

# Managing the Debt Drain – the critical issues for small business

February and March are traditionally the worst cashflow months for small business – the Christmas rush is over, the Business Activity Statement is due, and payments slow down with a dip in consumer spending. You might be ok but your customers could be under pressure and often whoever wields the most influence gets paid first.

No one likes a late payer and two Government measures tackle the small business debt issue from different ends of the spectrum. I take a look at the issues and their impact on business, and what you can do about managing obstinate debtors.

### **ATO adding tax debt to your credit record**

From 1 July 2017, the Australian Taxation Office (ATO) will inform credit rating agencies of businesses that have outstanding tax debts. Given 65.2% (\$12.5 billion worth) of these late payers are small businesses, the move will put significant pressure on business operators to prioritise tax debt above other creditors.

Announced in the Mid-Year Economic and Fiscal Outlook (MYEFO), the plan will see the ATO disclose the tax debt information of businesses that have "... not effectively engaged with the ATO to manage these debts" to credit agencies. This means that if your business has a tax debt and you have not taken steps to work with the ATO, they will ensure that you cannot access new finance or potentially maintain existing finance levels without first addressing the debt to the ATO. There are two problems with this approach. The first is that once your credit rating is downgraded, it's very difficult to repair. The second is the legitimacy of the ATO's tax debt claim – what if they it is wrong?

The measure will initially only apply to businesses with Australian Business Numbers and tax debt of more than \$10,000 that is at least 90 days overdue. I have little doubt however that this measure will eventually extend to all tax debtors.

The important thing is that anyone with an outstanding tax debt engage with the ATO. This will prevent the credit agency threat being triggered. If you are in this scenario, your tax agent can help by engaging the ATO on your behalf.

### **Why big businesses don't pay small business on time**

At the other end of the spectrum is the Payment Times and Practices Inquiry by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO). The inquiry's issue paper reveals that collectively, Australian small businesses are owed around \$26 billion in unpaid debts at any one time. In the last financial year, late payments have increased for six out of ten SMEs with one in four businesses experiencing an average payment delay of 31 to 60 days past agreed terms.

Debt plays a significant factor in a business's cashflow and survival. If larger businesses don't pay smaller suppliers within the terms of trade, the small business often has to resort to external funding to manage the cashflow requirements of the business.

The inquiry is looking at options to improve the payment times of large business. Some of these solutions are already in play in some States such as a requirement for large projects to use supply chain finance where project bank accounts hold funds in trust to ensure supply chain participants are paid. Other solutions are in the 'naming and shaming category' where large businesses would be obliged to report their current payment times or for smaller businesses to report late payments.

The inquiry is expected to deliver its final report to Government in March 2017.

### What to do about debt

Dealing with delinquent debtors is painful, particularly when you can't afford to lose the customer. The most obvious tactic is to stay on top of debtors: Ensure that your contracts and invoices have clear payment terms, and you have a procedure to follow through once a customer breaks these terms. Importantly, ensure you keep a record of actions you take to recover debt. This record will come into play if you have to use a more formal resolution mechanism.

Ultimately, some customers will not pay you even if your terms are clear and you have done everything in your power to recover the debt. Often small businesses just give up and don't deal with the customer in question again. Some of the other options available to you are:

- Final letters of demand with the relevant court documents attached. There are a growing number of legal document providers with clever products for this that take you through the Letter of Demand to the appropriate court documentation. Sometimes the letter will be enough to trigger action from the debtor to pay but you must have the intent of following through.
- Engage a debt recovery agency. Commission rates for debt collection services vary between 5% and 30% of the value of the debt.
- Sell the debt for a small percentage of the owing value.

*"Whenever a business that offers credit to customers fails, mistakes in debtor management will inevitably be one of the contributing factors in the collapse of the business. Very few of us enjoy playing the role of "debt collector" to chase our customers / clients for outstanding money, which is why many small businesses struggle with managing debtors. While there will always be those few troublesome debtors, the best approach is to review how you do business and offer credit in the first place – talk with your advisor about strategies for improving your business processes so that debtor management becomes less of a burden for your business."*



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