Covering Credit Bulletin

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Website:	www.covering-credit.com	
Email address:	mcdennis@covering-credit.com	

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Collection Tips and Tricks

This is an ongoing series of ideas you can use to handle collection problems more effectively.

1. Never allow your customer to know how badly you need their payment. Even if the collection call you are making is the most important call of the day, the week or even the month, try to make it sound routine. If you suggest to the customer that it is critical to your company to get a commitment or a quick payment, your bargaining position is weakened.

2. What a customer suggests an extended payment plan; require them to put their proposal in writing. If they are unwilling to do so, it is likely that there were serious about debt repayment.

3. Establish simple collection targets. Here are two examples: (a) every customer should be called by the time their account is more than seven days past due, and (b) every past due accounts should be called no less frequently than once a week after the first collection call.

4. Strive to develop a natural and interactive style when communicating with customers to inquire about the status of past due invoices. You are unlikely to impress anyone using your massive vocabulary by selecting a one dollar word when a one cent word would do just as well.

5. For every collection call requiring that you leave a voice mail message, make certain that you repeat your name and telephone number twice.

6. If you must leave a voicemail message, make it seem urgent. Ask the customer to return your call that day.

7. Make certain that collection calls are prioritized so that larger past due invoices are called sooner than smaller balances due.
8. Assume that customers will disregard and discard any routine collection correspondence you send. With this in mind, limit your use of collection letters and dunning notices.
9. If you have an account on hold over a seriously delinquent balance, make certain to tell the customer. Otherwise, you're wasting leverage that you have to get paid.
10. Before ending a collection call, it is not enough to know when a customer will be paying a past due balance; it is equally important to know why the customer's account is past due. If you don't have the answer to this question, ask.

Excerpted from "1001 Collection Tools, Tips and Techniques" by Michael Dennis.

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<u>Reader's Questions</u>

Question: Periodically, we are asked to establish open account terms for relatively new companies. Often, these new customers usually have no established credit history. They are startup companies, meaning that there is virtually no information available with which to make a decision about their creditworthiness. How would you handle this particular situation?

Answer: Cautiously. Establishing open account terms for newly formed companies can result in significant credit risk for the creditor company. Usually, the credit department is not incentivize or encouraged to take big risks relating to extension of credit to new and marginal accounts. Experienced credit professionals know that one of the complaints that they frequently hear in this scenario is that no one is willing to take the first step by offering a new company open account terms. To some extent, this complaint is accurate. However, it is not because credit professionals refuse to take risks. Instead, the types of risks that we do accept are expected to take are ones in which we have a high degree of certainty about payment.

Question: What do you think of incentive programs for commercial collectors?

Answer: I think that if I were a young and aggressive collector that I would relish the opportunity to earn a bonus based on my performance. I think that this type of program is not motivating to everyone, but that the benefits

clearly outweigh the costs - provided that the program itself is structured in such a way that the bonus does not become automatic. In other words, to earn a bonus collectors should perform significantly above what would otherwise be considered at an acceptable level.

Q. We have been having trouble finding a qualified commercial collector. We have contact with the local Credit Managers Association without success, and the help wanted ads running in the local newspapers unfortunately have not attracted the quality of collector were looking for. I do not have the money to hire a headhunter to find us the ideal candidate. Do you have any suggestions?

A. Not many. One suggestion would be not to give up too quickly on any candidate. Even if you don't have time to interview every applicant personally, telephone interviews takes less time and often enables the hiring manager to sort the wheat from the chaff. If this is a true collection position, consider hiring someone with experience in consumer collections. As a general statement, consumer collection specialists usually work in a high paced, high stress environment in which they are expected to make far more calls each day than the typical commercial collection specialist. Therefore, collectors with "only" consumer collection experience often have readily transferable skills in addition to thick skins, and a strong work ethic. At least that has been my experience in the past.

Q. One of our customers has an open credit balance which is more than two years old. Can we absorb it, or must we return it?

A. Usually creditors are required to return credit balances. If the credit balance in question is a credit memo and if you determine that the credit memo was issued in error, you can reverse it. However, if you determine that the credit was issued error or if you find that a customer erroneously overpaid an invoice or perhaps they paid your company in error then you have no choice but to return the money to your customer. The other lawful alternative involves sending the money to the state to hold for safekeeping if the customer has moved. This process is referred to as escheatment.

Q. I took your advice and called a past due account within three days of an invoice becoming past due. The customer complained to me and to my CFO that I had overstepped my responsibilities, and in doing so had damaged our company's relationship with this customer. Now I am in trouble with my boss. How would you respond to this criticism?

A. I am not sure I understand the question. If you're asking how I would respond to the criticism that you were blamed for taking my advice, my comment is that I stand behind the advice that I offered. Most customers in my more than 25 years of experience in this industry do not take offense when a creditor calls to inquire politely and professionally about the status of a past due balance.

If you're asking if I have any comments about your manager's decision to side with the customer, I think that it is fair to say that I am both surprised and perplexed by his or her actions. Most companies not only allow their collection department the latitude to contact customers promptly once the account becomes past due, they actively encourage their collection team to contact customers and pursue payments assertively and quickly.

Q. I have been invited to apply for a position as a credit manager an unrelated company in an unrelated industry. It seems to be a good employer, and this would be a promotion. Unfortunately, I have no experience in the industry of my potential employer, and I am concerned that there will be unexpected problems associated with transitioning from an industry I know well to one in which I know none of the customers. What your thoughts?

A. I have worked for and consultant with a number of companies over the last 25 years. At no time in this process did I ever feel incompetent or unskilled. There are specialties within the commercial collection field. For example, companies that supply building materials often expect their credit department staff to be familiar with the use of mechanics liens. However, in my experience, credit professionals usually have little trouble transitioning from one position to another because there job skills are usually readily transferable. My only advice would be to accept the job if you feel that this is a good business decision for you and your family - and to reject the offer f you have concerns about your potential new employer’s long-term prospects, working conditions, or in the interpersonal dynamics that your experience during the interview process or see in the workplace.

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<u>Keeping Credit Files Current</u>

It is always problematic when an account becomes seriously past due or when a debtor company files for bankruptcy protection or otherwise fails to pay an outstanding debt. This problem is made worse when the credit department does not have current information in the offending customers credit file.

The department manager should establish clear rules relating to how frequently customer files should be reviewed and updated. In some instances, limited budgets constrain the credit department from performing updates as frequently as they would like. Nevertheless, the goal of every department should be to review each active account at least once each year. Of course, there are exceptions to this rule but the exceptions tend to shorten the review cycle time. For example, if a customer becomes seriously past due, then it would be appropriate to update the credit file before deciding whether or not to continue to extend open account terms to that once delinquent customer.

If you are forced to prioritize or limit the number of reviews performed on customer accounts, consider limiting your updates or reviews to: (a) new accounts, (b) accounts that have become severely delinquent and (c) customers with your largest open account balances. This way, you will be mitigating to the extent possible bad debt losses and serious delinquencies despite the constraints placed on credit department.

One final comment: I encourage every credit professional who has had constraints placed on her or his ability to update files on a regular basis to share with senior management, in some formal manner, their concerns about the additional risk placed on the company and the investment in A/R when the company's credit files are not updated on a regular basis. If senior management understands and accepts the risks inherent in a decision to limit the resources, time, and money allocated to the credit department to update credit files, it is up to the credit department to do the best that can be done with limited resources available. On the other hand, if you are unfortunate enough to work for an organization which limits your ability to manage and control risk by updating credit files on regular basis - but nevertheless holds your department to high goals, it may be time to either make your concerns known more emphatically more to seek employment elsewhere.

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DSO and DDSO

Many companies use DSO which is the acronym for days sales outstanding to measure the credit department's ability to manage risk, to control delinquencies and to resolve customer deductions quickly. Unfortunately, DSO is a crude instrument for measuring credit department performance because DSO is heavily influenced by actions or decisions made outside of the credit manager's control. For example, if the sales department offers customers extended dating, DSO will increase through no fault of the credit department. Similarly, if the number of errors made in order entry increase, so will the number of disputed invoices and deductions and as a result DSO

will also increase. If senior management requires the credit department to accept more risk then DSO is likely to increase.

DDSO, the acronym for days delinquent sales outstanding. DDSO differs from the DSO calculation because it measures delinquencies. DDSO, also known as the Average Days Delinquent, calculates the average time from the invoice due date to the paid date. It provides information necessary to evaluate individual collector's performance as well as the credit department's performance as a group. The advantage of using DDSO is that the credit department, at least in theory, has direct control over the amount of delinquencies outstanding.

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