

Since 1989, fundamental changes have revolutionised the economic, political, legal and social systems in Central and Eastern Europe, and the former Soviet Union countries.

One of the advantages to these countries of entering a free market was that their companies were able to do business transactions without having to make immediate payment. But these new market rules, which were introduced in the emerging countries, caused several problems, including the onset of overdue payments.

In Poland, around 43% of all business transactions are currently made on credit, out of which 30% are overdue. In other Eastern European countries, the proportion of uncollectible debts is 32%, whereas for Western countries it is 37.6%. From east to west, the most frequent reasons for not paying on time are insufficient availability of funds and the use of invoices as a form of financing.

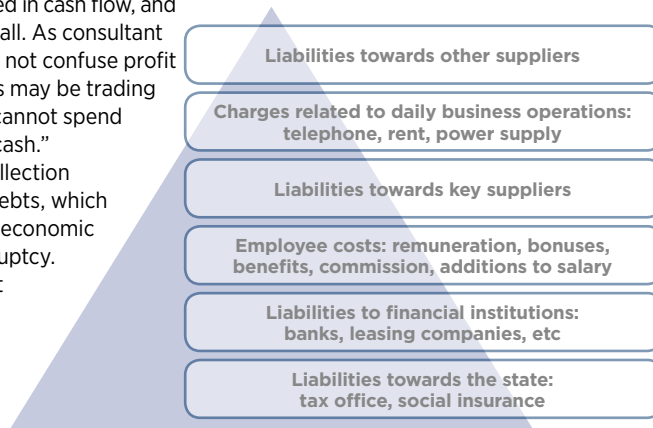
Many companies that have failed recently would have looked very prosperous if just their sales value and turnover were taken into account. Yet, the profits resulting from an increase in receivables were not reflected in cash flow, and this presents a lesson to us all. As consultant Charley Swords puts it: "Do not confuse profit with cash – while a business may be trading profitably, remember, you cannot spend profit, you can only spend cash."

Failure to initiate debt-collection procedures results in bad debts, which can plunge companies into economic crisis and, ultimately, bankruptcy. Entrepreneurs are often not aware of the consequences of outstanding payments, which include the cost of lost opportunities, debt-collection costs and

costs remitted to the state treasury for every transaction. Shorter recovery time guarantees smaller losses for the company. When a company is in financial difficulty, every day of a delay in recovering receivables can play a decisive part in determining whether the business continues or not.

Currently, almost all business-to-business transactions are made on credit, with terms of payment varying. Yet the reasons for overdue receivables are nearly the same in every business sector. One of the major reasons for this is that a company's source of funds is limited, which forces it to prioritise its payables. If the company does not have enough money, it starts to choose among its suppliers, beginning with the strategic ones. If a company is short of resources for day-to-day payments, this may be a result of its chosen order of settling liabilities, which could follow the pattern shown below.

First, companies make payments to the state authorities, which, in the case of late payments, charge penalty interest and quickly initiate recovery procedures. Debtors are afraid of the



## HOW TO MANAGE LATE PAYMENTS

- 1. MAKE IMMEDIATE CONTACT** with the debtor to ask when the overdue payment can be expected. Send the final notice outlining all the payment details. Remember that time is king, especially in debt collection, since research conducted in EU countries has shown that where a payment is three months overdue, the chances of recovering the receivable are 75%. This drops to 50% after six months and 25% after one year.
- 2. WITHHOLD THE DELIVERY** until the payment is received. Get everyone involved. Overdue receivables are not just an issue for financial managers; sales managers can be very effective in terms of collecting debts and stopping the debtors' purchases.
- 3. COMMENCE LEGAL ACTION.** Invest in a good legal adviser to help you to investigate your receivables in the court and to commence execution proceedings.
- 4. WRITE OFF THE DEBT.** The company may write off the receivables on the basis of probability of recovery in certain circumstances, such as:
  - *receivables from debtors who are in bankruptcy or in the midst of a liquidation process;*
  - *receivables from debtors whose request for bankruptcy was dismissed by the court;*
  - *questioning of receivables by debtors; and*
  - *due or overdue receivables for which recovery is very doubtful.*

state institutions, so they have a considerable predominance over others.

Next, there are those payables to financial institutions, mainly banks and leasing companies, that are related to operating activities and allow the entrepreneur to realise key company objectives. Again, the business cannot afford any stops in production or delivery service because of the consequences of overdue payments: the institutions may cancel the contract immediately.

Employee benefits, liabilities to strategic suppliers and payables for day-to-day operations

# Chasing payments

THE NUMBER OF DEBTORS IS CONSTANTLY GROWING AND SO IS THE NUMBER OF BAD DEBT LOSSES SUFFERED BY COMPANIES. WHY DON'T BUSINESSES SETTLE THEIR BILLS ON TIME? MAŁGORZATA WEJER EXPLAINS

are ranked third and fourth on the list because late payments bring no severe consequences. In the case of payments to staff, some employers will assume that people can wait.

Fifth come payables to suppliers of the basic services needed to run a business, for example, gas, energy and telephone providers. One of the reasons why these providers rank fairly low on the list may be the fact they apply ineffective collection procedures.

Last in line are liabilities to suppliers, whose trade credit helps businesses to finance themselves without incurring penalty interest for a delay. So, if your company is not a strategic supplier and does not represent a state organisation, you have to be prepared to wait for payment for a long time. Ironically, the fact that this situation is allowed to exist is probably a result of many entrepreneurs having effective debt-collecting procedures.

While the problem with uncollectable debts applies across Europe, the reasons why companies do not pay differ from west to east. I have chosen one country – Poland – to juxtapose the average results in Europe with those of an exact country.

According to the results (see above), the most frequent reason for delayed payment was insufficient availability of funds. Polish respondents also blamed complexity of the payment, as well as inefficiencies of the banking system, which the other European respondents did not concur with to the same degree. The other worrying reason for overdue payments was the inaccuracy of the information put on the invoice. This simple matter is a typical problem for Polish businesses. It is worth mentioning that a significant proportion of Polish market players use trade credit as a way of financing their businesses. This suggests

## MAIN REASONS FOR PAYMENT DELAYS BY DOMESTIC BUSINESS-TO-BUSINESS CUSTOMERS

	Eastern Europe	Western Europe	Poland
Insufficient availability of funds	58.6%	46.6%	51.2%
Dispute over quality of goods delivered or service provided	11.1%	16.7%	8.0%
Goods delivered or service provided do not correspond to what was agreed in the contract	9.5%	13.2%	12.9%
Complexity of the payment procedure	11.3%	18.0%	19.9%
Inefficiencies of the banking system	10.4%	17.8%	23.4%
Incorrect information on invoice	11.5%	16.2%	18.4%
Buyer using outstanding debts/invoice as a form of financing	30.0%	29.3%	35.3%
Formal insolvency of the buyer (liquidation, receivership, bankruptcy)	25.0%	20.5%	29.4%
Invoice was sent to wrong person	8.2%	12.7%	11.0%
Other	10.5%	6.7%	2.5%

Source: Atradius Payment Practices Barometer – June 2014

that overdue payables are a practice commonly used by Polish entrepreneurs.

### Better late than never

In order to minimise the level of overdue receivables that they have, companies could monitor all of their payments on a regular basis.

The perfect tool to help managers control the outstanding accounts is an ageing schedule that presents a company's invoices and its due dates, usually in a table format. Another method is checking days' sales outstanding, which gives an approximation of the average age of accounts receivables. These techniques inform managers of the current financial standing of the company, so they can promptly initiate its debt-collection procedure.

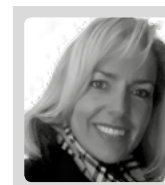
Once this procedure is initiated, the first step would be to investigate why the customer did not make the payment and check when

this overdue payment can be expected. All employees involved in the business transactions should know that deliveries to that debtor will be withheld until the payment is received.

It is paramount that the business's legal adviser be engaged at this stage. If there is no possibility of collecting the receivables, then the accountant should write off the debt, allowing the creditor to adjust previously accrued tax.

### Conclusion

The above-mentioned reasons for not paying on time should serve as a warning against the growing number of overdue receivables. The perfect solution for businesses would be to avoid overdue receivables altogether, but this is almost impossible. If your business struggles with an increasing number of bad debts, then all of your actions should lead in one direction: effective and immediate debt collection. ⚡



**Małgorzata Wejer** is an academic business and financial teacher. She is a member of the Polish Corporate Treasurers Association. Contact her at [malgo.wejer@gmail.com](mailto:malgo.wejer@gmail.com)