



Credit - Extending Credit to Customers



TOWNSENDS BUSINESS
& CORPORATE **LAWYERS**



What I need to know about...

Extending Credit to Customers

Why do businesses extend credit?

The biggest lenders to business, after banks, are trade creditors. When suppliers extend lengthy periods of credit to their business customers, those customers can often manufacture, import, distribute, market, sell and be paid for their products before having to pay their suppliers. They are paying suppliers from money received on sales rather than paying in advance from working capital.

Since extending credit to your customers is no different from granting a loan, it should be managed the same way as a loan.

Getting to know your customers

Would you give a loan to someone who was a complete stranger you knew nothing about? Of course not. So why do businesses often grant credit to brand new business customers they know little about? It is amazing how often businesses have to chase unpaid debts without having all of the important facts about their customers.

Your business should have a standard credit application form which captures all the important, relevant information about the customer. This should include: the precise name of the customer, whether or not the customer is a company, where the customer's business premises are located, and the identity of the owners and directors.

The application form can also confirm that the customer's directors (if any) will guarantee repayment and that this guarantee forms part of the supply contract. The form would also ask the customer to provide trade references and bank details and to give some indication of their assets and trading history. This information is vital when deciding whether or not to extend credit (ie. a loan) to the customer.

Complete due diligence on the customer

When considering extending credit to a customer do at least the following:

- obtain trade and bank references
- commission an experienced credit agency to carry out a credit check (if the amount is significant)
- find out precisely who they are by carrying out company searches, bankruptcy searches, business name and court writ searches.

Getting security

You wouldn't give a loan to someone you barely knew and not ask for any security? So why do businesses grant credit on an unsecured basis just to get one more customer? If they don't pay, it is hardly worth getting them.

There are a number of different forms of security that a supplier can use to secure credit advanced to a customer. While it is not usually possible to obtain a real estate mortgage, some less formal types of security could provide reassurance.

- Personal guarantee: If the customer is a company, the directors should personally guarantee the credit. If the customer is an individual or partnership ask them for a personal guarantee from a third party such as a family member.
- Retention of title clause: Your terms of sale should include a clause which states clearly that ownership in the goods you have sold does not pass to the customer until they pay for the goods, even if the goods have been delivered. There are some technical rules for drafting these clauses in order to make them fully effective. An effective clause of this kind may enable you to take back the goods if the customer fails to pay for them.
- Acknowledgement of debt: This is not so much a security as a clear statement by the customer that money is payable to you. It prevents the customer from trying to defend any litigation you need to bring to recover the money.
- Others: Other forms of security you could consider include a personal property security over some of the customer's assets, a charge over the customer's book debts or an assignment to you of a particular debt owed to the customer.

Whichever security you choose, or you can convince the customer to give, remember that a customer is of no use to you unless the credit you advance to them ultimately leads to their success and, as a result, payment of your bill.

You must also ensure that any security is registered on the Personal Property Securities Register so that you can establish your priority to be paid over any later creditors.

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