Commercial Collection Guidelines for Credit Grantors

INTERNATIONAL ASSOCIATION OF COMMERCIAL COLLECTORS
Est. 1970
IACC

Contents

A Personal Note to Credit Managers 2

Credit Granting and Collecting 3

Internal Credit Control 5

- Credit Policies
- Opening Credit Lines
- Billing Practices
- Collection by Letter
- Collection by Telephone
- Collection in Person

Commercial Collection Services 16

- Referral to a Specialist
- Selection of a Service

Commercial Collection Guidelines is a publication of the International Association of Commercial Collectors, Inc.,
4040 West 70th Street, Minneapolis, MN 55435
http://www.commercialcollector.com

A Personal Note to Credit Managers

This booklet has been prepared to assist commercial account credit managers and their staffs in evaluating receivables and collecting accounts regardless of size or scope.

This guide has been prepared by members of the International Association of Commercial Collectors, Inc. (IACC), the largest community of commercial collection professionals in the world. IACC members serve nearly every major metropolitan area and thousands of small communities throughout the United States, Canada and 37 other countries.

Commercial Collection Guidelines is not intended to teach professional credit managers how to operate in their specialized fields. Rather, the purpose is to provide guidelines for the extension of credit. In addition, this booklet provides information on how and when to enlist professional commercial collection services.

IACC members share with others in the credit industry recognition of the important position of commercial credit managers and their staffs. The increasing number of seminars, conferences and graduate courses offered to commercial credit personnel is a good indicator of the importance of your function.

We hope that this booklet will assist you in establishing and following effective credit department policies and procedures, especially those involved with slow-paying accounts.

Credit Granting and Collecting

It is estimated that literally tens of billions of dollars in delinquent commercial credit is currently being carried on the books of both American and international businesses.

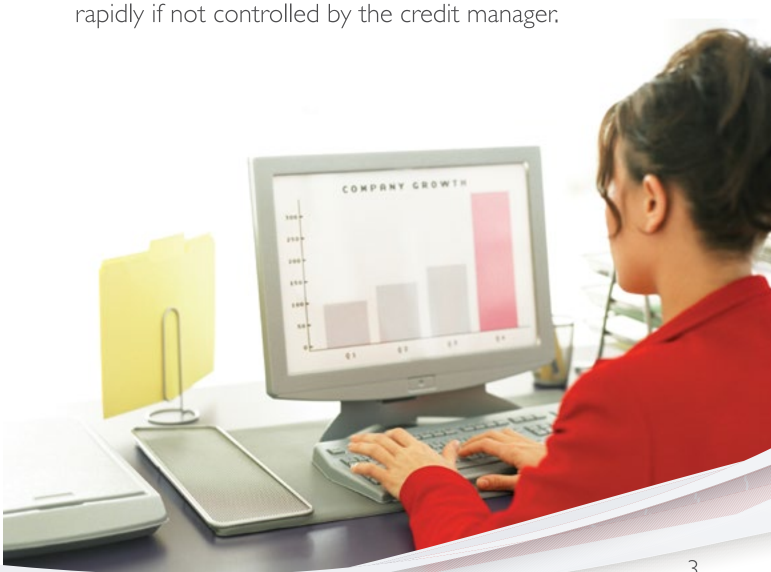
This figure fluctuates as our economy expands or contracts. Increased competition, diversification of product lines and/or governmental pump-priming to industry all seem to indicate, however, that these figures will continue to move upward.

Regardless of the state of either the national or international economy, the need to grant credit and to collect receivables using professional methods remains important to all businesses.

Volume of Credit Sales Are Significant

Most commercial companies sell about 2 to 5 percent of their products for cash. The credit department is responsible for the other 95 to 98 percent of the goods and/or services sold.

Businesses have varying percentages of their liquid financial resources tied up in receivables. Actual losses might range from one-half of 1 percent to 5 percent of sales without serious results. This depends on mark-up for profit and other factors. Losses can grow to significant sums very rapidly if not controlled by the credit manager.



Accounting and Finance Knowledge is Needed

Knowledge of accounting and finance, along with tact and foresight in customer relations, are qualities that characterize the professional commercial credit manager.

You should have some background in accounting in order to evaluate financial statements submitted by prospective customers. You should have additional financial background or training so that you can estimate risk factors, company profits and recovery rates. In this capacity, you must be knowledgeable about the cost of money outstanding and its value to your employer.

Good Customer Relations Are Important

You and your department must also be attuned to customer relations in order for the company to prosper through growth. It is very easy to say "no" to prospective customers, and it is very easy to firmly demand payment. But, if this attitude raises havoc with sales, then the credit department is not performing its complete function, which is to create a balance between sales and recovery of money.

The job of the credit manager is an important position in this industry. The credit manager's effectiveness is crucial to the success of the company, and because of this, management will seek help from the credit manager when making important business decisions.

Internal Credit Control

Credit Policies

International economic conditions change. Regional market conditions change. Therefore, management goals change.

It is the management's obligation to advise and consult with the credit department when considering a change of policy. Management should call for the expertise of this department when drawing up new programs relating to sales and the subsequent recovery of receivables.

It is your responsibility in the credit department to be aware of changes in economic conditions in order to advise and assist your management team with possible difficulties that may ensue.

The credit department is a vital segment of a company's success. You must be aware, you must be consulted with and you must contribute to the decisions involving proposed changes. Company growth and its credit policies are inextricably tied together.

Credit Controls May Be Relaxed

For example, if the company plans a sales expansion program through increased geographic exploration, there may have to be a relaxation of strict credit policy controls in those areas. There may be a dollar amount under which no credit check will be made. The decision may be that any order under $200 will be shipped at once rather than spending time and money for credit checking.

Such a policy may create a problem of money recovery, but it is a situation that is tolerable. You must set up tight controls so these new accounts are not neglected. You recognize that there will be a percentage of credit loss with such a sales expansion program. You must work closely with the salespeople in order to encourage this expansion while avoiding unnecessary risk.

Commercial and industrial experience has proven the following percentages: of 10 new customers, six will pay on time, two will pay in 60 to 90 days and two will become collection problems.

Always watch your new sales. As money becomes tighter, you will receive one-time sales from firms that may be experiencing financial problems. These customers will bounce from business to business and need your close attention.

The company can plan its expansion program based on this experience: of the 10 new sales, two to four will be one-time sales and bring a small credit loss; six to eight will become valuable customers in the future, two of whom will consistently pay in 60 to 90 days. Using these figures, the company can project sales expansion and the controller can project percentage of recovery. Of course, these figures vary by industry.

Faster Recovery May Be Required

Your industry may experience a tight supply for its raw materials or a profit squeeze through increased labor or supply costs. In this environment, growth through new customer acquisition may not be critical. Instead, supplying your existing accounts may be your highest priority.

In this instance, the credit department may be required to recover receivables more rapidly because the profit margin is reduced. The 60- to 90-day customers must be induced through closer contact—by reminders, notices, letters and tactful personal attention—to bring themselves within your company's prescribed terms.

It is possible that your company may decide to reduce its customer list and sell more of its goods to fewer accounts. This is a policy of reducing inventory, storage space and employees. The credit department will then have to police larger—but fewer—accounts.

Opening Credit Lines

When extending credit to a new customer, the following basic information should be gathered for your credit evaluation and kept on file:

- **Is the applicant firm individually owned, a partnership or a corporation?** You must obtain full names of owners, partners or officers and all business addresses. A follow-up form letter to the hastily approved customer may supply this information, and the local city directory may be helpful with details of ownership or tenancy. You should, however, get the information before delivery of the merchandise.

- **How long has the applicant been in business?** Statistics show that 50 percent of business failures are firms less than one year old, and 75 percent are less than five years old.

- **At what bank does the applicant do business?** What is the average size of his or her bank balance and are there any loans outstanding? The customer may have a financial statement which will reveal this, and certainly a phone call to their bank manager is in order. They might only confirm the existence of an account, unless your customer preapproves release of the details. A carefully worded and signed application will gain you the most information.

- **What do the records show?** Are financing agreements kept, or have legal suits been filed? If the amount of credit requested is substantial, additional financial information may be secured from an outside credit information source such as another supplier, trade association or business reference.

- **What are some of the business firms with which the applicant is currently dealing?** Check with at least three company references to determine how much credit has been extended and the creditors' payment experience with the applicant company. This procedure may help you and other businesses in exposing customers who exploit their suppliers.

Watch for Patterns of Problems

Analyze those customers who have become collection problems and note reasons for their delinquency. A pattern may be revealed.

Your review may reveal that some collection problems involve businesses which were in operation less than a year at the time credit was originally granted. This is a "red flag." It does not mean that a new business should be denied credit, but it does mean that additional information should be obtained to ensure that the business is potentially a good credit risk.

Sometimes the credit manager will have to deal with a salesperson who is overanxious or undertrained. In the desire to sell, they may make promises that lead to collection problems. When such a pattern develops in an area, advise the sales manager about the problem. It is often expedient with large orders to send the potential customer a letter spelling out credit terms.

Some Delinquencies Are Unavoidable

Unforeseen conditions and unavoidable delinquencies are inevitable in granting credit.

It is usually an acceptable company policy that credit losses within certain percentage limits can be sustained, as growth can only be achieved by reasonable risk taking. Reserves for bad debts and collection costs are an acceptable and recognized expense for business. A too-tight credit policy can dry up potential growth, and a too-loose credit policy can be a great expense.

By granting credit intelligently and by following good billing and collection procedures, it is possible to hold risk to an acceptable figure—to a balance between company growth and losses due to bad debts.

Billing Practices

Speed is really the key to collecting past due commercial accounts since commercial accounts depreciate more rapidly than consumer accounts.

In planning and carrying out a billing system, a credit grantor should recognize that time is the safest refuge of any debtor. The more time they are given, the less likely they are to pay. Hence, sales documents should be explicit about payment terms, return privileges, interest charges on overdue accounts, guarantee and service costs.

Varied Collection Programs Used

Collection programs should be organized around the company's existing facilities. A series of letters used together with an account aging spreadsheet or data printout will help to track slow-paying accounts.

All systems should have an organized and mechanical follow-up of accounts at regular intervals, for instance, 10, 30 and 60 days past due.

It is essential to establish regular billing and collection procedures. Follow up on every account to the point where contact—or lack of contact—with the customer indicates some alternative action should be taken.

Assist Collection from the Start

Built-in collection controls at the time of sale often assist in receivables recovery and help avoid delinquencies. These include such items as sales contracts or a well-defined vendor's purchase order with conditions of sale clearly spelled out. Appropriate terms should be printed on sales documents (contracts, invoices, statements) clearly and without equivocation. Such terms will include notice of interest charged on overdue accounts and discounts granted for prompt payment.

Internal control of receivables should include an aging policy that permits periodic assessment and meshes with collection routines. The average break-off point for referral to professional commercial collectors should come from the aging at 60 or 90 days past due. Some circumstances, however, may require a more timely referral.

After a first statement has gone unheeded, start your collection procedure. Any program that permits three statements—or a two to three month time lag—before the first collection step is taken will result in a lower recovery ratio.

Any procedures for handling slow-paying accounts should emphasize speed in contacting the delinquent bill payer. A company with a past-due account on its books is probably in the same condition with a number of other suppliers. The debtor may be on the verge of serious financial trouble, and the creditor who moves first is the most likely to recover their money.

Collection by Letter

Letters are a basic collection technique used by nearly all credit grantors to collect past-due accounts. They are usually the first approach to a debtor.

It is sometimes beneficial to bring the sales manager into this step of the collection program. Information concerning the delinquency can often be obtained from the sales manager.

The number of collection letters in a series should be kept to a minimum. Experienced commercial credit grantors have found that there is a point of diminishing returns that is generally reached after the first letter goes unanswered. The reason for a limited series is that letters are one-way communication. Letters can only attempt to motivate a customer to pay the debt. A letter usually cannot uncover the customer's reason for nonpayment though it must subtly ask, "Why is this not paid?" while asking for payment in full.

Tips for Collection Letters

Consider the following when writing collection letters:

- **Include all basic information.** The letter should state how and when you expect payment, and should suggest why the account should be paid in full. It should motivate the debtor to actually do this—now.

- **Use an effective writing style.** Most collection letters are written to appeal to the writer and not necessarily to the delinquent customer. Appeal to the debtor.

- **Use the "you" approach.** Too many letters emphasize "we." Avoid such phrases as "we insist," "we remind" and "we want." Include the customer into the letter, saying such things as "you will appreciate" and "it is to your advantage." Remember that the debtor is not interested in your best interest, but in their own.

- **Don't say, "We will not write again."** This assures the debtor of their success in evading payment, and a phrase such as "to keep your good credit rating" may be impractical in a situation that has reached a certain stage of collection.

- **Use motivating factors.** If a customer has not paid, there is a reason for it. Although a letter cannot discover the reason, it can give the customer a way in which they will benefit. For example, by paying now, they may continue to enjoy "open account" terms.

- **Appeal to pride, honesty and security.** As a last resort, appeal to anxiety. These are factors that can be used to bring prompt payments.

- **Address the letter to an individual.** Direct it to the person who is authorized to initiate payments. Keep the letter short, be as brief as possible and cover only the most important points.

- **Sign the letter personally.** Do this even if it is a form letter.

- **Follow consumer guidelines where appropriate.** If there is any chance your matter may be construed as a consumer claim rather than commercial, it is advisable to include language required in collection letters under the Fair Debt Collection Practices Act, including the "validation language" in the initial communication as well as the mini-Miranda in the initial communication and words to the effect "our office is a debt collector" in all subsequent communications. The exact language is available in the *Ideas for Collection Letters* section of this brochure. An example of such a claim would be a cellular phone contract or other product or service intended for a business and its employees, but the product or service is actually used for personal, family, or household purposes, such that a judge could reasonably construe the matter to be a consumer debt.

Ideas for Collection Letters

Your first collection letter could be this brief message:

> Your account is seriously past due. Please send your check by return mail. Failure to make payment will prevent us from authorizing additional purchases to your company's account.

Ten days later, if you have not heard from the account, something like this could be sent:

> Our previous letter to your company regarding its overdue account has gone unanswered. It is essential that you immediately send payment in full or send a substantial payment with a firm arrangement for the balance. Failure to respond to this request will force us to take additional collection action which may prove costly for your company.

If a third letter is needed, it could be sent 10 days later and contain wording similar to this:

> Unless payment of this seriously past due balance is received by (give date, about 10 days from the date of the letter), your account will be referred out of this office for final collection action. So your account with us can remain open and so additional costs will not be charged to your company, it is extremely important that you respond to this letter today.

If you determine your letter should comply with the Fair Debt Collection Practices Act (e.g., the matter could be construed to be a consumer claim), you should include, in the initial letter language which allows validation of the debt, as follows:

> This communication is from a debt collector. This is an attempt to collect a debt and any information obtained will be used for that purpose.

> Unless you notify this office within 30 days after receiving this notice that you dispute the validity of this debt or any portion thereof, we will assume this debt is valid. If you notify this office in writing within 30 days from receiving this notice that you dispute the validity of this debt or any portion thereof, this office will obtain verification of this debt or obtain a copy of a judgment and mail you a copy of such judgment or verification. If you request of this office in writing within 30 days after receiving this notice, this office will provide you with the name and address of the original creditor, if different from the current creditor.

In subsequent written and verbal communications (all communications) the debtor should be told that your office is a debt collector and/or, as some agencies still do, state:

> This communication is from a debt collector and is an attempt to collect a debt. Any information obtained will be used for that purpose.

Collection by Telephone

The telephone enables a credit manager to make many contacts in the shortest period of time. A call permits you to present your case to the debtor for immediate response. During the conversation you can determine whether the claim will be paid in full and when. This is the time to determine reasons for nonpayment.

Advantages in telephoning are the two-way line of communication and the speed in obtaining a response.

For most calls, follow a set pattern:

- Call directly to the person in charge.
- Identify yourself and your company.
- Ask for payment in full at a specific date.
- Suggest a solution once you have determined the real reason for the bill not being paid.

Main Reasons for Nonpayment

The most difficult part of a call is to determine the real reason the bill has not been paid. There are usually three reasons for nonpayment.

1. **Lack of funds or belief that there is a lack of funds.** Most nonpayments result from real or imagined lack of funds. You have to determine which of the two is truly the case. Frequently, businesses have assets they don't recognize. Sometimes, they may be short of funds because too much is tied up in accounts receivable. You can point this out and suggest ways in which they can release some of their capital and keep their accounts receivable more in line.

2. **Dispute.** Disputes can be discussed to determine whether or not they are valid. The valid claim must be adjusted quickly and fairly. The nonvalid claim should be exposed and immediate payment should be requested.

3. **Refusal to pay.** If it is a refusal to pay, your next step has been dictated by the customer/debtor. You must take third-party steps to enforce payment.

Pin down the arrangements agreed upon. Make sure your customer puts them down in writing while you wait. Remember, your customers have past due obligations to other creditors, and you are competing for their money. Be sure they do not send your money to some other creditor. Follow up with a notice reminder or form letter.

Collection in Person

If all else fails and if it is practical, the final step is to arrange a personal interview with the customer.

Personal interviews are the strongest demand for payment. The interviewer must show authority and positive ability to negotiate the claim, if necessary. At this time, the customer must pay, show valid proof of a dispute or be completely honest in stating their financial position.
A collection interview requires business-like persistence, firmness, tact and an impersonal attitude.

Aids Needed on Collection Visits

Try to get the customer to come to your office. If a collection visit to the customer is necessary, you may need these items:

- A copy of the customer's ledger.
- Copies of invoices involved.
- An envelope addressed to you.
- Copies of correspondence.

Basic steps in a personal interview are the same as on the telephone. You should confirm all information on your application form and make sure it is up to date.

Then you should determine the problem. Once again, it will be one of three things: a lack of funds or a belief that there is lack of funds, a dispute, or a refusal to pay.
If it is a refusal, you have no choice but to place the account with your collection service. If it is a dispute, once again you can immediately decide whether it is a bona fide dispute or an imaginary one and take the necessary steps to resolve it.

Disputes, valid or invalid, are handled in the same manner as in the telephone interview.

Finally, when you have found a solution, if it is not a payment in full, put the arrangement in writing.

Salespeople as Collectors

Using salespeople as collectors is a subject which occasionally arises when the credit department completes its automatic procedures and when the company policy is heavily sales oriented.

The sales management theory is that salespeople know their customer and, therefore, can ask them for past-due money. The theory may be valid, but in practice, it is not usually successful.

In fact, it may be very costly. Consider these factors:

- The good salesperson has been trained to sell their company's goods and services and is not trained for collection work.
- The poor salesperson may have been a source of the delinquency because of promises made in order to get the sale.
- Time spent on collection of an account may detract from time allotted for selling.
- The credit department must set a follow-up system to watch for the salesperson's reports.
- Adjustment of the account should be the responsibility of a salesperson's supervisor in consultation with the credit department.
- There may be a 30- to 45-day additional delay before more positive action can be taken by the credit department.
- There may be inter-departmental resentment. The salesperson is being asked to do a credit department job, and this should not be their responsibility.

In summary, there are some exceptional salespeople who can sell and collect accounts. Usually, the combined duty is not a good policy because of delay, cost and resentment.

Key Word for Collection: Speed

Whatever the method of collection, the key word is "speed." The sooner contact is made with the debtor, the sooner the money will be forthcoming or the sooner you will know that outside assistance is needed.

Commercial Collection Services

Referral to Specialists

When the credit department loses effective contact with the debtor, it is time to refer the account to a commercial collection service.

If the debtor has ignored requests or has broken payment arrangements, continued internal efforts may not be worth additional time. They will cost your firm money.

Of course, referral should be made in accordance with the company's aging policy unless special circumstances arise.

Being responsible for the principal's assets, the credit manager will have set up internal controls that will account for a high percentage of receivables. But the small remaining percentage should be placed with a specialist—a professional commercial collection service.

This option provides many advantages for the credit manager:

- **A collection service has special procedures and a position as a third party that commands attention from a debtor.** It provides efficient and immediate collection contact and advises at once if preemptory salvage action is required. It is persistent and assertive in obtaining prompt action for its clients.
- **A collection service has strong psychological advantage.** The debtor is no longer dealing directly with the seller. They are dealing with a third party whose sole function is to collect this account. The debtor knows this, and they know that all legal means of collection will be used.
- **A collection service allows the credit department's time to be used more productively.** It is estimated that 5 percent of delinquent accounts take at least 20 percent of the credit department's time. This time is consumed by letters, follow-up notes, telephone calls and other communications. By using a collection service, more time can be given to internal credit controls and, in the long run, fewer accounts will be allowed to reach severance status.

Experienced credit and financial people are aware of the value of a collection service in maintaining the continuity begun in their internal control system. They know that delinquent accounts are not always "bad." But contact time, cost of money outstanding and pressure from new accounts for collection indicate to them that professional assistance is a practical consideration.

The Role of the Attorney

The commercial attorney also has a role in the collection procedure. When it is determined that an account cannot be collected by collection service procedures, an attorney may be retained. Most commercial collection agencies have effective contacts for placement of claims with commercial attorneys.

Exchange of business between collection services and attorneys guarantees informed attention for the credit grantor wherever the debtor is located. If suit is justified, it will often be recommended that the claimant advance the necessary costs and provide the backup paperwork.

It is often asked why there are such long delays in resolving a simple collection matter through the legal process. The reason is that the debtor, whatever their excuses may be—financial problems, an honest dispute or an unfounded desire to stall—uses the legal machinery for delay.

For example, they may hire their own attorneys and instruct them to use every tactic that the law allows to delay or defeat the suit. They may find many reasons, all acceptable to the courts, to delay their appearance. They may enter a counter claim against the creditor. They may offer a settlement. Finally, if the claimed obligation is large enough, they may request a superior court or a jury trial.

Often, the company's reasons for delay are linked to financial problems. Throughout these long procedures and pleadings, they avoid paying their creditors and, thus, buy time.

Additional costs and possible long delays through the legal process are the primary reasons that most credit managers use professional collection services as the first step and the legal process as a last resort. A service such as a third party representative has the expertise to maintain close contact with a debtor, to police a schedule of payments and to present a client's demands for payment by direct contact.

Selection of a Service

Before selecting a collection service, a creditor should review certain essential factors. There will be a financial relationship between a credit grantor and the collector, and the collector has ethical and legal responsibilities.

The credit grantor should:

- Investigate the commercial service's financial responsibility and position in the community.
- Check on the bonding and licensing of the service, particularly if required by state law. IACC requires that its members be bonded.
- Be sure the service is aware of federal and state collection laws and follows good business practices. IACC members have access to individual collector and agency certification programs. Certification assures clients of the knowledge and professionalism of the agency's service.
- Determine the relationship of the service with its peers and competitors. IACC sets the highest standards for its members and demands strict compliance with its rules of conduct and its code of ethics.
- Know how the service approaches the customer. An effective service will understand the client's credit and public relations policies and provide a collection approach that compliments these policies.
- Learn the geographic or trade strength of the service. Find out first-hand what area it covers and if it has access to fellow collectors throughout your market area in order to give your claims on-the-spot coverage. Find out how far the service will proceed on typical cases. Learn how it recommends continuation with attorneys and forwarders, if necessary.
- Determine how fees are charged and obtain a schedule in writing. A collection service often uses a written agreement that establishes the relationship with the client, but it works on a contingent fee basis. Be sure that special situations are understood in advance.

Select a collection service as you would any other firm with which you have business relationships—by reputation and by performance. You will find members of IACC highly qualified in both areas.

Reports

Fully understand the service's reporting practices and policies for money remittance. You know you have made a wise choice of a collector by the type of report you receive. You want to know if a payment has been made and that a check is forthcoming. You are interested in the collection potential from the debtor and the recommendations of the collector.

Reports are essential to the credit manager as you have an obligation to keep others informed, namely the controller, the treasurer, the vice president of sales, the president and the stock holders. The decision of a creditor company to borrow or to liquidate its assets may hinge on the collectibility of overdue accounts. It may also be a crucial factor in the sales department's proposals for growth. Modern business conditions require that management be aware of accounts receivable fluidity.

Specify when reports are required. A good collection service will tailor its reports to meet your schedules, if possible. Know what types of reports will be used—check-list forms with added comments or special reports which give information of special value. For example, if the debtor moves, changes its trade style or accepts new people into its business, this information is valuable to you.

Communicate with Your Collector

Once you have selected a collection service, communicate effectively with its staff. This creates rapport, confidence and understanding. It encourages cooperation which results in prompt collections.

Supply the service with all background information, ledger experience, debtor's business organization and information on the principals. This gives the collector an informed approach to the debtor, thereby enabling him to do a better job for you.

Professional Services Pay

The annual cost of complete professional collection services is a fraction of the money that would otherwise have gone uncollected. Yet for these costs, the credit manager has at his or her disposal a fully staffed and professionally trained collection service organization.

For its positive results, hiring a collection service is a recognized, accepted and legitimate business expense. Most credit executives realize this fact as a necessary check to substantiate accounting procedures for write-off and tax procedures as well as recovery.

Members of IACC recover millions of dollars annually for their clients. They can give valuable assistance to your credit department in controlling mounting delinquencies and credit losses.

What is IACC?

The International Association of Commercial Collectors, Inc. (IACC) is an international trade association comprised of nearly 350 commercial collection agency, attorney, law list and affiliate members with members throughout the United States and in 30 international countries. IACC is the largest community of commercial collectors in the world.

In addition to serving nearly every major U.S. metropolitan area, IACC members also serve thousands of smaller communities. For 40 years, members of IACC have successfully collected past due commercial accounts for manufacturers, processors, wholesalers, distributors and many other industries.

IACC members have the qualifications, training, experience and resources to effectively handle commercial claims for any field, anywhere in the world. In addition, the national and international network of IACC members assures quality coverage of accounts when claims are forwarded.

THE IACC MISSION:

IACC enhances the growth of its members by delivering education and professional resources in a collaborative environment.

www.commercialcollector.com

Email: iacc@commercialcollector.com
Web: www.commercialcollector.com
Phone: (952) 925-0760 – Fax: (952) 926-1624
4040 West 70th Street, Minneapolis, MN 55435