal credit department.
- Credit management activities
- Costs associated with credit investigation.

- Costs of financing debtors.
- Costs associated with the collection of debt.

## **2.4.2 Factors influencing the decision to develop an internal credit department**

The decision to operate an internal credit department is often difficult because a new department requires increased costs of operation and qualified personnel. These employees need specific knowledge and experience in credit management. Other important considerations include the amount of capital available, type of goods sold, legal restrictions and the availability of outside providers of credit programmes.

### **2.4.2.1 Cost of operation**

There are many costs involved in operating an internal credit department. These costs are salaries paid to the credit controllers, funds invested on equipment and the supplies necessary to support the credit activity. There are also costs associated with promoting credit programmes, conducting credit investigations and collecting accounts. If credit control is not effectively carried out, large amounts of debt may be written off as bad debts. Legislation allows organisations to charge interest on overdue accounts, but this often does very little to alleviate the problem of late payment and bad debts.

### **2.4.2.2 Amount of capital available**

A business that offers customers additional time to pay for goods is investing financial capital as it waits for customers to repay the funds. The capital that the enterprise uses to finance its debtors costs money. For example, when an enterprise uses loan capital to finance debtors, it has to pay interest on the loan. Alternatively the capital used to finance debtors could have been used in short-term investments to earn an income.

Occasionally in consumer credit, no interest is charged during the time funds are owed. The business must always have capital available because it may be required to pay its own bills before it has collected from its debtors.

#### **2.4.2.3 Availability of qualified credit personnel**

According to Cole et al.(1995:21) one of the causes of small business failures is the problem associated with account's receivables. Many business owners lack the skills and experience in credit management. Policies need to be developed that help employees determine who qualifies for credit. Experienced credit controllers are needed to make decisions, work with customer accounts and implement effective collection techniques. Many laws influence credit activities. Some laws, for example, CAA set the maximum repayment periods and deposit requirements on instalment contracts, while the Usury Act regulate the rate of interest that may be charged. Well trained credit personnel is required to follow changes in these laws and comply with legal provisions in the many laws that exist. If an organisation cannot afford to attract qualified personnel, outsourcing the function would be a better option.

#### **2.4.2.4 Type of goods and services offered**

One of the basic principles of credit is that the value of the goods financed should never fall below the amount owed. According to Cole et al (1995:22), a customer may not pay for an item if the benefits of owning it have disappeared or been significantly reduced, for example, allowing customers to charge groceries carried additional risk since, once consumed, the desire to pay later may vanish. Borrowers are more likely to make regular payments on their mortgage and car finance because the goods purchased continue to provide an economic benefit. Before offering a credit purchase

option, the business must make sure that the product offered is valuable, and that the value is sustainable over the repayment period. Today this is not the case with the clothing sector. Goods charged on clothing accounts do have the economic value that is sustainable over six to twelve months repayment period, but they do not have any residual value to the enterprise once taken out of the shelf. Other retailers like Woolworths for example, allow their customers to charge groceries on their accounts, while others like Edgars allow their customers to charge services like hair dressing on their accounts.

#### **2.4.2.5 Availability of outside credit providers**

Business may be required to offer credit programmes as a result of competition and the desire of the organisation's customers because they do not have enough disposable income that would allow cash purchases, but if the organisation does not have capital to finance its debtors, this function could be outsourced.

#### **2.4.3 Credit management activities**

It is important for the credit manager to develop various policies or guidelines to help achieve the goals of the credit department. These policies are used by the credit personnel to make decisions and determine which actions to take under different circumstances. Policies help ensure consistency and are designed to promote the most efficient and profitable activities. Cognisance should be taken that these policies are guidelines and the specific characteristics of an individual case may dictate that alternative actions be taken. The policies allow the credit manager to delegate many routine activities and unless an unusual case arises, credit personnel can generally carry out the required functions. Some policies, rules and procedures are dictated by

credit laws and must be carefully adhere to, in order to prevent problems of compliance. The most important management policies are the following;

➤ **Credit policy**

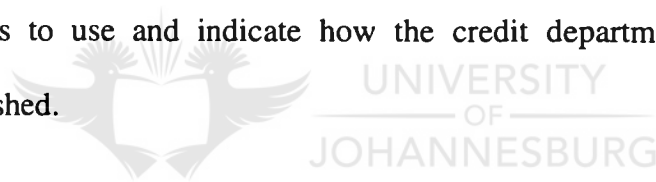
A credit policy is a written policy statement used by a credit department to define the type of credit offered and to state the basic characteristics of an acceptable risk. The credit policy will explain the type of credit plans or loans offered, for example, retailers like Edgars offer both six and twelve months credit terms. It may also define what the credit department views as an acceptable purpose for credit, even though this is only applicable to financial credit. The policy may also outline the type of customers the enterprise is seeking. The credit policy should define acceptable credit terms and describe satisfactory collateral if appropriate. In many respects, the credit policy will outline the mission and basic purpose for the credit department.

➤ **Investigation policy**

An investigation policy is a written guideline to help credit investigators gather sufficient information to arrive at a sound decision. This policy must define credit qualities that are considered important and establish minimum investigation standards. The policy might, for example, require that residence histories and employment be verified for a minimum of two years. The policy might also require that credit bureau reports be obtained on all customers and that salaries be verified by contact with employers. The actual details, of course, will vary depending upon the type and volume of credit offered by the individual credit department.

### ➤ **Collection policy**

A collection policy is a guideline to help credit workers decide which collection devices to employ and how to proceed when attempting to collect moneys owed to the organisation. According to Kritzinger (1997:21) the most commonly used aids in the clothing industry are, account statement, collection letters, telephone, personal visits, collection agencies and attorneys, even though personal visits and attorneys are not very cost effective in consumer credit. The collection policy will typically cover various collection stages and devices and indicate how long an account will stay in each stage. If a payment becomes ten days overdue, for example, a reminder should be sent out. If the payment becomes 120 days past due, however, the policy might require that legal action be initiated to collect the debt. The collection policy will also outline acceptable methods to use and indicate how the credit department wants certain activities accomplished.



#### **2.4.4 Costs associated with credit investigation**

Once the policies and procedures have been formulated and the framework set up, the credit department will now proceed with the process of credit granting and collection. The process of credit granting starts with gathering information about the potential customers from various sources which will be discussed later in this section.

According to Dixie (1997:117), the last decade has seen a considerable change in the way organisations credit check potential customers. He goes further to say that days of the bank and trade references are numbered, as tomorrow heralds a new dawn built upon the age of computer technology.

Business information is one of the fastest areas of growth within the credit sector. Every year new organisations move into the market offering a greater variety of systems, and every year this additional level of competition reduces the cost of on-line credit checking. Even though this applies to trade credit, credit checking is just as important in consumer credit. There is no doubt that credit reporting has become big business in Europe, but is it really as important as its purveyors would like us to believe? The answer is yes. Even in South Africa credit checking is very important, even though this kind of information is still provided by non-profit making organisations like the information trust societies (ITC), that charge a fee every time an enquiry is made.

The most important reason why organisations should spare no expense in credit checking is because, every bad debt that an organisation picks up will have started its life as an application for credit. The more effort one puts into credit checking potential customers, the fewer bad debts an organisation is likely to incur during its normal trading activities.

By offering a new customer credit facilities, an organisation is investing its financial resources in those debtors. This investment in debtors is no different from any capital investment, it would therefore need to see return on its investment, and thorough credit checking then become very important. Even with today's sophisticated technology, it is still practically impossible to eliminate bad debts, therefore each individual business needs to formulate its own credit sanctioning policy that allows it to achieve results within its own parameters.

The main purpose of credit checking is to maintain an acceptable level of risk, not to eliminate trading altogether. If an organisation's credit policy is too conservative it will have a stifling effect on its sales activity. At the same time, a too liberal credit policy must be complimented by a conservative collection policy, otherwise the level of bad debts might escalate out of control, not only with customers who would not pay, but also with those who cannot pay. There are sources where information about potential customers can be gathered, but these add direct or indirect costs to the organisation, but they are very important as highlighted above, and these are;

➤ **Credit application form**

Any customer who applies for credit should be asked to complete an application form.

The format of these forms will vary from one organisation to the next, but the following information should always be requested as standard for credit scoring in consumer credit;

- Age
- Marital status
- Residence
- Income dependants
- Banking information
- Trade references
- Credit bureau information
- Employment
- Contact (CSM,1997:112)

It takes time and money to gather and verify the above information, for example, employment and income should be confirmed with the customer's employer.



### ➤ **Credit bureau**

Credit bureau charge a fee every time an enquiry is made, but it provides a very valuable service to organisations. According to Kritzinger (1997:75), credit bureau are established to accumulate information about people and organisations who buy on credit. This information is stored on databases for the exclusive use of organisations and individuals who become members of that credit bureau. The type of information made available to these members is as follows;

- The date every time an enquiry is made to the bureau. This suggests that the applicant has applied for credit from various suppliers and the frequency of the applications.
- Every time an enquiry is made, the present address of the applicant is recorded. From that, it can be established if the applicant is moving around which is an indication of stability at residence, business location or employment addresses.
- Information of an adverse nature any member of the bureau may have had with a person is recorded.
- Any judgement obtained against a person is recorded reflecting who the judgement creditor is, the date of the judgement, the amount and the reason.

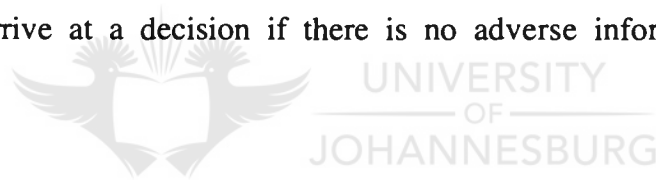
### ➤ **Trade references**

References should preferably be obtained from concerns supplying similar products, and should be at least equal in volume trading to enable a fair comparison. This is important because it was stated earlier that customers would rather maintain their regular mortgage and automobile loan instalments than clothing repayments during times of recession and rising interest rates. A good credit record from the bank would

therefore not necessarily give a clear picture of a customer's creditworthiness in other forms of credit, like clothing accounts CSM (1999:58).

### ➤ **Bank reports**

Banks are very reluctant to supply the kind of credit information that is really needed to assess a credit risk. According to Kritzinger, the bank of an applicant for credit can on request supply some financial information in confidence to the bank of a credit grantor, but are very reluctant to supply that information to other industries. They however, will never reveal any financial information in actual money terms. The banking information that is of importance to clothing stores is whether a customer has a credit card and a current account that is well maintained. This information can help a credit controller arrive at a decision if there is no adverse information about the customer.



Besides the credit bureau that charges a fee for information supplied, other sources also add costs that tend to erode organisation profits. Trained credit controllers must be found who would be able to carry out these activities, the time it takes to gather and verify this information and other credit facilities used to carry out this function all add to the costs of managing your own credit. These functions are carried out by the factor for those organisations, like Queen's Park that outsource their credit function.

### **2.4.5 Costs of financing debtors**

According to Dixie (1997:145, the costs of overdue debts that erode organisation profits fall into three main categories which are;

- **Financing additional credit**

When organisations set their price levels, they build in associated costs of financing their credit sales. If all their customers paid their accounts on time, there would not be a problem, but this rarely is the case. The longer it takes an organisation to collect its debts, the quicker the erosion of its profits. For example, if an organisation's DSO is 30-days and it takes its customers 78 days to settle their debts, this additional 48 days cost has not been factored into their price structure. This additional cost will have to be financed separately from the organisation's profits or by means of an overdraft.

- **Bad debts provision**

All businesses need to make a provision for bad debts, and the level of provision will depend on three factors: the type of market the business operates in, the quality of its credit control function and the organisation's policies for calculating its bad debts provision. There is no standard format for calculating bad debts, a organisation uses any format it feels comfortable with. A flat percentage rate of the debtor's book is the easiest format, but one should bear in mind that they will not be allowed a tax relief against this provision. An organisation is only allowed to claim tax allowance against a specific debtor.

- **The cost of administering credit**

The longer a debt is, the more it costs to administer. Dixie maintains that according to surveys carried out by various trade groups, the average cost of administering credit is around 2% of the gross sales revenue.

#### **2.4.6 Costs associated with the collection of debt**

No matter how professional or effective a credit control department is, there will always be some debts it will be unable to collect. These debtors will be made up of customers who cannot afford to pay their debts and those who will not pay until they are forced to. An organisation reaches a point where it needs to hand over the account to a third party for collection. There is no standard norm but an organisation needs to hand over the account when it is still reasonably overdue, all the phases of the collection procedure have been completed and every possible collection attempt has been made internally. If overdue accounts are not handed over on time, it might be too late even for a collection agency to recover the debt.

Dixie maintains that many organisations feel that using a collection agency would be of little benefit. They believe that if their credit controllers have carried out their job correctly, the collection agency would have very little extra impact on their uncollected debts. This is not the case however, because a letter or telephone call from a collection agency has a proven psychological effect on the debtor.

When an overdue account has been handed over to the third party for collection, it will be for the first time in the chase cycle where the debtor will feel threatened. A debtor who cannot pay will not suddenly find the resources needed to clear the account, but it will focus his mind on the problem. More often than not, the debtor ends up clearing the account even if it is over an extended period. It was stated before that an extended collection period erodes organisation profits because it was not factored into the price. Once the in-house collection cycle has been completed, it is always wise to move the overdue accounts to a collection agency for the next level of contact rather than

proceed directly to legal action. The collection cycle that a organisation must complete before handing over the account is described by Kritzinger (1997) as follows;

➤ **Reminder phase**

The debtor is reminded that he has not yet settled the outstanding account. The letter has a friendly tone and the debtor is usually requested to ignore it if the payment has already been mailed or made personally.

➤ **Follow-up phase**

If the reminder has not produced any results, the enterprise can proceed to the follow-up phase in which more strongly worded letters are sent to the debtor. The enterprise at this stage aims at collecting the outstanding amount, but at the same time retain the goodwill of the debtor. In the follow-up phase the enterprise can also, for example, find out why the debtor has not yet settled the account.

➤ **Drastic phase**

A collection letter with “drastic implications” is sent to the debtor compelling him to settle the outstanding account before a certain date. If payment is not made before this date, the enterprise will hand over the account to an attorney or a collection agency.

It is however important to note that the enterprise should never send such a collection letter to the same debtor twice otherwise it will lose its impact and meaning. The enterprise must also ensure that it does proceed with the planned course of action if no payment has been received by the specific date. As stated above, the delinquent debtors will feel threatened for the first time when they receive a letter or telephone

call from the third party. According to CSM (1999:128) a letter or telephone call from a collection agency will have broadly the same psychological impact as the attorney's. A collection agency will only charge for its services if it is successful in collecting the debt, while an attorney will charge for a collection letter regardless of whether he is successful or not. If a collection agency is performing well, it should be able to collect at least 70% to 80% of the accounts handed over, provided the debts are free from queries and of a reasonable age.

Even after handing over the accounts to the collection agency, the enterprise should make sure that it remains in-charge of those accounts and maintains some level of control over them. It should not allow its accounts to remain with the agency for the entire agency's chase cycle. A typical time frame should usually be one to two months on average



After their final application, the agency should always refer back to you for authorisation before proceeding with legal action. Once you proceed with legal action your costs will start escalating fairly rapidly. At this point it is important to compare the costs of a collection agency to those of the attorney.

The costs to an organisation using a collection agency varies with the type of service required and the agency selected. The most common form of collection charge and certainly the most economical is the contingency fee, whereby the agency charges a percentage of debts successfully recovered with no charge made for unsuccessful cases. The scale of percentage offered to a creditor is normally dependant on the type of debts to be collected and centres around the average invoice value and total volume

of debts to be passed to the agency. A collection agency is more beneficial because an enterprise will not incur any costs if the debt passed over is not collected. Most agencies use a policy of 'no collection – no fee'.

The attorneys on the other hand charge a fee whether the debt is collected or not. An attorney charges a fee for any letter and telephone call made to the debtor. If the debt has to be collected through the courts, it will take a long time and money to collect. A business should therefore, weigh the costs of collecting a consumer credit through the courts of law versus the value of the outstanding debt. More often than not, the costs might outweigh the value of the debt. Even though these costs are more often passed on to the debtor, the main aim of an organisation is to collect the debt while maintaining that customer.

If the collection agency fails to collect the debt and the enterprise feels that the value justifies collection through the courts, the account would be passed over to an attorney. The other important factor to consider is the criteria for choosing a collection agency or an attorney. If the organisation fails to choose a reputable agency, it might end up incurring more expenses trying to collect the money from the agency.

It should be stressed that when passing accounts to a collection agency, the title to the debt should remain with the creditor at all times, with the agency acting on behalf of the creditor. According to CSM (1999:99) it is important that a creditor should satisfy himself concerning his choice of agency and its financial standing. The minimum requirement would be the same as for any new customer requiring credit, bearing in mind that at any one time an agency could be holding the funds of the enterprise's successfully recovered debts. A copy of the agency's latest audited statements must be

analysed to make an informed decision. This should be followed by a selection of letters to be used on behalf of the creditor. Finally, details as to the frequency of reports and advices of payments received should be agreed upon. The recovery performance of an agency should always be monitored by the creditor over a minimum period of six months. This allows for recognised trade fluctuations of payment and the general economic patterns.

When choosing an attorney, organisations are usually faced with the decision between legal firms it uses for its other corporate affairs or the legal firm that is used by the collection agency. According to the CSM (1999:135, the biggest single factor for use of agency's attorneys is the preparatory work undertaken by the agency prior to recommending legal action. It is therefore no coincidence that agency attorneys have a far higher success rate in the recovery of overdue accounts than ordinary attorneys used by the organisation. This is mainly due to the fact that all circumstances surrounding the debt have been explored and the validity of the debt established prior to recommending legal action.

The legal firm an organisation uses for its other corporate affairs will probably be the wrong one to use for debt collection. If an organisation hands over accounts to an attorney on a regular basis, it would best be advised to use a firm that specialises in debt collection work. These firms operate a computerised litigation system which can be dealt with quite adequately by a legal executive, thereby reducing the organisation's legal costs. Debt collection cases however, need to be handled by a fully fledged attorney only if they progress to the serious defended stage. This is the reason why it was stated before that attorneys may not be cost effective and ideal for



consumer credit because the values of debts involved are usually not very significant to justify the expense.

All the above-mentioned costs are the costs that an organisation operating an in-house credit control strategy will incur in managing its credit control function. These costs will vary from those of setting up a credit control department where adequately qualified credit personnel and facilities should be found to those of collecting debt through collection agencies and sometimes through attorneys. An organisation that operates a factoring strategy will not incur these costs but this strategy has its own benefits and limitations also, and these will be discussed in the preceding topic.

## **2.5 FACTORING CREDIT CONTROL STRATEGY**

### **2.5.1. Introduction**

Factoring the credit control function entails different strategies ranging from outsourcing the entire credit function to a factor or managing the credit function internally and discounting invoices only. This process is referred to as factoring, but there are different definitions and views about factoring from different authors. Ross et al (1996:495) defines factoring as a secured short-term loan that involves selling accounts receivables to a factor. Accounts receivables often form a major part of the assets of an organisation. Factoring is a way of turning this asset quickly into cash, thus reducing the level of investment in assets needed by the firm. The accounts receivables are sold to a financial institution (the factor) which specialises in this form of activity.

Although factoring is a process of purchasing an asset (the firm's receivables), funds advanced against a receivables ledger are advanced against a future payment. Interest

charges in the South African factoring industry range from prime to prime plus four percent.

Ross further goes on to maintain that if a firm so wishes, the factor will perform the complete administration of the receivable function in the firm (so-called full factoring). The factor captures the invoices, produces monthly statements, an age analysis and any other information necessary for the administration of the receivables. They send out letters of demand and payments are made directly to the factor. Factoring can be done openly or confidentially. The latter is known as invoice discounting.

According to Ross, factoring is therefore an all encompassing concept whether the organisation administers its ledger and discounts invoices only or outsources the administration of its entire accounts receivables. Cole et al (1995:263) claims that factoring is a subject that is mostly misunderstood, which is true considering the different definitions and views of different authors. They differ from Ross in the sense that they equate factoring with full service factoring of accounts receivables. They maintain that there are two types of accounts receivable financing, the ordinary accounts receivable financing and factoring.

Ordinary accounts receivable financing involves an agreement under which a financing institution;

- (a) purchases the open accounts receivables of its customers or advances them loans secured by the pledge of such receivables,
- (b) with recourse to them for any losses and
- (c) without notice to their trade debtors.

Factoring on the other hand involves a continuing agreement under which a financing institution;

- (a) assumes the credit and collection function for its clients and
- (b) purchases their open accounts receivable as they arise
- (c) without recourse to them for credit losses and
- (d) with notice to their trade debtors.

In both types the lending institution will examine the quality of the accounts receivable offered. To be accepted, the major portion (75 – 80 percent) of the assigned receivables must have a high rating granted by some credit reporting agency.

Dixie (1997) like Ross views factoring as a generic term but divides the process into three different packages, namely full service which could be offered with or without recourse, bulk factoring and invoice discounting. The South African financial institutions interviewed, for example, Standard bank is in line with Dixie's framework even though they use different terms for some packages. Standard bank refers to factoring as debtor administration and divides it into full service factoring, agency debtor finance, invoice discounting and selective invoice discounting.

Dixie's framework will be adopted for discussion in this section. The advantage of factoring is that it increases the rate of turnover of current assets and leaves a business with more cash available for other purposes like cash purchase in order to benefit from cash discounts. The down side though is that the business may suffer from customer complaints and lost goodwill. Factoring is also denigrated by many as simply the last

desperate attempt to salvage an ailing business. It is generally regarded as an expensive form of finance and therefore mostly used as a short-term form of finance of last resort.

In this section the different types of factoring and the costs associated with each will be explored. The process of factoring, operation agreements, financial costs of factoring, the comparison between different types of costs and the laws of factoring will be discussed in detail.

## **2.5.2 The main factoring services**

According to Dixie (1997:154), although services may vary slightly from organisation to organisation, the main services offered by factoring organisations are as follows;



### **2.5.2.1 Full service factoring**

Full service factoring is the most common service offered by factoring organisations. It eliminates the need for the participating organisation to operate a full credit control function as these are carried out by the factoring organisation. As a result this service is popular with small businesses. Queen's Park and Bally Spitz among other small organisations use this kind of factoring, and they are managed by Standard Bank card division and First National bank retail unit. Under this arrangement the factor purchases from its client the equity of its debts as each invoice is raised. The factor operates the credit sales ledger and chases for payment when these fall due. As part of the agreement, the factor would supply its client with detailed reports of the debts purchased, the level of cash advanced and the level of debts collected. The full service agreement is usually broken down into one or two types, recourse or non-recourse.

- **Recourse factoring**

According to Cole et al in this type of service the client remains liable for any bad debts incurred. Money advanced against these debts will be recovered by the factor from the client's accounts. Credit checking in this type of service is carried out by the client, hence it has to bear the costs of bad debts.

- **Non-recourse factoring**

Under this agreement the factor will absorb losses incurred by its client through a debtor's inability to pay. In this type of agreement the factoring organisation will insist on taking out credit insurance through a credit insurance organisation such as Trade Indemnity or Namur in UK, and Credit Guarantee in South Africa. To obtain credit insurance, the factor needs to take control of its client's credit sanctioning functioning. This will take the form of credit checking every new customer its client take on and the operating of strict credit limits for these customers. According to the Nedbank Credit Focus volume 4, it is usually not economically viable for a organisation with a high level of low-value debts to take out a full service, non-recourse agreement. Even with non-recourse agreements, the client has to absorb a certain portion of the bad debts that accrue, although this may vary depending upon which factoring organisation is used and the level of sales-to-customer ratio. As a general rule, the lower the value of each individual sale, the higher the cost of coverage for bad debts.

#### **2.5.2.2 Invoice discounting**

Invoice discounting is provided for organisations that wish to maintain their own sales ledger and credit control functions. Under this type of agreement, an organisation

receives an advance from the factor against its trade debtors and then acts as an agent for the factor in the collection of its own debts. All moneys collected though, must be paid into the factor's account.

One advantage of this service is that it is confidential. Factoring can be rendered on either a disclosed or undisclosed basis and in the case of invoice discounting the process is undisclosed. In this case the factoring house might use the client's stationery on its computer, with the client's letterheads and postal address. The participating organisation's customers will not know that it is factoring its debts. This service is popular among large organisations that have developed large effective sales ledgers and credit control departments. The only motivation for these organisations is just to maintain an acceptable level of cash flow. This type of factoring is usually subject to a full recourse agreement because the credit checking and approval of accounts is done by the organisation.

### **2.5.2.3 Bulk factoring**

Bulk factoring is a disclosed form of factoring. The factoring house informs all debtors of the client that the debts have been purchased and ceded to it, and that all payments in respect of such debts must be made directly to the factoring house and not the client or any other party. The organisation however, still has the responsibility to collect its own debts but it has to inform its customers to make payment to the factor. Once again, effective in-house credit control and sales ledger functions are a prerequisite for the success of this type of factoring. Bulk factoring is usually popular among smaller organisations that have a high percentage of low-value debts. This type of debtor-to-sales ratio renders a full factoring agreement uneconomical. The service fee charged

for debtor administration ranges from 0,2 – 5%. The actual fee charged depends on the number of debtors and invoices, the higher the invoices the higher the fee because of the amount of work involved.

From the above content, it is clear that each type of factoring service is viable for different types and sizes of businesses. For example, full service factoring is ideal for a small organisation that does not have the financial resources to set up a credit department and finance its own debts, while the invoice discounting strategy will benefit organisations with very effective in-house credit departments. Invoice discounting is ideal for big businesses because of its undisclosed nature of functioning. As stated before, factoring is still regarded negatively by many as a final attempt by an ailing organisation to stay in business.



### **2.5.3 The process of factoring**

It should be borne in mind that not all businesses are suitable for this type of finance agreement, for example, organisations that trade in goods of a perishable nature might not secure factoring agreements. Even if a business fits into an acceptable trade grouping, this in itself does not guarantee that it will secure a factoring agreement because there are various other factors to consider. The spread of an organisation's debtor base is another important aspect to consider. According to Dixie, factoring organisations like to see a fairly even spread of sales across the debtor base with no single customer exceeding more than 25% of the total figure. It is also important that a business does not offer abnormal or excessive credit terms. No factoring organisation will advance 80% of a debt that it cannot legally collect within a period of six months,

but that is different with the South African practice. The credit terms offered by clothing retailers that factor their accounts range from six to twelve months.

If the factor finds the organisation to be a viable candidate, it will carry out a survey to determine the financial stability of its client because it would advance up to 80% of the debtor's book to it. It will also make sure that there are no aspects of the organisation's trading that may affect its title to the book debts. For example, if the organisation has an outstanding loan that is secured against its book debts, the factor will not have the first call if the organisation ceases to trade.

Having satisfied itself with the feasibility of the agreement, the factor will move to the next stage which incorporates an in-depth review of the debtors list, the level of sales, average invoice value and the number of customers. This data is applied to a standard formula in order to calculate the cost of the service. According to Dixie the costs of factoring are usually charged as follows;

Administration fee = 1,5% of the sales ledger balance

Discount charge = repurchase rate + 3% calculated on the outstanding balance and capitalised on the account daily.

#### **2.5.4 The financial costs of factoring**

There are three types of costs charged by factoring organisations;

##### **2.5.4.1 Administration charge**

This charge is known as the service or commission charge. It is calculated as an agreed percentage of the total debtor's figure. The percentage will vary depending on the



factor used and the type of service rendered. The projected sales volume, number of debtors and average value of debts will also have an effect on the eventual amount charged. For full service, non-recourse arrangements for example, it will cover the cost of bad debt protection.

The purpose of the administration fee is to cover the costs incurred by the factor while carrying out its client's sales ledger and credit control activities. It should be remembered that even under an invoice discounting agreement, where the client controls its own sales ledger and credit control functions, there will still be a small administration charge. This charge is raised to cover the cost of monitoring the account. Administration charges usually vary from 0,5% to 4% of the gross value of each invoice depending on the type of factoring service.

#### **2.5.4.2 Discount charge**

The discount charge is just another name for the interest levied on the funds advanced to the client. This charge is usually between 2 and 3% above the prime rate and normally around the same level as the bank overdraft rate. As explained earlier, this is an alternative to bank overdraft or personal loan and it is calculated on daily basis.

#### **2.5.4.3 Re-factoring charge**

On occasion a factor may make an additional administration charge known as a re-factoring charge. This is the fee which is usually charged on debts over 90days old that are proving difficult and time consuming to collect and is charged around 1%. However, it should be noted that this charge does not cover costs incurred by the factor as a result of having to take legal action to recover a debt. Costs for legal action

are passed onto the client as a separate charge in the case of full service factoring with recourse.

### **2.5.5 The law of factoring**

Laws regulating factoring are very complex and ill-defined, proper legal advice should therefore be sought if a organisation, especially the smaller ones do not understand the legalities involved. The difficulty in clarification of factoring laws arises from the way factoring has developed from its early forms. According to Dixie (1997:164), factoring was imported into the UK from USA and little thought was given to the differences in the laws governing the two countries. In the USA they have a uniform commercial code which clarifies the law of factoring and in the UK there is no such clarification.

Credit is a highly regulated function in this country, and like any other function it evolves all the time. Today organisations are gradually passing on the risk burden associated with credit to financial institutions. In these deals there is a third party involvement but the laws that mainly regulate credit in this country, for example, the Credit Agreements Act 75 of 1980 and the Usury Act 73 of 1968 are silent about the rights of the third party in the event of a breach of contract where the debtor is liquidated.

To enable the factor to trade freely however, it needs to know that it has legal title to the debts it is purchasing. Legally debts are a type of intangible asset in which physical possession cannot exist, the client therefore cannot sell a debt to the factor in the same way as they would sell a tangible asset. Factoring agreements actually transfer the benefit of equity that its client is legally contracted to receive from the customers.

The title to the debt from an enforcement point of view remains jointly between the factor and the client. This means that if the factor wished to proceed with legal action to recover a debt, the action would have to be instigated jointly by the factor and the client. This however depends on the type of factoring package selected. Standard bank and Nedbank credit managers both stated that where there is no disclosure, for example, in invoice discounting, the bank would act as an agent on behalf of the organisation in the collection of debt. Where there is full disclosure, the debtor is aware of the bank's involvement. The bank in such cases can enforce its rights through legal means without any assistance from the organisation.

## **2.6 COST COMPARISON BETWEEN IN-HOUSE AND FACTORING**

It is difficult to use cost comparisons on their own to make a decision as to whether you should manage your own credit or seek services of a factor and if so which service would benefit your organisation's unique circumstances. Other factors such as the adverse effect factoring may have on your business should be considered, hence big businesses choose undisclosed factoring agreements. Other factors to consider are the reduction in the level of bad debts your organisation may benefit from through using a factoring service, especially factoring with non-recourse and the effect on the growth potential of your business.

It was stated before that factoring organisations charge the same rate of interest for funds advanced to clients as the bank overdraft charges. The same rate of interest would therefore be used to compare the costs of the following credit granting strategies, namely, in-house and factoring. Factoring would be divided into full

service, bulk factoring and invoice discounting. It should however, be remembered that each factoring arrangement is negotiated on its own merits, and the rates can vary depending on which factor one uses. But for the purposes of this exercise the same rate will be used.

Dixie (1997:161-162) compares costs associated with different credit control strategies using different size organisations with R30m and R1m sales volumes respectively. Figure 2.1 shows a comparison between factoring and in-house collection costs for Needaloan. This organisation has an annual sales figure of R30 000 000 and a DSO of 78 days which is the United Kingdom average collection period. Staff costs are calculated at salary plus 50%. The overdraft requirements are governed by the need to finance its DSO level. This organisation employs five credit controllers and five sales ledger clerks. It should be noted that even under full service factoring agreements, an organisation would still need the services of at least one credit controller and one sales ledger clerk.

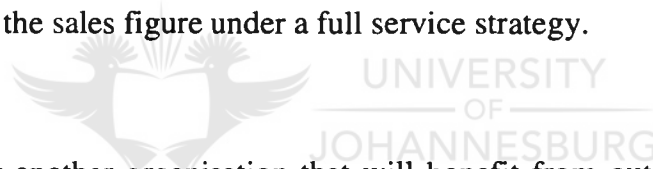
**Figure 2.1 A comparison between factoring and in-house collection costs.**

<b>Needaloan Ltd: Collection Costs</b>			
<b>Collection costs</b>	<b>In-house</b>	<b>Full service</b>	<b>Invoice discounting</b>
Credit controllers	150 000	22 500	150 000
Sales ledger clerks	100 000	100 000	100 000
Overdraft (6 410 000 @ 10%)	641 000	----	----
Discount charge (6 410 000 @ 10%)	----	641 000	641 000
Service charge (30 000 000 @ 2%)	----	600 000	----
Service charge (30 000 000 @ 0,5%)	----	----	150 000
<b>Total costs</b>	<b>891 000</b>	<b>1 282 000</b>	<b>1 041 000</b>

Source: Dixie, 1997 p161

Looking at the costs only, Needaloan would increase its profit if it financed its own credit. But as stated before, there are other factors that one need to consider before deciding on which strategy to use. For example, if this organisation has the capacity to raise R6 410 000 overdraft with the bank, it would save on service charges worth R600 000 which are charges on the sales figure for handling the account over and above the interest levied on money advanced to the client.

This organisation would benefit from the in-house credit control strategy if its credit control department is effective in its collection of debts because under a full service strategy, bad debts would be absorbed by the factor. Under invoice discounting, bad debts are usually absorbed by the client hence the service charge is levied at 0,5% compared to 2% of the sales figure under a full service strategy.



Let us now look at another organisation that will benefit from outsourcing its credit function. Justbegun Ltd has been trading for two years, and has an annual sales figure of R1 000 000 and a DSO level of 95 days. Again, staff costs are calculated at salary plus 50%. Their overdraft requirements are governed by their need to finance their DSO level. This organisation employs one credit controller and one sales ledger clerk.

**Figure 2.2 Comparison of collection costs for Justbegun**

Justbegun Ltd: costs			
Collection costs	In-house	Full service	Invoice discounting
Credit controllers	24 000	----	24 000
Sales clerks	18 000	18 000	18 000
Overdraft (260 270 @ 10%)	26 027	----	----
Discount charge (260 270 @ 10%)	----	26 027	26 027
Service charge (1 000 000 @ 2%)	----	20 000	----
Service charge (1 000 000 @ 0,5%)	----	----	5 000
<b>Total costs</b>	<b>68 027</b>	<b>64 027</b>	<b>73 027</b>

Source: Dixie, 1997 p162

This organisation would clearly benefit from outsourcing its credit control function. When looking at both the costs and other factors, it is evident that the full factoring service is an ideal strategy. This organisation has been trading for only two years, it might not have the capacity to raise the required level of loan or overdraft with the bank. Also, the sales figure points out that this is a small organisation and might therefore not have the financial resources and expertise to set up an effective credit control department. Full service factoring is the best strategy for small enterprises because the credit checking and collection functions would be performed by the factor and it would also absorb any bad debts that have to be written off. In-house, invoice discounting and bulk factoring would be uneconomical for this organisation because their success depend on how successful the organisation's credit control department is.

## 2.7 CONCLUSION

Regardless of the specific credit program offered, the retailer or service provider benefits from offering credit purchase options. Most important is the opportunity to increase sales since a new category of buyers is now available, those who do not have enough disposable income to buy cash. Customers using retail credit tend to spend more and generally purchase better quality products. Better quality products often result in fewer returns and increased customer satisfaction. Retail credit options help a business match the offerings of its competitors and will attract customers who prefer to use credit for convenience. Some retailers also believe that offering credit programs provides an opportunity to strengthen customer loyalty.

There are however many problems and challenges that occur for retailers offering credit programs. Operating costs will increase along with the need to promote credit plans, investigate applications for credit, manage accounts and collect past due amounts. Extra equipment, space and personnel will be required to conduct the credit operations. Collection problems will occur since some customers will fail to pay and may require legal action to provide payment. The retailer may have to borrow additional funds to pay for merchandise if the time frame for customer payments does not match the terms of sale for the inventory. Finally, disagreements about credit activities can adversely affect customer relations and the image of the retailer in the community. In the case of factoring, for example, a factor might wish to institute a legal action to recover the debt, where as the client may have preferred a lesser action like a collection agency or writing off the debt to maintain goodwill with other customers.

If organisations are able to choose a strategy that will eliminate the above problems while benefiting from offering credit programs, they can improve their profitability and growth potential.





## CHAPTER 3

### THE SOUTH AFRICAN CLOTHING INDUSTRY

#### 3.1 INTRODUCTION

As stated before in chapter one, organisations in the clothing industry that sell on credit can choose an in-house credit control strategy where they manage and finance their own credit. They can also choose to outsource the credit control function to financial institutions that specialise in the factoring practice.

Factoring at Standard Bank and other financial institutions like Nedbank is offered under their factoring division, but there is another form of factoring that is offered by these financial institutions under their card divisions. For example, Queen's Park outsources their debtors book to Standard Bank card division while Bally Spitz is managed by First National Bank through their retail banking division. The qualifying criteria, terms and conditions offered to organisations that wish to outsource their credit control function is different depending on whether factoring is secured through a card division or a factoring division.

It is quite evident that the trend in debtor administration is gradually changing from in-house to factoring. In the past factoring was viewed negatively as a desperate attempt by organisations that lack financial resources to stay in business. This perception has drastically changed as pointed out by bank managers interviewed. They claim that with more and more financial institutions offering this service, organisations have begun to realise the importance of using specialists in debtor administration.

In South Africa factoring services are offered by the following financial institutions, to mention a few; Cutfin, ABSA, Sasfin, Nedbank Factors, First Factors and Standard Factors. As stated before, factoring is not only offered by these bank's factoring divisions, but also through their card divisions or retail banking divisions. The qualifying criteria, packages, terms and conditions for participation will be discussed later in the chapter.

Organisations in the clothing industry, small, medium and large realise the importance of offering credit terms. They are equally aware of the problems associated with selling on credit, for example, setting up the infrastructure and collection costs. As a result of these problems, organisations are gradually beginning to realise that outsourcing their debtor's ledger to a financial institution that specialises in debtor administration is just another strategy worth considering. It is important for growing organisations that could be hampered by insufficient working capital or organisations that do not have an external need for working capital but only need to streamline their internal operations because mostly debtor administration is not given the prominence it deserves.

Informal interviews were conducted with bank credit managers as well as credit managers from organisations operating in the clothing industry to determine what strategies they use in the management of their credit control function. In this chapter, information gathered from these credit managers will be divided into three categories. The first section will explore different factoring packages offered by financial institutions, the qualifying criteria for participation and the procedure followed in the maintenance of these factoring agreements. The second section will look at different

packages implemented by South African clothing organisations that outsource their debtor administration to determine the factors that influenced the choice of strategy and package and those factors that contributed to the success of their application because not all organisations qualify for factoring. Three credit managers from different organisations that implement different factoring strategies were interviewed. The last section will look at organisations that implement an in-house credit control strategy to determine the costs associated with this strategy.

### **3.2 FACTORING PACKAGES OFFERED BY BANKS**

Informal interviews were conducted with credit managers from three different banks. For the purposes of this exercise these would be referred to as X, Y and Z. These banks offer different packages through their factoring as well as card and retail banking units. This is important because the qualifying criteria differs depending on the unit within the bank where the agreement was secured. This section will therefore look at the qualifying criteria for participation, organisations that are ideal candidates for factoring and advantages of factoring. It will also explore different packages offered and the costs associated with each package.

#### **3.2.1 Qualifying criteria for factoring**

According to these bank managers, when a prospective client approaches the bank, an in-depth investigation is undertaken with particular attention to the debtor's ledger. The quality of the ledger and payment record is ascertained, the collection and bad debt experiences of the client are recorded. Cash flow projections are formulated and the product is examined to ensure that disputes are minimal. Financial statements are analysed and trade references obtained before the final approval of the application.

This function is usually carried out by a small team of the bank's internal auditors that go out to the client's premises to evaluate the viability of the organisation. For that business to secure a debtor finance facility through the bank, the following criteria must be met;

- The debtor's book must be ceded to the bank. Before any funds are advanced under a debtor finance agreement, satisfactory evidence is required that there are no prior cessions. If other cessions exist, confirmation would need to be obtained that the bank's cession takes precedence. This means that the bank would need to ensure that in the event of liquidation, the bank would have the first call on the debtor's book.

For organisations that secure debtor finance from the factoring division, the following criteria must be met. The organisation must;

- Be involved in a manufacturing, distribution, wholesale or service industry.
- Generate a minimum credit turnover ranging from R300 000 – R500 000 per month depending on the bank used.
- Ideally receive a high incidence of repeat orders from its clients because it is too costly and time consuming to load the debtor's details into the bank's system. It will not be economically viable for the bank if orders were once off or occasional deals.
- Be profitable or have a potential to be profitable for relatively new organisations that have not yet established themselves.
- Sell a product that is acceptable to its customers in terms of quality and service.

Other organisations that sell to individual customers but meet the above criteria will also qualify for factoring agreements but will secure their finance through the bank's

card or retail divisions depending again on the bank selected. For example, Queen's Park, an organisation that sells to individual customers secured its debtor finance through Standard Bank card division while Bally Spitz uses FNB's retail banking unit. Another big organisation that operates a non-disclosed debtor finance facility secured theirs through Nedbank's retail unit.

If the organisation meets the criteria set by the bank, both parties will enter into a debtor finance agreement. Once the facility is granted, the bank can advance up to eighty percent of the debtors ledger immediately with the balance paid out once the debt is settled in full. On a continuous basis, the same percentage will be advanced against invoices generated again with the balance paid out once it is settled in full. The bank will open a special account for the client and drawing the funds is optional but in a similar manner to a traditional bank overdraft facility, interest will only be charged on funds withdrawn.

### **3.2.2 Who is suitable for debtor finance?**

According to Standard bank, organisations that are under-capitalised, highly geared or "overtrading" would find a need for debtor finance after having exhausted traditional overdraft funding. Debtor finance could be well suited to organisations that experience any of the following problems;

- Their cash flow is affected by delayed payment from debtors.
- They experience difficulty in collecting and administering their debtor's ledger.
- The growth of the business is hampered by insufficient working capital.
- A business that is granting excessive settlement discounts to collect outstanding debts.

- They experience cash flow problems resulting from differences in their debtors and creditors cycles.

### **3.2.3 Benefits of debtor finance**

According to Nedbank, administration of a debtors book can be costly and time consuming. The bank's solution provides consistent cash flow, low administration costs and reduces the risks associated with a debtors book. The bank guarantees a benefit from credit expertise in setting up credit limits and detailed reporting that can help an organisation manage and control its debtors book on regular basis depending on the package selected. Standard bank adds the following among other benefits of debtor finance;

- A financial facility directly linked to turnover with no limited constraints in the case of first-class debtors.
- The availability of finance to secure settlement discounts, benefit from bulk purchases and generally provide better bargaining power.
- The ability to extend a debtor's terms instead of having to grant trade discounts.
- The opportunity to draw on a wealth of knowledge and experience gained by the bank in diverse industries.
- Full debtor finance offers a professional debt collection service together with a computerised management information system.
- Bad debt risk is minimised through professional credit advice and efficient debtor administration.

### **3.2.4 Types of factoring facilities**

Different banks offer different facilities but these differences are very insignificant, this paper will therefore group these into three categories. These differences would be in the form of amounts advanced, for example, one bank would pay up to sixty percent of the invoice whereas the other one would advance seventy percent on the same package. Also, one bank might require a minimum of R300 000 credit turnover per month for participation while the other would require R500 000 for example in bulk factoring. The factoring facilities offered by the banks will be grouped into full service factoring with or without recourse, invoice discounting and bulk factoring.

#### **3.2.4.1 Full service factoring**

This is a traditional form of debtor finance in which the bank carries out the complete administration of the ledger, including sending out statements, following up overdue accounts and reconciling payments. Invoices and statements will record that the debt has been ceded to the bank to whom payment must be made.

To qualify for this facility, a business must have been in existence for at least twelve months. If an organisation has potential in terms of sales projections and profitability, but it has been operating for less than a year, it can be recommended for participation. Other factors that could be considered are the type and quality of the product, the background and qualifications of the organisation's management. A business that applies for this facility must be generating a credit turnover of at least R100 000 per month.

This facility can be offered with or without recourse, but organisations securing their debtor finance through a factoring division of any bank will only qualify for a full service facility with recourse. According to the Standard bank and Nedbank managers interviewed, all factoring agreements in South Africa secured through a factoring division are offered with recourse. Full factoring secured through card and retail units can be offered with or without recourse depending on various factors such as the relationship the client has with the bank, the profile of the client's target market and the financial position of the organisation. With this service, a bank can advance up to eighty percent of the ledger and invoices generated on daily basis.

#### **3.2.4.2 Agency debtor finance or bulk factoring**

According to Standard bank debtor finance brochure (2001:3) to satisfy individual business needs, the basic debtor finance can be offered in different forms. The main element of the traditional debtor finance service is debtors ledger administration, but the fact that many larger organisations administer their own ledger successfully has led to a move away from full service debtor finance to agency or confidential debtor finance.

With this option the organisation acts as an agent for the bank and is responsible for its own ledger administration. Collections may be deposited into the business's existing bank account although daily or weekly information must be communicated with the bank. In this case invoices and statements must state that the account has been ceded to the bank. This service is better suited to smaller and medium size businesses that generate a high volume of small value invoices because the service fees charged for administering the ledger are determined by the amount of work



involved. The higher the number of invoices the higher the service fee. An effective credit department is a prerequisite for the success of this type of facility. A small team of auditors from the bank will go out to verify balances with the balances the organisation has in its debtor's book on regular basis. An audit confirmation of balances with debtors asking them to use a P O Box address that is different from the organisation's address is also done to guard against fraudulent claims. These auditors will also verify bank balances to ensure that funds destined for the bank are not deposited into the business's current account. These are checks and balances put in place by the bank to ensure that the organisation does not pass on fraudulent invoices or keep the payments from debtors that were destined for the bank. This facility is offered with recourse only. The bank will monitor the movement of the debtors book using the organisation's age analysis and the bank's detailed reporting expertise will help the organisation to manage and control its outstanding debtors. The advances on this facility range from seventy to eighty percent depending on the bank selected. To qualify, the organisation must generate a monthly credit turnover ranging from R300 000 – R500 000 per month depending on the bank used.

#### **3.2.4.3 Invoice discounting or confidential factoring**

According to Standard bank, this option works in the same way as agency debtor finance except that there is no need for any annotation on invoices and statements. For both options the bank's review staff or auditors must be allowed to inspect the debtors ledger and all relevant correspondence and documentation regularly.

To qualify for this facility, the organisation must have been in existence for more than three years. It must offer a product that is acceptable to its customers, show an

acceptable market share and profitable trend. It must generate a monthly credit sales turnover of R300 000 – R500 000 per month. Advances under this facility range from sixty to eighty percent depending on the bank selected. Banks that advance sixty percent of the credit sales ledger do so because the bank is not involved in the management of the ledger directly even though it still monitors the movement of accounts on regular basis because the ledger serves as its sole security.

#### **3.2.4.4 Selective invoice discounting**

This is not a different factoring service but is an adaptation of the above-mentioned facilities that allows flexibility in the management of the debtor's book. Where a business does not see a need to factor or borrow against its entire debtors ledger, it can decide to select certain debtors which when financed would provide the necessary cash to satisfy working capital needs. This facility can be adapted to either full service, agency or confidential debtor finance provided the relevant criteria are met.

#### **3.2.5 Costs associated with factoring facilities**

Generally, there are two types of costs charged by banks for rendering factoring facilities;

##### **3.2.5.1 Interest charge**

According to Standard bank debtor finance brochure (2001:5) factoring is the process of purchasing an asset and not that of lending money, funds advanced against a debtors ledger or an invoice are advanced against future payment. Interest is therefore charged on any amount advanced, calculated on the daily outstanding balance and payable monthly in arrears. Debtor finance is regarded as a conditional loan against

debtors ledger or invoice hence interest is payable. Interest payable on funds advanced is linked to the prime rate and is the same as for a traditional overdraft facility, but this differs depending on the bank used and through which unit of the bank it was secured. The above applies to all agreements secured through the factoring units.

### **3.2.5.2 Service fee**

The service fee charged depends on the type of facility selected. In the case of a full service facility, the fee is levied to cover the costs of administering the debtors ledger. The administration fee is calculated as a percentage of turnover and is based on the average number of invoices and credit notes issued, the total number of active debtors, the quality of the debtors and turnaround time of the ledger. As each client is unique, this cost can vary substantially from business to business. Businesses with few large-value invoices will pay less than those with many smaller value invoices. The fee takes into account the amount of work to be done and time required to process the client's ledger. The service fee varies depending on the bank used but the banks interviewed quoted service fees ranging from 0,2 – 5% of the credit sales ledger or invoice.

In the case of agency and invoice discounting facilities, the fee is quoted as a fixed minimum amount of R3 500 per month and debited to the client's account once monthly. The calculation of this charge is based on the amount of paperwork involved and the location of the client's premises.

### 3.3 FACTORING CREDIT CONTROL STRATEGY

Credit managers from three organisations that participate in factoring agreements in the clothing industry were interviewed. Two of these organisations are relatively small in comparison because one has about 19 stores and the other 39 stores countrywide, whereas the third organisation has about 700 stores. But in terms of their turnover these are all big organisations. The department of Trade and Industry does not make a distinction between clothing and manufacturing sectors and therefore defines sizes of organisations in this sector as follows;

- Micro R0,15 million
- Very small R0,15 - R4 million
- Small R4 – R10 million
- Medium R10 – R40 million
- Big R40 and above



For the purposes of this exercise these organisations would be referred to as Organisation A, B and C. These organisations generate an annual turnover of R300 million, R40 million and R6,8 billion respectively. Organisation A and B outsource their entire debtor administration but using different banks, while the third organisation operates both in-house and factoring strategies in the management of its debtors book.

#### **Organisation A**

This is a medium size organisation if one considers the number of stores countrywide. This is a rapidly growing organisation that could be hampered by insufficient working capital if it did not participate in factoring. It can secure an overdraft facility but a

organisation can only secure a third of its debtor's book if used as a security whereas through factoring it can secure the full invoice value less the discount fee immediately.

This organisation's main objective in selling on credit is to increase its turnover in the short-term. The manager claimed that scientific research proves that customers buy 3,3 times more on credit than they would otherwise for cash. The organisation also uses credit as a marketing strategy because their credit card serves as an ongoing reminder every time the customer sees it and it also creates customer loyalty. This organisation outsources its entire debtor administration to the bank which is responsible for sending out statements to customers and collecting the outstanding debts. It is therefore implementing a full service factoring strategy.

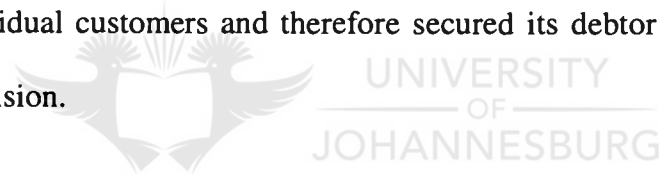


### **3.3.1 Factors that influenced the choice of strategy**

- Initially the organisation started small but its long-term strategy was to grow and open more new stores in new shopping malls countrywide, but this growth was hampered by insufficient working capital.
- It lacked infrastructure for setting up a credit department because this would have required significant investment in equipment and information technology to facilitate transactions between stores.
- It lacked credit control expertise and would have needed investment in the human resources.
- The organisation viewed an in-house credit control strategy as costly and the economies of scale would not have justified the expense. The organisation was not generating enough sales volume to absorb the cost and still make a profit.

### 3.3.2 Factors that contributed to the success of their application

- The client's customer profile. The organisation positions itself above the normal clothing chain stores, but below the exclusive boutiques. Its target market therefore is the middle to high income earning customers that are generally viewed as low risk group.
- The organisation is under geared and has positive liquidity ratios.
- It's holding organisation has a long standing relationship with the bank and provided a guarantee.
- The organisation receives a high incidence of repeat orders from its customers.
- The organisation sells high quality products with minimal returns.
- It sells to individual customers and therefore secured its debtor finance with the bank's card division.



### 3.3.3 Factoring package selected and costs

This organisation is implementing a full service factoring strategy without recourse. This means that the entire debtors book is ceded to the bank which is responsible for credit assessment, collection of debts, sending out statements, reconciling accounts, set up credit limits and bears the responsibility for bad debts. The invoices and statements sent out to customer's record that the debt had been ceded to the bank and payment should be made directly. In this facility there are two types of costs charged. The organisation is charged a factoring commission or service fee of 2,25% on the full debtor's ledger and invoices generated thereafter. When an invoice is forwarded to the bank, it will advance the full invoice value after deducting the service fee. The interest on the funds advanced will be charged from the customer. Interest is

calculated on daily balances and capitalised into the account monthly. The card from this store operates in the same way as a normal credit card issued by the same bank except that the store card is for exclusive purchases made from this store.

### **Organisation B**

This is a small organisation in terms of the number of stores even though it is regarded as a big organisation in terms of its turnover according to the department of Trade and Industry's definition. Like organisation A, it has a target market of middle to high income earning customers hence their factoring agreement is without recourse. The organisation is implementing a full service facility, which means that the bank is responsible for the management of the entire debtors book.

The bank charges this organisation an all inclusive service fee of 15% on the debtors book and invoices generated thereafter. The service fee covers the costs of managing the organisation's ledger and interest on funds advanced. For example, if the bank receives an invoice of R1000, it will deposit R850 into the special account opened for the client immediately. The statements and invoices reflect that the account is ceded to the bank and payments must be made directly to the bank.

### **Organisation C**

This is a big organisation that has about seven hundred stores countrywide. It has a group of six different stores each with a distinctive brand name. The credit control function of this group is centralised into three centres, in Johannesburg, Durban and Cape Town. Even though the credit control function is centralised, debtor's books are segmented with each store managed as a separate debtor's book and separate debtor's

books within each store if it offers different credit plans. For example, six months and twelve months accounts are managed as separate debtor's books.

Organisation C implements both in-house and factoring credit control strategies in the management of its debtors. It entered into a selective invoice discounting agreement with the bank. In invoice discounting as explained earlier, the organisation is responsible for the management of the credit control function, for example, credit assessment, sending out statements and collecting money. The most important characteristic of invoice discounting is that it is confidential especially for big organisations.

This organisation has within one store for example, four debtors books, a six months and twelve months books which are funded from the organisations working capital. It has another twelve and twenty months debtors books that are discounted with the bank. In this agreement the bank sets its required rate of return on its investment. The twelve and twenty months plans are interest bearing, and the interest is paid by the customer. The interest that may be charged is not linked to the prime rate but regulated by the Usury Act 73 Of 1968 and reviewed from time to time. The rate currently stands at 25%. The organisation pays a discount fee, which is a percentage of the invoice discounted. This percentage will make up the difference between the interest charged from the customer and the bank's required rate of return. The rate is reviewed monthly and the discount fee therefore varies from month to month, but the manager declined to disclose the actual rates.



### **3.4 IN-HOUSE CREDIT CONTROL STRATEGY**

Information gathered from organisation C which implements both factoring and in-house strategies will be used in this section. As stated before, this is a group of six chain stores in the clothing industry which sell on credit. The credit control function for this group is centralised but each store is managed as a separate debtor's book because they behave differently and serve different target markets. For example, three of these stores target value orientated customers that are not brand conscious, while the other stores in the group sell both in-house as well as international brands and therefore target middle to high income earning customers. The organisation implements an in-house strategy in the management of the debtors because some stores might not qualify for bank funding because of the risk associated with the profile of their target market. In this section, this paper will look at the credit policies, factors that influenced the choice of strategy, costs of managing the function, costs of financing debtors and finally the collection costs.

#### **3.4.1 Credit control policies**

The organisation formulated credit and collection policies that serve as guidelines for its credit controllers. When formulated, these policies were based on the economic conditions that prevailed at the time. For example, for the past three years the organisation was implementing a conservative credit policy and a liberal collection policy. During the Asian crisis which resulted in the escalation of interest rates, customers experienced a short-fall in their disposable income. The policies were therefore used to contain the size and condition of the debtors ledger. Liberal collection policies were implemented to allow customers to pay their accounts over an extended period. The prime rate escalated to its highest ever rate of 25% sometime in

1998 even though it has now decline to 13%. During that time the interest rate charged on interest bearing accounts was 30% as set by the Usury Act. Because of the favourable economic conditions the organisation has decided to relax its credit policies and adopt a more aggressive approach to stimulate growth in sales.

#### **3.4.2 Factors which contributed to the choice of strategy**

- Economies of scale do not justify a factoring strategy. The organisation is generating enough credit turnover to make it more cost effective to manage it internally. The organisation generated a turnover of about 6,8 billion. If these debtors were outsourced the organisation would have been charged a maximum service fee of 5% (6,8 billion X 5% = 340 million).
- The organisation is generating a large volume of low value invoices which would be costly to manage if the debtors book was outsourced. The percentage charged for managing a debtor's book is determined by the turnover, the number and value of invoices. More work and time is required to process a large number of debtors and invoices.
- Some stores in the group target emerging markets which are usually associated with high risk by the bank.

#### **3.4.3 Costs of managing the credit control function internally**

The organisation has centralised the management of debtors for the group into three offices. The costs of setting up infrastructure in these three operations are as follows;

- Human resources – remuneration packages as well as training costs must be paid.

The Johannesburg office alone has a staff compliment of 2400.

- Office space – rental costs for these three offices which are purely set up for credit control activities.
- Infrastructure – large amount of money is invested in main frame computers as well as software to facilitate transactions between the 700 stores countrywide and these three offices to update records.
- New account processing – the organisation incurs costs associated with data collection. It incurs costs through collecting information from sources such as the credit bureau and the software required for electronic credit assessment. The organisation uses very sophisticated software for credit scoring. This software analyses data and makes a decision with regards to whether the application should be approved or declined.

#### **3.4.4 Costs of financing the debtors book**

The organisation incurs costs in financing debtors. It operates six and twelve months plans that are funded from its own working capital and another twelve and twenty months plans that are bank funded through invoice discounting. The costs associated with the latter have been discussed in 3.3.3 earlier, this section will focus on the former plans only.

The organisation invests money in stock that is sold on credit over a period of six or twelve months. Their creditor's cycle is sixty days after invoice date. The organisation would therefore need to find money to pay its creditors because their debtor's cycle is longer. It uses its own working capital and depending on the time of the month, its working capital needs could also be financed by creditors. Within the sixty days the organisation would sell and collect money from its debtors which could be used to

finance working capital needs and only pay creditors after sixty days of the invoice date. The working capital invested in debtors could have been invested in other forms of short-term investments that yield higher returns. The opportunity cost therefore should be taken into consideration, especially for the six months plan which is interest free. If there is still a short-fall in the working capital, the organisation would utilise an overdraft facility. This facility carries costs in the form of interest charged.

The organisation also needs to make provision for bad debts if the function is managed internally. The percentage provided for bad debts would vary depending on the type of debtor's book and profile of customers. Those stores within the group that target low income earning customers provide a higher percentage of about 7% of the sales to reflect the risk. As stated before, this organisation operates different debtor's books within the same store and these books behave differently. For example, provision for a six months debtor's book would be lower than that of a longer period like twelve months because the longer the credit terms the higher the risk will be of recovering the debt.

#### **3.4.5 Collection costs**

The organisation incurs costs in the collection of debts, for example, printing statements and postage costs. For collecting overdue accounts the organisation incurs extra costs which were not built into the price of the product. Minimum costs such as sending out reminder letters and telephone expenses to more costly means could be incurred depending on the nature of the account. For example, for seriously overdue accounts of about 5 – 8 months the organisation uses the services of a collection agency and attorneys. Even though most agencies and attorneys work on a contingency basis of “no collection no fee”, their commission could range from 15 –

25 or 30% depending on the age of the account. Older accounts are very difficult to collect and this will be reflected by the commission charged. This organisation hands over its overdue accounts after five or even eight months depending on the payment performance of the debtor. If the debtor manages to pay up to 75% of the instalment the organisation will delay handing over the account but will charge interest of 25% per annum which translates to 2,08% per month on the total outstanding debt. The organisation tries to accommodate the customer by extending the payment period because once an account is handed over it will lose that customer. The manager claimed that it is more costly to sign in new a new customer than to retain an existing one with known payment history



## CHAPTER 4

### CREDIT CONTROL STRATEGIES IN THE CLOTHING INDUSTRY

#### 4.1 INTRODUCTION

Chapter two looked at the secondary information on the strategies for managing the credit control function in the South African clothing industry. Chapter three looked at different clothing retailers that sell on credit and the different strategies they implement in managing their credit control function. This chapter will therefore analyse information from both chapters and provide guidelines for organisations that do not sell on credit but would wish to increase their turnover and compete effectively in the market. It is a scientific fact according to Organisation A's credit manager interviewed that customers who buy on credit spend 3,3 times more than those who buy for cash. Offering credit terms does not only increase turnover but also creates customer loyalty. It is however important to note that not all organisations can afford to sell on credit because managing the function can be very risky, costly and detrimental to the organisation's growth and survival if this function is not managed properly. Knight (2001:11) pointed out that debtors is one of the largest assets in any organisation's balance sheet and if this asset is not managed properly the organisation can have serious working capital problems.

Guidelines on the factors that should be considered when choosing a strategy will be provided for organisations that sell on credit to assist them in the evaluation of their strategies. Valuable information gathered from financial institutions on debtor administration packages targeted at different sizes of organisations that wish to outsource their credit control function will be made available.

This chapter will also provide guidelines for big organisations that sell on credit and have effective and efficient credit departments but experience insufficient working capital problems that could hamper their trading activities. It will also provide credit control strategies that could be applicable to other organisations that sell on credit but do not necessarily operate in the clothing industry.

The following sections will make a comparison between different credit control strategies and provide broad general guidelines for choosing a strategy that will suite an organisation's unique circumstances.

#### **4.2 A COMPARISON BETWEEN CREDIT CONTROL STRATEGIES**

All organisations that sell on credit incur costs associated with debtor administration, but the extent to which these costs can be reduced will depend on the strategy used. Costs associated with the administration of debtors are those of gathering information to assess the creditworthiness of a potential customer, and collecting debt as explained earlier, personnel costs and setting up infrastructure. These expenses must be paid whether the organisation is managing the function internally or outsourcing it.

An organisation can reduce these costs, improve cash flow and profitability without increasing its turnover depending on the strategy used. Different strategies will be compared to show how an organisation can reduce costs and improve its profits without increasing turnover. Table 4.1 will illustrate which strategy can help an organisation like Organisation C improve cash flow, reduce costs and increase its profits without necessarily increasing its turnover. Organisation C has a staff compliment of 3 600 and an estimated payroll of R288million at an average of R80

000 per annum per employee. Organisation C's turnover of R6,8billion is made up of 6, 12, and 20 months credit terms, but for the purposes of this exercise we will assume a DSO of 180 days and an overdraft rate of 13,5% per annum. To finance this turnover, the organisation would need R3 353 425 658 (6,8billion X 180/365).

**Table 4.1 Comparison of collection costs for Organisation C**

ORGANISATION C			
Collection costs	In-house	Full service	Invoice discount
Personnel	288 000 000	2 000 000	288 000 000
Overdraft (3 353 425 658 @ 13,5%)	452 712 329	---	---
Discount (3 353 425 658 @ 13,5%)	---	452 712 329	452 712 329
Service fee (6,8billion @ 0,5%)	---	---	34 000 000
Service fee (6,8billion @ 5%)	---	340 000 000	---
<b>Total costs</b>	<b>740 712 329</b>	<b>794 712 329</b>	<b>774 712 329</b>

According to the above table, Organisation C will reduce costs if it managed its credit control function internally. There are, however other factors that should be taken into consideration as well. While the banks interviewed maintained that their discount fees range from a minimum of 0,2 and a maximum of 5%, they also mentioned that the fee would vary depending on the amount of work involved. The amount of work involved in managing this debtor's book could warrant a higher percentage than the normal maximum fee of 5% and the fact that the turnover is made up of a significant number of debtors and invoices with low values.

Some of the stores in the group would not qualify for debtor finance from the banks. To balance the need to increase turnover, improve cash flow and reduce DSO,



Organisation C must manage this function internally and outsource a portion of its debtor's ledger. The bank funded portion would be contained at 180 days because banks are generally risk averse hence very conservative in the granting of credit and collection of debts. This strategy would therefore increase the organisation's cash flow.

The organisation can still increase its turnover by granting credit to customers who would not have been successful with the bank and finance these from its own working capital. It must bear in mind though that it would be difficult to contain the DSO at 180 days because of the risk associated with this category of customers. The manager mentioned that some accounts are handed over after 360 days. Let us assume for example, an amount of R15million which was due in 180 days is paid in 270 days, this would reduce the profits by  $R499\ 355$  ( $15m \times 13,5\% \times 270/365$ ) - ( $15m \times 13,5\% \times 180/365$ ). The organisation would need to use an overdraft facility to finance this debt at 13,5% over an extended period of 90 days. If the opposite were true it could have increased its profits without increasing its turnover if the money was invested in short-term investments with the same rate of return.

Organisation A and B generate an annual turnover of R300 million from its 39 stores and Organisation B an annual turnover of R80 million from 19 stores. There are, however many similarities between these two organisations in terms of size, type and quality of products, target markets and the strategies used in managing the credit function. Only one organisation will be used therefore to illustrate cost comparison but the findings are valid for both organisations.

Even though Organisation A has an annual turnover of R300million, for the purposes of this exercise a turnover of R30million will be used. This organisation would have needed a staff compliment of ten credit controllers if it managed its credit control function internally. The organisation would need R14 795 000 (R30million X 180/365) to finance an annual turnover of R30 million at the rate of 13,5% over a period of 180 days.

**Table 4.2 Comparison of collection costs for Organisation A**

ORGANISATION A			
Collection costs	In-house	Full service	Bulk factoring
Credit personnel	800 000	----	800 000
Overdraft (14 795 000@13,5%)	1 997 325	----	----
Discount fee (14 795 000@13,5%)	----	1 997 325	1 997 325
Service fee (30 000 000@ 2,25%)	----	675 000	----
Service fee (30 000 000@0,5%)	----	----	150 000
<b>Total costs</b>	<b>2 797 325</b>	<b>2 672 325</b>	<b>2 947 325</b>

Both organisation and bank credit managers interviewed did not view bulk factoring as an ideal strategy for a small or medium size organisation. The economies of scale do not justify setting up an internal infrastructure. They also claimed that the organisation might not provide the kind of expertise that banks have acquired from operating in diversified industries.

According to table 4.2, a full service strategy is an ideal one for an organisation of this size. Other factors that make a full service strategy more favourable are the fact that

an organisation can streamline its activities and focus its resources and efforts mainly on selling. An organisation of this size could have been hampered by insufficient working capital if it financed its debtors from its working capital or even from an overdraft facility because it could only secure a third of the debtor's ledger as explained earlier.

### **4.3 FACTORS TO BE CONSIDERED WHEN CHOOSING A CREDIT CONTROL STRATEGY**

An organisation that sells on credit must formulate a credit policy which will determine the strategy to be used. The determination of the strategy must take into consideration the following factors, the organisation's financial position especially its liquidity, financial expertise of staff, availability of outside providers of debtor administration, target market, type of the product and the size of the organisation.

#### **4.3.1 Financial position of the organisation**

Organisations that have cash flow problems may not be in a position to finance their debtors. This also depends on the organisation's credit cycle and its debtor's cycles. In the clothing industry the debtors cycle is usually longer than the payment cycle. The credit terms range from six to twelve months whereas the normal trade terms between the organisation and its suppliers is normally 30, 60, 90 or 120 days according to CSM (1999:68). A cash flow position of an organisation would therefore determine the strategy to be adopted. It would be advisable for an organisation that generates an annual turnover of about R6,8 billion like Organisation C to adopt an in-house credit control strategy. If it experiences a need for working capital, it could make use of an overdraft facility. Financial institutions require collateral for an

overdraft facility which could be in the form of a debtor's ledger. Most banks interviewed stated that they can only advance a third of the ledger because they are not directly involved in the management of the ledger. If a third of the ledger is not enough to finance the working capital needs, the organisation can also implement a selective invoice discounting strategy as explained in 3.4.2. This strategy advances up to 80% of the debtor's ledger because the bank would be directly involved in the management of the ledger. This strategy is ideal for an organisation of this size because it offers flexibility and more options of raising working capital. A big organisation that generates about R6,8billion cannot benefit from outsourcing the entire credit control function because it would be charged a discount fee for funds advanced at the same rate as normal overdraft facility, but will also be charged a service fee. The service fee ranges between 0,2 – 5% depending on the number of debtors and invoices. In the clothing industry the number of debtors and invoices is significantly high and this organisation could easily pay a maximum rate of  $R6,8\text{billion} \times 5\% = R340\text{million}$ .

An organisation that generates this amount in turnover but experiences cash flow problems must therefore finance its working capital needs from its overdraft facility because it will only pay interest on the funds advanced. It can discount a selected number of invoices with the bank. Because the organisation is responsible for managing the ledger it can excess 80% of the invoices and be charged a minimum fee of 0,2% for monitoring the movement of the invoices discounted only.

A small or medium organisation that generates an annual turnover of about R100million and experiences cash flow problems would benefit from outsourcing the

entire function. It can access 80% of its ledger and will not be charged the maximum service fee because the number of invoices will be significantly less than those in the previous example.

An organisation of this size however, that already has an established credit control infrastructure, but experiences cash flow problems will benefit from bulk factoring. It could access 80% of its ledger and pay a minimum service fee of 0,2% because it manages its ledger internally.

#### **4.3.2 Financial expertise**

In many organisations debtor administration is not given the attention it deserves, they do not look at the financial expertise of their credit personnel. If the organisation is unable to attract people with the necessary expertise, outsourcing the function would be an ideal strategy. The credit manager for Organisation C for example, said that a financial background is not a criteria for recruitment for their credit controllers, a financial background is only required for managerial positions only.

#### **4.3.3 Availability of outside debtor finance facilities**

The availability of outside providers of debtor administration would also influence the type of strategy to be chosen. In this country almost all financial institutions offer debtor administration services but a organisation that wishes to outsource its ledger must conduct extensive research because factoring for organisations in consumer credit is fairly new and unstructured. Debtor administration for organisations in trade credit is offered by factoring divisions and the packages, terms and conditions are fairly consistent throughout the industry. Debtor administration for organisations in

the clothing industry is offered by card or retail units of the bank and the packages, terms and conditions differ significantly depending on the institution used. These differences were highlighted by Organisation A, B and C in chapter three.

#### **4.3.4 Target market**

The target market of an organisation will also have an influence on the type of strategy to be used. Not all organisations will qualify for debtor finance offered by banks, the qualifying criteria for participation was discussed in chapter three. Organisations that target low income earning customers will not qualify for debtor finance for the same reason that low income earning clients do not qualify for bank loans hence they opt for micro lenders with very high lending rates. Organisations like Jet Stores for example, offer in-house branded products and targets different income groups. For an organisation like this to secure a debtor finance deal with the bank it would need to maintain different debtor's books and segregate by income. An ideal strategy would therefore be a selective invoice discounting.

#### **4.3.5 Type of product**

It was mentioned in chapter three that one of the qualifying criteria for factoring is the type and quality of the product offered. Banks want to ensure that the quality of the product is acceptable to customers and that there are minimal returns for credit notes. Organisation C is a group of six stores that specialise in branded and non-branded products. Three stores in this group would not qualify for factoring because of the quality of their products and the markets targeted.

#### 4.3.6 Size of the organisation

The size of an organisation determines the type of strategy to be adopted. Organisation C for example, that generates an annual turnover of about R6,8billion would benefit from an in-house credit control strategy with some debtors funded by the bank through invoice discounting to finance the short-fall in working capital. The basic strategy here is to look at the number of debtors and invoices generated in the total turnover. If the number of debtors and invoices is fewer, it would be more cost effective to outsource the entire ledger.

Organisations with few debtors and invoices who qualify for debtor administration packages would benefit from streamlining their internal operations by outsourcing the entire credit control function. The reason is that with fewer debtors and invoices the service fees charged by the bank would be much lower than those of setting up the infrastructure internally. Organisation A for example outsources its ledger and charged a service fee of 2,25% which might be lower than the costs of setting up and maintaining an internal infrastructure. Organisations that do not necessarily operate in the clothing industry, but generate an annual turnover of about a billion could also benefit from outsourcing the entire ledger if they wish to streamline their operations or if they have fewer debtors and invoices. This is the reason why bank managers interviewed claimed that the trend especially in trade credit is gradually shifting from in-house to factoring. These organisations for example, mining houses are benefiting from bank debtor administration expertise, while focussing their resources on their core business function of mining.

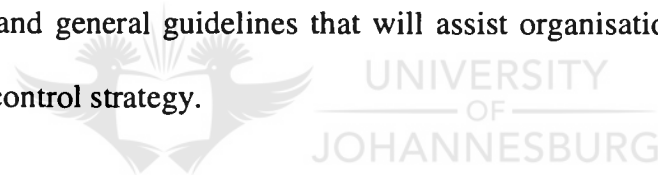
## CHAPTER 5

### 5.1 SUMMARY

The main objective of this study was not to rewrite topics in financial management textbooks but to formulate practical guidelines for managing one the largest assets in many organisation's balance sheets, their debtors.

Specific objectives were to;

- Identify credit control strategies which organisations operating in the South African clothing industry can choose from.
- Explore the identified strategies in detail and weigh their costs and benefits as applicable to the clothing industry.
- Provide broad and general guidelines that will assist organisations in choosing a suitable credit control strategy.



The clothing industry operates within the retail industry which is very wide with diverse goods and services offered under different credit terms and regulated differently by the Credit Agreements Act and the Usury Act to mention a few. The scope of this paper was therefore limited to the clothing industry only even though some of the strategies can be applied by other industries with minor adjustments.

Organisations in the clothing industry can choose between an in-house credit control strategy and factoring. An in-house strategy is where an organisation manages and finances its own debtor's ledger. An effective and efficient credit department is a prerequisite for the success of this strategy. Organisations implementing this strategy



finance the ledger from their own working capital or through other means of short-term borrowing, for example, an overdraft facility or buying stock on credit.

Factoring on the other hand is where an organisation either outsources the entire credit control function to a financial institution that specialises in debtor administration or manages this function internally but discount invoices only. An effective credit department is also a prerequisite for the success of the latter. Financial institutions that participate in factoring offer three packages, namely full service factoring, bulk factoring and invoice discounting.

Full service factoring is where the bank manages the debtors ledger and charges a service fee which is a percentage of the ledger and a discount fee for funds advanced. This package can be offered with or without recourse depending on the division of the bank in which the deal was secured as explained earlier.

Bulk factoring and invoice discounting are similar debtor finance facilities. An organisation manages the ledger internally and discounts invoices as they are raised. The bank only monitors the movement of invoices discounted because these serve as collateral for the funds advanced. The only difference between the two packages is that bulk factoring is disclosed while invoice discounting is confidential.

In chapters three and four the above-mentioned strategies were explored in detail. In chapter three the qualifying criteria for participation was discussed, different packages and costs associated with each package were highlighted. Costs associated with in-house were explored in detail. In chapter four six factors to be considered when choosing a strategy were discussed and these are;

- Financial position of the organisation
- Financial expertise
- Availability of outside debtor finance facilities
- Target market
- Type of the product
- Size of the organisation

If these factors are analysed properly they can provide an indication of a strategy which could enable the organisation to increase cash flow and reduce collection costs. For example, a big organisation that generates a high turnover cannot benefit from outsourcing the entire ledger. A cost comparison between different strategies was done in tables 4.1 and 4.2. These tables showed clearly that big organisations could benefit from implementing an in-house credit control strategy whereas smaller and medium size organisations would benefit from factoring.

## **5.2 RECOMMENDATIONS**

In this section each strategy will be summarised, guidelines for choosing such a strategy provided and the type of organisations that can benefit from each strategy will be suggested.

### **5.2.1 In-house credit control strategy**

It is a strategy where an organisation manages and finances its own debtors ledger. The costs of both managing and financing this function were discussed in detail earlier, in this section only guidelines will be provided with regards to the type of organisations that would benefit from implementing this strategy as follows;

- Organisations that generate a high level of turnover because outsourcing the entire ledger will be very costly.
- Organisations with a large number of debtors and invoices with low values.
- Organisations with large cash reserves to finance their working capital needs because outsourcing carries costs associated with short-term borrowing.
- Organisations that have assets that can be pledged as collateral against an overdraft facility because banks only advance a third of the debtors ledger.
- Organisations that have effective and efficient credit control departments.

### **5.2.2 Factoring**

Factoring as explained earlier is a means of utilising the debtors ledger to generate cash flow by selling them to a factor. The organisation can outsource the entire ledger or manage it internally and discount invoices only. Factors offer different packages under this strategy as follows; full service factoring, bulk factoring and invoice discounting.

#### **5.2.2.1 Full service factoring**

Organisations that can benefit from implementing this strategy are those that;

- Do not have working capital management expertise.
- Are in fast growing areas and do not have sufficient cash reserves to finance their growth.
- Have a few to a fairly reasonable number of debtors and invoices. If they outsource the entire ledger the service fee will be determined by the amount of work involved, and the amount of work is determined by the number of debtors and invoices.

### **5.2.2.2 Invoice discounting and bulk factoring**

There is no difference between invoice discounting and bulk factoring except for the fact that the former is confidential while the latter is disclosed. An effective and efficient credit control department is a prerequisite for the success of both strategies. Organisations do not choose between the two strategies, but the choice is made by the bank on the basis of their qualifying criteria which was discussed in detail earlier. The following are guidelines for choosing the above-mentioned strategies.

- Organisations operating in rapid growth areas that do not have cash reserves to finance their growth.
- An organisation with a large number of debtors and invoices but lacks cash flow to finance the debtor's ledger.
- Organisations that have effective and efficient credit control departments but have inadequate working capital.
- A minimum service fee of R3 500 per month for monitoring the movement of invoices discounted is an incentive for managing the function internally.

### **5.3 CONCLUSION**

Different credit control strategies were identified, costs and benefits for each strategy weighed and practical guidelines for choosing a strategy were provided. But it is important to note that factoring in trade credit is fairly standardised throughout the banking system. In consumer credit however this facility is fairly new and unstructured. Some banks offer this facility through their card divisions while others offer it through their retail divisions. The facilities can be offered with or without recourse and the charges levied differ significantly depending on the bank used as pointed out by organisations A, B and C in chapter three. It is therefore important for

organisations in consumer credit to approach as many banks as possible and compare the packages offered in order to make an informed decision.



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